Securities Litigation under the Private Securities Litigation Reform Act (PSLRA)

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This practice note provides an overview of the key provisions of the Private Securities Litigation Reform Act of 1995 (PSLRA) 104 P.L. 67, and examines practical considerations at various stages of a typical securities class action under the PSLRA. Congress enacted the PSLRA to deter so-called professional plaintiffs from bringing frivolous securities lawsuits in the hopes of extracting quick settlements from companies who did not want to bear the costs of litigation. The PSLRA implemented a number of protections designed to curb these abusive securities claims.

This note highlights best practices and key considerations for companies and their counsel and discusses the most important provisions of the PSLRA. More specifically, after providing an overview of the statutory framework and discussing the applicability of the PSLRA, this note examines:

- Appointment of Lead Plaintiff and Lead Counsel
- Automatic Stay of Discovery
- Heightened Pleading Standards
- Safe Harbor for Forward-Looking Statements
- Damages
- Mandatory Review for Abusive Litigation and Mandatory Sanctions
- Settlement
- Practical Considerations

For further practical guidance on the PSLRA, see Safe Harbors for Forward-Looking Statements, Forward-Looking Statements Safe Harbor Checklist, and Forward-Looking Statement Legend (IPO Prospectus).

For additional information on liability provisions and potential defenses under the federal securities laws, see Liability under the Federal Securities Laws for Securities Offerings, U.S. Securities Laws, Liability for Securities Offerings Checklist, Securities Act and Exchange Act Liability Provisions, Section 11 Elements and Defenses under the Securities Act, Section 12(a)(2) Elements and Defenses under the Securities Act, Control Person Liability, Reliance in Securities Fraud Actions, Materiality in Securities Fraud Actions, Scienter Defenses in Securities Fraud Actions, Special Litigation Committees, U.S. Supreme Court Securities Litigation Decisions, Defense Strategies under the Securities Act, Jurisdictional Defenses under the Exchange Act, and Jurisdictional Defenses under the Securities Act.

Overview of the Statutory Framework

Enacted in 1995 over President Bill Clinton's veto, the PSLRA established a number of requirements designed to curb what Congress perceived as abuses in the private securities litigation context.

To achieve its purpose of deterring frivolous and meritless securities claims, the PSLRA implemented several key procedural reforms in private securities litigation, including:

- **A process for the appointment of lead plaintiff and lead counsel**. Congress intended to discourage the use of professional plaintiffs who were motivated by bounty payments and did not fairly represent other shareholders. To that end, the PSLRA requires prospective lead plaintiffs to file a certification with the complaint, implements a method for determining the most adequate plaintiff, and limits lead plaintiff's recovery. H.R. Conf. Rep. 104-369, at 32–35. See Appointment of Lead Plaintiff and Lead Counsel.
- **An automatic stay of discovery while a motion to dismiss is pending.** Congress recognized that the costs of discovery often forced parties to settle frivolous securities class actions. To prevent abusive discovery in securities litigation, the PSLRA imposed an automatic stay of discovery pending a ruling on a motion to dismiss with very limited exceptions. H.R. Conf. Rep. 104-369, at 37. See Automatic Stay of Discovery.
- **Heightened pleading standards**. Congress sought to strengthen existing pleading standards for civil suits alleging fraud by requiring plaintiffs to specifically plead with particularity each statement alleged to have been misleading and the reasons why those statements are misleading. Further, for statements based on information and belief, plaintiffs must state with particularly all facts on which that belief is formed. H.R. Conf. Rep. 104-369, at 41. See Heightened Pleading Standards.
- **A safe harbor for forward-looking statements.** Congress was concerned that abusive securities litigation had a "chilling effect" on corporate management's willingness to disclose financial results. To that end, the PSLRA created a statutory safe harbor for forward looking statements designed to protect projections or estimates that are identified as forward-looking and that refer clearly to the risk that the actual results may differ. H.R. Conf. Rep. 104-369, at 43. See Safe Harbors for Forward-Looking Statements.
- **Limitations on damages.** Congress observed that the traditional system of joint and several liability created "coercive pressure" that forced parties to settle frivolous securities class actions. Thus, the PSLRA largely eliminated joint and several liability for defendants in Securities Exchange Act of 1934, as amended (Exchange Act) cases predicated on non-knowing conduct and for outside directors under Section 11 of the Securities Act of 1933, as amended (Securities Act) predicated on non-knowing conduct. H.R. Conf. Rep. 104-369, at 37–39. Congress also found the then-existing methods of calculating damages in Exchange Act cases to be complex and uncertain. The PSLRA thus includes a method of capping damages in Exchange Act cases to the difference between the stock's purchase price and the issuer's average stock price during the 90-day period after information correcting the alleged fraud is disseminated to the market. H.R. Conf. Rep. 104-369, at 42. See Damages.
- **A mandatory judicial review at the conclusion of a case to assess the parties' compliance with Rule 11 of the Federal Rules of Civil Procedure (FRCP) and mandatory sanctions in the event of a violation.** Congress intended to "give teeth" to FRCP 11 and enacted provisions in the PSLRA that mandate the court make FRCP 11 findings at the end of all securities litigation cases. The PSLRA also includes a presumption that the appropriate sanction for FRCP 11 violations is an award of attorney's fees and costs to the prevailing party. H.R. Conf. Rep. 104-369, at 39–40. See Mandatory Review for Abusive Litigation and Mandatory Sanctions.
- **Disclosure and notice of proposed settlement terms.** Congress was concerned that class members often did not have meaningful information and received insufficient notice about the terms of a proposed settlement. To ensure they are properly informed, the PSLRA requires certain information to be disseminated to class members, such as a statement on the average of damages per share and an explanation of proposed attorney's fees and costs sought. H.R. Conf. Rep. 104-369, at 35–36. See Settlement.

