

# Effective Securities Class Action Defense Post-Cyan

By **Doug Greene and Jessie Gabriel** (June 29, 2018, 2:26 PM EDT)

On March 20, 2018, the U.S. Supreme Court unanimously held in *Cyan Inc. v. Beaver County Employees Retirement Fund*<sup>[1]</sup> that securities plaintiffs could bring class actions under the Securities Act of 1933 in state courts. At the same time, a related Section 10(b) class action under the Securities Exchange Act of 1934 may proceed in federal court. In any case involving a registered offering, the defendants must now brace for these parallel proceedings. Competition among plaintiffs securities law firms suggests these firms will file in multiple states to attempt to get around the traffic in the state where the company defendant is headquartered. And there is no device for consolidating state court and related federal court suits.



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Defense lawyers and directors and officers insurers and brokers have neither a map nor a compass to navigate this new landscape. For the past 20 years, defending the multiple lawsuits that arose out of any alleged securities law violation was relatively straightforward. Through the Private Securities Litigation Reform Act of 1995 (Reform Act) and Securities Litigation Uniform Standards Act of 1998, the vast majority of actions were filed in federal court, related cases were consolidated, a lead plaintiff was appointed, and discovery was stayed while the defendants moved to dismiss under the Reform Act's heightened pleading standards.



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But now, key strategic and economic aspects of securities class action defense will take place in the uncharted territory of state court. And decisions defendants make in the first few days of the litigation will have a significant impact on their options for resolution. Strategic missteps will prejudice not just their clients, but all of securities litigation defense, as we develop new law, set new strategies and create economic benchmarks.

In this article, we begin to chart a course for navigating the new landscape.

## Effective Management of Multijurisdictional Litigation

One of the most practically important features of the Reform Act is its mandate that courts consolidate related cases in a single forum. There is no similar device for concurrent state and federal claims.<sup>[2]</sup>

In nearly all multijurisdictional cases, the best strategic course for the defendants will be to seek to stay all of the state court actions while the Reform Act motion-to-dismiss process plays out in federal court. Such a stay will prevent inconsistent rulings and wasted effort during the Reform Act's mandated stay of discovery in federal court.

Defense counsel should begin to formulate legal and practical arguments in favor of a stay. Unlike tag-along derivative litigation, we should expect plaintiffs to attempt to push state court 1933 Act claims, to get out in front of other state court plaintiffs for competitive purposes and to get valuable discovery materials for strategic advantage. Since there can be only one 1933 Act plaintiff class regardless of how many separate actions are filed, a plaintiff that gets a fast start may be able to effectively take control of the litigation for settlement or other strategic purposes. We thus should be ready for contested stay motions.

In addition to requesting stays, we should make an alternative forum non conveniens motion to minimize the risk of multiple active state court actions. This dual-motion strategy will require us to quickly decide on the most convenient state in which to litigate. Although the headquarters state will often be the most logical forum, other forums might be better — for example, the state in which the federal litigation is pending might be best for the parties and courts. In any event, we should be prepared to thoughtfully pick an alternative forum.

We also should be prepared to file motions to transfer venue within a particular state. For example, San Mateo, California, may be an appropriate forum if an issuer is located there, but cases filed there against issuers whose headquarters are located elsewhere are subject to transfer.

### **Motion-to-Dismiss Arguments in 1933 Act State Court Cases**

Pre-Cyan, defendants got clobbered in state court motions to dismiss and demurrers. Some states, including California, do not have even the equivalent of *Ashcroft v. Iqbal*[3] and *Bell Atlantic Corp. v. Twombly*[4] or Rule 9(b) — and regardless, state court plaintiffs would not trigger the sounds-in-fraud rule, since they cannot join their 1933 Act claims with fraud claims under state law (because of SLUSA) or federal law (because of the lack of state court jurisdiction).

But most states do require some factual basis for allegations, or should, and we must work hard to develop the law governing pleading standards in a way that is fair to defendants. If we do, we will win many motions, because the substantive law — which applies in state court or federal court — favors defendants if properly understood and applied.

Most importantly, the Supreme Court's decision in *Omnicare Inc. v. Laborers District Council Construction Industry Pension Fund*[5] provides significant protection to statements of opinion. *Omnicare* held that a statement of opinion is false under the federal securities laws only if the speaker does not genuinely believe it, and is misleading only if it omits information whose absence, in context, would cause the statement to mislead a reasonable investor.