After the PSLRA was enacted, Congress became concerned that plaintiffs had begun filing class actions in state court asserting securities or common-law fraud claims under state law to avoid the PSLRA's procedural and substantive protections that did not apply to state-law claims brought in state courts. Congress responded by enacting the Securities Litigation Uniform Standards Act of 1998 (SLUSA). See 112 Stat. 3227. Generally, SLUSA prohibits class actions based on state statutory or common law brought on behalf of more than 50 individuals from proceeding in either state or federal court. 15 U.S.C. § 77p(b). Further, SLUSA provides for the removal of certain of those class actions to federal court. 15 U.S.C. § 77p(c).

A circuit split arose as to whether SLUSA eliminated concurrent state court jurisdiction over cases asserting only Securities Act claims and whether those cases were removable to federal court, notwithstanding Section 22(a) of the Securities Act (15 U.S.C. § 77v) making Securities Act claims generally nonremovable. The Supreme Court resolved this circuit split in Cyan, Inc. v. Beaver Cty. Emples. Ret. Fund, 138 S. Ct. 1061 (2018), holding that SLUSA did not override Section 22(a). Under *Cyan*, state courts continue to have concurrent jurisdiction over class actions asserting only

Securities Act claims and these cases are not removable to federal court.

For additional information on SLUSA and the impact of *Cyan*, see Jurisdictional Defenses under the Securities Act.

Applicability of the PSLRA

The PSLRA applies to all private actions brought under the two principal federal securities statutes: the Securities Act and the Exchange Act. See 15 U.S.C. § 77z-1 and 15 U.S.C. § 78u-4. The sections added by the PSLRA to the Securities Act and Exchange Act are in most respects the same but with a few notable differences, as discussed further below.

The main civil liability provisions of the Securities Act and Exchange Act are:

- **Section 11 of the Securities Act.** This section imposes civil liability for material misstatements or omissions in registration statements filed in connection with public offerings of securities (e.g., initial public offerings (IPOs), follow-on offerings, and secondary offerings). See 15 U.S.C. § 77k. Claims under this section typically do not require proof of reliance, causation, or scienter.
- **Section 12 of the Securities Act.** This section imposes strict liability for (1) offering or selling securities in violation of Section 5 of the Securities Act, which provides that all securities must be registered with the Securities and Exchange Commission (SEC) unless some exemption applies; and (2) material misstatements or omissions in the prospectus used in connection with public offerings of securities. See 15 U.S.C. § 77l. Section 12 claims typically do not require proof of reliance, causation, or scienter.
- **Section 10(b) of the Exchange Act and Rule 10b-5.** This "catchall" section imposes liability for the making of any misstatement or omission of material fact in connection with the purchase or sale of any securities, registered or unregistered. See 15 U.S.C. § 78j. Rule 10b-5 (17 C.F.R. § 240.10b-5), adopted under Section 10(b), is the most heavily relied upon provision in private securities litigation. Section 10(b) and Rule 10b-5 claims require proof of all of the following:
  - Scienter
  - A false or misleading statement or omission of material fact
  - The purchase or sale of a security
  - Reliance
  - Loss causation
  - Economic loss

For more information on the civil liability provisions under the Securities Act and Exchange Act, see Securities Act and Exchange Act Liability Provisions, Section 11 Elements and Defenses under the Securities Act, Section 12(a)(2) Elements and Defenses under the Securities Act, Jurisdictional Defenses under the Exchange Act, and Jurisdictional Defenses under the Securities Act.

Appointment of Lead Plaintiff and Lead Counsel

The PSLRA requires the court to appoint a lead plaintiff and lead counsel to supervise or manage the class action litigation on behalf of absent class members. 15 U.S.C. §§ 77z-1(a)(3), 78u 4(a)(3). Congress intended for the lead plaintiff provisions to encourage institutional investors to become lead plaintiffs and sought to discourage the use of "professional plaintiffs" who held small amounts of stock in many companies and who were often motivated by "bounty payments or bonuses" that put their incentives at odds with rest of the class. H.R. Conf. Rep. No. 104-369, at 34, 32–33.

Lead Plaintiff Appointment Process

The PSLRA established certain procedures for appointing the lead plaintiff:

- **Certification filed with the complaint.** Each plaintiff seeking to become the lead plaintiff must provide a sworn certification that:
  - States the plaintiff has reviewed and authorized the filing of the complaint
  - States the plaintiff did not purchase the security at issue in the complaint at the direction of plaintiff's counsel or in order to participate in any securities class actions
  - States the plaintiff is willing to serve as class representative
  - Identifies all of the plaintiff's transactions in the security at issue during the class period specified in the complaint
  - Identifies any other securities class actions filed in the preceding three years in which plaintiff has sought to serve as class representative
  - States plaintiff will not accept any payment for serving as class representative beyond plaintiff's pro rata share of any recovery, except as ordered or approved by the court

(15 U.S.C. §§ 77z-1(a)(2)(A), 78u 4(a)(2)(A))

- **Early notice to class members.** Within 20 days of filing the complaint, the plaintiff must publish notice advising class members of the pendency of the action, the claims asserted, the purported class period, and that any class member may move the court to serve as lead plaintiff. 15 U.S.C. §§ 77z-1(a)(3)(A), 78u-4(a)(3)(A).
- **Motion for appointment as lead plaintiff.** Within 60 days after publication of the notice to class members, any member of the class may move the court to become lead plaintiff. 15 U.S.C. §§ 77z-1(a)(3)(A)(i)(II), 78u-4(a)(3)(A)(i)(II).
- **Court appointment of lead plaintiff.** Within 90 days after publication of the notice to class members, the court shall consider any motions for lead plaintiff and appoint as lead plaintiff the member(s) of the purported plaintiff class that the court determines to be most capable of adequately representing the interests of class members. 15 U.S.C. §§ 77z-1(a)(3)(B)(i), 78u-4(a)(3)(B)(i).
- **Consolidation**. An initial class action complaint is often followed by multiple additional complaints premised on substantially the same allegations and asserting substantially the same claims, which are sometimes filed in different districts or even states. Where cases are filed in different districts, they may be brought before the same court through a motion to transfer under 28 U.S.C. § 1404 or through a motion to the Judicial Panel on Multidistrict Litigation (JPML or MDL Panel) under 28 U.S.C. § 1407 to transfer all cases to a single judge for coordinated or consolidated pretrial proceedings.
  - If a motion for consolidation is pending, the PSLRA provides that the court shall appoint a lead plaintiff as soon as practicable after rendering its decision on consolidation. 15 U.S.C. §§ 77z-1(a)(3)(B)(ii), 78u 4(a)(3)(B)(ii).
  - Under FRCP 42(a), a court may consolidate actions that involved a "common question of law or fact." U.S.C.S. Fed Rules Civ Proc R 42. Consolidation of securities class action complaints arising from the same series of alleged misrepresentations or omissions is generally appropriate. Consolidating multiple complaints also benefits courts and parties by expediting pretrial proceedings and reducing costs and time spent by all parties involved.