*Omnicare* declared that whether a statement of opinion (and by clear implication, a statement of fact) was misleading "always depends on context." The court emphasized that showing a statement to be misleading is "no small task" for plaintiffs, and that the court must consider not only the full statement being challenged and the context in which it was made, but also other statements made by the company and other publicly available information, including the customs and practices of the relevant industry.

We believe that evaluating challenged statements — both of fact and of opinion — in their broader context almost always benefits defendants because it helps the court better understand the statements and makes them seem fairer than they might seem in isolation. *Omnicare* now explicitly requires this.

With or without a strong procedural pleading standard, *Omnicare*'s substantive standards will give courts the ability to understand whether the defendants said anything false or misleading. A practical state court judge who concludes the defendants acted in good faith, and did not make a misstatement, may well find a way to dismiss the litigation.

## **Attack or Surrender? The Importance of Early Strategic Decisions**

The early moments of state court 1933 Act litigation will be critical — defense counsel must make key decisions, including whether to aggressively defend or strategically settle.

It may be in defendants' interest to promptly move to dismiss in the most convenient state court case, while they move to stay in the other cases, and if they prevail, to seek dismissal of the other cases. Defendants will want to argue that any decision made by a state court should apply equally to the same claims, between the same parties, in another state. While the named plaintiffs will not be identical, the parties in interest will be the same, as each plaintiff will have the same interest as every other shareholder that has filed suit. In fact, plaintiffs will likely admit this in their pleadings as they attempt to certify a class of purchasers. And even if the other courts do not dismiss on the basis of preclusion, they may well be persuaded by the dismissal, since each case comprises one 1933 Act class asserting the same claims.

Defendants will also want to consider early settlement of one of the state court cases and go through a settlement-approval process that results in a final dismissal with prejudice to the class. Although other individual plaintiffs will undoubtedly object to the settlement, courts should approve the lion's share of such settlements if they are fair and reasonable, and the lion's share of courts in the nonsettling cases will agree to stay their cases during the settlement-approval process. Defendants then will be left to defend only the federal securities class action — just like in the good old days.

## **The Importance of a Prompt and Prudent Defense Counsel Interview Process**

The process for defense counsel selection must radically change. The Reform Act's procedures provide defendants ample time to select counsel. Post-Cyan, companies will not have the luxury of a leisurely defense counsel selection process; many key decisions will need to be made in the initial days of the litigation.

Thus, companies should begin to conduct defense counsel interviews at the earliest possible time — ideally between when plaintiffs firms start to troll for plaintiffs and when litigation is filed. Companies should not simply default to hiring their corporate firm, especially if that firm worked on the offering, since the directors and officers may want to rely on the firm's work on the offering documents in establishing their due diligence defense. Companies should seek independent input from knowledgeable advisers — especially their D&O carriers and broker, who are repeat players in securities class actions — to identify several lawyers to interview, and then conduct an interview process. If corporate firms are consulted, they must give disinterested advice on this critical issue.

Companies will need to select a full-time securities litigator to lead the litigation — the prompt strategic decision-making outlined above requires decades of experience. The lead lawyer must be from a national firm that can cover the full terrain of the litigation. Yet defense counsel must be able to defend litigation not just effectively but efficiently, as good stewards of their clients' policy proceeds. There is no doubt that Cyan will increase defense costs. The only question is by how much. There is no room within D&O policy limits or most companies' budgets for wasting money on legal frolics.[6]

## **Conclusion**

Securities class action defense counsel is entering a new world. We have many challenges

ahead of us. Through this article, we hope to start a discussion that will help us serve public companies and their directors and officers both effectively and efficiently.

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[1] --- S.Ct. ----, 2018 WL 1384564 (2018).

[2] Count us as skeptical that Congress will act, but a bit more optimistic that the corporate bylaws solution professor Joseph Grundfest has proposed will take hold and withstand challenge. For more information about Grundfest's proposal, please see B. Feldman & I. Salceda, "After Cyan: Some Prognostications," Law360, March 30, 2018.

[3] 566 U.S. 662 (2009).

[4] 550 U.S. 544, 570 (2007).

[5] 135 S. Ct. 1318 (2015).

[6] For a detailed discussion of post-Cyan defense counsel selection, please see our article, "The State of Securities Litigation After Cyan," <https://www.dandodiary.com/2018/04/articles/securities-litigation/guest-post-state-securities-litigation-cyan/>.