Most Adequate Plaintiff

The PSLRA establishes a rebuttable presumption that the "most adequate plaintiff" is the person or group of persons that meets all of the following:

- Either filed the initial complaint or made a timely motion in response to the early notice to class members
- Has the largest financial interest in the relief sought by the class, as determined by the court
- Otherwise satisfies the requirements of FRCP 23 (U.S.C.S. Fed Rules Civ Proc R 23)

15 U.S.C. §§ 77z-1(a)(3)(B)(iii)(I), 78u-4(a)(3)(B)(iii)(I).

This presumption can be rebutted only if a purported class member proves that the presumptively most adequate plaintiff (1) will not be able to fairly and adequately protect the interests of the class or (2) is subject to unique defenses that render them incapable of adequately representing the class. 15 U.S.C. §§ 77z 1(a)(3)(B)(iii)(II), 78u 4(a)(3)(B)(iii)(II).

A member of the purported plaintiff class may conduct discovery related to the adequacy of the presumptively most adequate plaintiff only after that member demonstrates a reasonable basis for a finding that the presumptively most adequate plaintiff is incapable of adequately representing the class. 15 U.S.C. §§ 77z 1(a)(3)(B)(iv), 78u 4(a)(3)(B)(iv).

The PSLRA allows a group to be appointed lead plaintiff, but courts are divided on whether unrelated individuals may aggregate their financial interests together to become the group with the largest financial stake. For instance, the Third Circuit allows unrelated plaintiffs to aggregate their financial interests together to become a group with the largest financial stake without imposing additional requirements. See In re Cendant Corp. Litig., 264 F.3d 201, 266–67 (3d Cir. 2001). District courts in other circuits have reached the opposite conclusion. See, e.g., Chauhan v. Intercept Pharms., 2021 U.S. Dist. LEXIS 13369, at *16 (S.D.N.Y. Jan. 25, 2021) (rejecting group of unrelated investors as lead plaintiffs because they were the "paradigmatic example of the 'random assemblage of unlike individuals'" courts in the Second Circuit have previously rejected); In re Netflix, Inc., Sec. Litig., 2012 U.S. Dist. LEXIS 59465, at *14–15 (N.D. Cal. Apr. 27, 2012) (collecting cases) (noting district courts in the Ninth Circuit uniformly refuse to allow unrelated investors with no apparent connection to each other besides their counsel to aggregate losses).

Defendants typically do not participate in the lead plaintiff appointment process. Indeed, the majority of courts have held that defendants do not have standing to oppose a motion for appointment of lead plaintiff. See Newby v. Enron Corp. (In re Enron Corp. Sec. Litig.), 206 F.R.D. 427, 439 (S.D. Tex. 2002) (collecting cases). However, some courts have held that defendants may challenge procedural prerequisites of the lead plaintiff appointment process, such as the adequacy of the movant's certification or notice to class members. See, e.g., Greebel v. FTP Software, Inc., 939 F. Supp. 57, 61 (D. Mass. 1996). Other courts have entertained defendants' substantive objections, despite finding defendants lacked standing, by considering those objections sua sponte. See, e.g., Takeda v. Turbodyne Techs., Inc., 67 F. Supp. 2d 1129, 1138 (C.D. Cal. 1999).

While defendants generally do not participate in the lead plaintiff process, you should evaluate whether candidates for lead plaintiff have complied with the procedural prerequisites and substantive requirements of the lead plaintiff appointment process. The following are some key points to keep in mind:

- It is unsettled whether the PSLRA's requirement that a candidate for lead plaintiff file a certification with the complaint applies to lead plaintiff candidates who did not file a complaint. See Pirelli Armstrong Tire Corp. Retiree Med. Benefits Trust v. LaBranche & Co., 229 F.R.D. 395, 407 n.18 (S.D.N.Y. 2004) (collecting cases). You should carefully review the law of the relevant jurisdiction in assessing whether to raise this challenge.
- You should consider assessing whether the candidate for lead plaintiff's notice to members of the putative class complies with the PSLRA's requirements. For instance, in Holley v. Kitty Hawk, Inc., 200 F.R.D. 275 (N.D. Tex. 2001), the court found that the purported lead plaintiff's notice was insufficient because it did not specify to purported class members that they could seek appointment as lead plaintiffs. Holley, 200 F.R.D. at 278. Further, the notice did not give the style of the case, case number, or any indication where in the Northern District of Texas the case was filed. Holley, 200 F.R.D. at 279.
- Although the majority of courts have held defendants do not have standing to challenge substantive aspects of the appointment of the lead plaintiff, courts may address any objections you lodge sua sponte. For instance, in Takeda, the court considered sua sponte, but ultimately rejected, defendants' argument that a lead plaintiff group comprising American and German investors presented serious logistical issues and included class members with interests different from the majority of the class. Takeda, 67 F. Supp. 2d at 1138–39.

You should also keep in mind that you may be able to raise substantive challenges to the adequacy of the lead plaintiff at a later stage in the litigation, such as during the class certification stage. See Greebel, 939 F. Supp. at 62 n.4. However, some courts have criticized defendants for challenging the adequacy of lead plaintiff's representation later at the class certification stage. See Public Emples Ret. Sys. of Miss. v. Merrill Lynch & Co., 277 F.R.D. 97, 110, n.19 (S.D.N.Y. 2011) (noting that lead plaintiff had sought to represent the class from the outset and defendants could have raised alleged conflict of interest concerns long before class certification).

Lead Plaintiff's Recovery

The PSLRA provides that the lead plaintiff's recovery is limited to their pro rata share of the final judgment or settlement awarded to all other members of the class. 15 U.S.C. §§ 77z-1(a)(4), 78u-4(a)(4). This provision does not limit lead plaintiff's recovery of an award of reasonable costs and expenses (including lost wages) directly relating to the representation of the class. Id.

Lead Counsel

The PSLRA allows lead plaintiff to select and retain lead counsel, subject to court approval. 15 U.S.C. §§ 77z-1(a)(3)(B)(v), 78u-4(a)(3)(B)(v). Some courts have employed auctions or competitive bidding processes to determine whether prospective lead counsel is the most qualified. See, e.g., Blitzer v. Comdisco, Inc. (In re Comdisco Sec. Litig.), 141 F. Supp. 2d 951, 955 (N.D. Ill. 2001). Other circuits have adopted a strong presumption in favor of approving lead plaintiff's selection and retention of counsel. See Cendant, 264 F.3d at 276.

Although the PSLRA does not specifically prohibit lead plaintiff from selecting multiple law firms to serve as lead counsel, courts have been wary of requests to appoint multiple law firms. See, e.g., Khunt v. Alibaba Group Holding Ltd., 102 F. Supp. 3d 523, 540 (S.D.N.Y. 2015) ("[T]he mushrooming presence of ever-more attorneys in a case more often serves to delay than to expedite the just and efficient administration of justice" and "tends to increase costs"). Courts, however, have appointed multiple law firms as colead counsel in cases where a single law firm lacked the necessary resources or where multiple firms would be beneficial given their geographic diversity.

If the plaintiff class is represented by an attorney who directly owns or otherwise has a beneficial interest in the securities at issue in the litigation, the court shall determine if the ownership constitutes a conflict of interest such that the attorney should be disqualified from representing the class. 15 U.S.C. §§ 77z-1(a)(8), 78u-4(a)(9).

Further, the PSLRA restricts the total attorney's fees and expenses awarded by the court to class counsel to a reasonable percentage of the amount of any damages and prejudgment interest actually paid to the class. 15 U.S.C. §§ 77z-1(a)(6), 78u-4(a)(6).

Automatic Stay of Discovery

Under the PSLRA, in both individual and class actions, discovery is automatically stayed during the pendency of a motion to dismiss. 15 U.S.C. §§ 77z-1(b)(1), 78u-4(b)(3)(b). Courts generally take an expansive view of the automatic discovery stay. Thus, courts have held that the stay applies before a motion to dismiss is filed (where the defendant has indicated an intention to file such a motion) and pending a motion to dismiss an amended complaint. The stay has been held to apply to all claims asserted in the action, even if some claims would not be subject to the PSLRA if asserted independently.

SLUSA amended the PSLRA to provide federal courts with the ability to stay discovery proceedings in any private action in state court as necessary in aid of its jurisdiction, or to protect or effectuate its judgment in an action subject to a stay of discovery. 15 U.S.C. §§ 77z 1(b)(4), 78u-4(b)(3)(D). Although SLUSA eliminated many state court securities class actions, the concern that plaintiffs will use state courts to avoid the PSLRA's automatic stay of discovery could still arise in stockholder derivative actions brought in state court—which are specifically exempted from SLUSA per 15 U.S.C. § 78bb(f)(5)(C)—and Securities Act cases brought in state court, to the extent that state court judges do not stay discovery in those cases.

Further, courts have anticipated that plaintiffs could use their rights as shareholders under state law to inspect a corporation's books and records to circumvent the PSLRA's automatic stay. For instance, before allowing a books and records action to proceed, Delaware courts consider whether:

- The plaintiff is currently involved in the related federal action
- The plaintiff's counsel is currently involved in the related federal action
- The plaintiff will agree to enter into a confidentiality agreement preventing them from sharing the information obtained with the plaintiff or counsel in the related federal action

Beiser v. PMC-SIERRA, Inc., 2009 Del. Ch. LEXIS 36, at *12 (Feb. 26, 2009).

Although formal discovery is automatically stayed under the PSLRA when a motion to dismiss is pending, you should keep in mind that plaintiff's counsel can continue to collect information through other channels (e.g., by obtaining information extrajudicially from third parties, former employees, or public sources, such as court files or news reports). In fact, it is common for plaintiff's counsel to employ investigators to obtain information from former corporate officers or employees. See Information and Belief below.

Statutory Duty to Preserve Documents

The PSLRA created an automatic document preservation obligation during the stay of discovery. 15 U.S.C. §§ 77z-1(b)(2), 78u-4(b)(3)(C)(i). Any party with "actual notice" of the allegations in the complaint must treat all documents, data (electronically stored information), and tangible objects in its custody or control that are relevant to the allegations as if they were the subject of a continuing request for production of documents from an opposing party under the FRCP. Id. The court may award sanctions if a party willfully fails to comply with this obligation. 15 U.S.C. §§ 77z-1(b)(3), 78u-4(b)(3)(C)(ii).

In light of the PSLRA's statutory obligation for parties to preserve evidence during the automatic stay of discovery, you should advise your client(s) to take appropriate and timely steps to preserve documents and electronic evidence, including issuing a litigation hold to relevant personnel and suspending any systematic deletion of email, texts, or other relevant information.

Application of Automatic Discovery Stay in State Court Securities Act Class Actions after Cyan

In holding that class actions asserting Securities Act claims may proceed in state courts and are not removable, the Supreme Court in *Cyan* stressed that "wherever those suits go forward, the [PSLRA]'s substantive protections apply." Cyan, 138 S. Ct. at 1072–73. The Supreme Court left open, however, whether the PSLRA's arguably procedural provisions, such as the automatic stay of discovery, apply to Securities Act claims brought in state court. Post-*Cyan*, state courts have reached different results on this issue. New York and California state trial courts do not agree on whether the PSLRA's automatic stay extends to state court actions, whereas at least one Connecticut state trial court has held that the PSLRA's automatic stay does apply to Securities Act cases in state court. No state appellate court has resolved this issue.

Exceptions to the Automatic Stay

There are two exceptions to the PSLRA's automatic stay of discovery at the pleading stage:

- Preservation of evidence exception
- Undue prejudice exception

15 U.S.C. §§ 77z-1(b)(1), 78u-4(b)(3)(B). Requests for the automatic stay to be lifted under either exception must be particularized.

Preservation of Evidence

The automatic stay of discovery can be lifted to preserve evidence that would otherwise be lost or destroyed. Parties to a litigation seeking to invoke this exception must identify the specific discovery sought and specify the reasons why the evidence would be lost or destroyed. Courts typically require more than generalizations of fading memories or allegations of possible loss or destruction, and parties must show that the loss of evidence is imminent rather than speculative. See Sarantakis v. Gruttaduaria, 2002 U.S. Dist. LEXIS 14349, at *5–6 (N.D. Ill. Aug. 5, 2002). For instance, the terminal illness of a key witness might require the deposition of that witness before the court rules on the motion to dismiss. H.R. Conf. Rep. 104-369, at 37.

Relatedly, several courts have allowed a narrow exception to the automatic stay to allow parties to serve so called preservation subpoenas on nonparties, who are not covered by the statutory preservation obligation, directing them to preserve documents identified in the subpoena. See, e.g., In re Tyco Int'l, Ltd., Sec. Litig., 2000 U.S. Dist. LEXIS 11659, at *8 (D.N.H. July 27, 2000).

Undue Prejudice

The automatic stay of discovery may be lifted to avoid undue prejudice to a party, which courts have defined to mean improper or unfair treatment that is less than irreparable harm. See Sarantakis, 2002 U.S. Dist. LEXIS 14349, at *6. Delay caused by the automatic stay itself does not result in undue prejudice. See In re Initial Pub. Offering Sec. Litig., 236 F. Supp. 2d 286, 287 (S.D.N.Y. 2002).

Courts have lifted the automatic stay in narrow circumstances where:

- **The defendant would be unfairly shielded from liability through pursuit of its pending action.** For instance, in Global Intellicom, Inc. v. Thomson Kernaghan & Co., 1999 U.S. Dist. LEXIS 5439, at *4 (S.D.N.Y. Apr. 15, 1999), defendants acquired holdings in a company through an allegedly improper short-selling scheme and, based on those holdings, filed suits in other forums to try to take over the company. The court allowed plaintiff to take limited discovery because defendants' success in those other forums raised the possibility that plaintiff would not be able to seek redress for its alleged short-selling violations before the court. Id.
- **Plaintiff would be placed at an unfair disadvantage to make informed decisions about litigation and settlement strategy without access to documents that form the core of the proceeding.** In In re WorldCom Sec. Litig., 234 F. Supp. 2d 301, 305 (S.D.N.Y. 2002), the court lifted the stay with respect to documents the defendants had produced in a related action, where the plaintiffs would be disadvantaged in global settlement discussions without them. Other courts have rejected this approach, concluding that an informational disadvantage does not rise to the level of undue prejudice contemplated by the PSLRA. Dipple v. Odell, 870 F. Supp. 2d 386, 394 (E.D. Pa. 2012) (collecting cases).

Heightened Pleading Standards

Before the PSLRA, securities fraud claims were already subject to heightened pleading requirements under FRCP 9(b), which requires a party alleging fraud or mistake to state with particularity the circumstances constituting fraud or mistake. U.S.C.S. Fed Rules Civ Proc R 9. Although FRCP 9(b) also provides that a party's state of mind may be alleged generally, the Second Circuit imposed a requirement that facts giving rise to a "strong inference" of scienter must be alleged, to avoid the facility with which claims of fraud by hindsight could be made. Ross v. AH Robins Co., 607 F.2d 545, 556 (2d Cir. 1979); Shields v. Citytrust Bancorp,, 25 F.3d 1124, 1129 (2d Cir. 1994).

FRCP 9(b)'s "particularity" pleading standard applies to fraud claims under the Exchange Act. A majority of circuits have also applied FRCP 9(b) to claims under Sections 11 and 12(a)(2) of the Securities Act, which do not require proof of fraudulent intent, where the complaint nevertheless "sounds in fraud," meaning the complaint is based on misrepresentations or omissions made with fraudulent intent or alleges a unified course of fraudulent conduct.

The PSLRA imposes additional pleading requirements, beyond those imposed by FRCP 9(b), and adopts a version of the Second Circuit's strong inference of scienter requirement, for fraud claims brought under the Exchange Act. 15 U.S.C. § 78u-4(b). First, in actions where the plaintiff alleges the defendant made an untrue statement of material fact or omitted to state a material fact necessary in order to make the statements made, in the light of the circumstances in which they were made, not misleading, the complaint must:

- Specify each statement alleged to be misleading
- Specify the reason(s) why the statement is misleading
- State with particularity all facts on which that belief is formed for allegations made on "information and belief"

Thus, vague, unspecific, blanket, or catchall allegations that may be sufficient under the traditional FRCP 12(b)(6) pleading standard will not survive a motion to dismiss under FRCP 9(b) and the PSLRA's heightened pleading requirements. See 15 U.S.C. § 78u-4(b)(1); Dura Pharms., Inc. v. Broudo, 544 U.S. 336, 345 (2005).

In addition, in any action requiring proof that the defendant acted with a particular state of mind, the complaint must allege, with particularity, facts that give rise to a strong inference that defendant acted with the required state of mind. See 15 U.S.C. § 78u-4(b)(2); Tellabs, Inc. v. Makor Issues & Rights, Ltd., 551 U.S. 308, 321 (2007).

The PSLRA's heightened pleading standard does not apply to Securities Act cases. Moreover, although the requirement to plead facts giving rise to a strong inference that the defendant acted with the required state of mind applies to all Exchange Act claims requiring proof of scienter, courts have divided on whether this requirement applies to negligence claims under Section 14(a) of the Exchange Act.

Information and Belief

Where a plaintiff alleges on "information and belief" that a defendant made untrue statements of fact or misleadingly omitted to state facts, the PSLRA requires the complaint to plead with particularity all facts on which that belief is formed. This requirement was intended to prohibit plaintiffs from making allegations based on unspecified sources that could be verified only after discovery.

This requirement of the PSLRA may not be avoided by merely alleging that the allegations are based on the "investigation of counsel." Courts will treat allegations based on an investigation by counsel as based on "information and belief" because to draw a distinction between the two would "elevate form over substance" and allow plaintiffs to circumvent the protections of the PSLRA. See Adams v. Kinder-Morgan, Inc., 340 F.3d 1083, 1098 (10th Cir. 2003) (quoting In re Theragenics Corp. Sec. Litig., 105 F.Supp.2d 1342, 1350–51 (D.Ga. 2000)).

Most courts do not interpret the requirement that the complaint plead with particularity "all facts" on which the plaintiff's belief is based to require allegations of every single fact gathered by the plaintiff or its counsel, but only "*sufficient* facts to support those beliefs." See, e.g., Novak v. Kasaks, 216 F.3d 300, 313 (2d Cir. 2000) (emphasis in original).

Where allegations are attributed to unnamed, confidential sources, courts are divided on the level of information that must be provided about the source. Most courts generally permit the use of confidential sources as long as there is some sufficiently particularized indicia of reliability, such as disclosure of the confidential source's position and a basis for inferring she had access to the information attributed to her. You should carefully consider whether the allegations based on confidential witnesses are sufficiently particularized as to the sources and the sources' basis of knowledge and reliability. Some courts also consider whether corroborating information supports the confidential witness allegations.

Where allegations are drawn from newspaper articles, courts have held that the articles should be credited only to the extent that they are sufficiently particular and detailed to indicate their reliability. See In re McKesson HBOC, Inc. Secs. Litig., 126 F. Supp. 2d 1248, 1272 (N.D. Cal. 2000). Newspaper articles and other media reports that consist of generalized forecasting or factually unsourced speculation, standing alone, typically will not satisfy the PSLRA's requirements. Altimeo Asset Mgmt. v. Qihoo 360 Tech. Co., 2020 U.S. Dist. LEXIS 146995, at *36 (S.D.N.Y. Aug. 14, 2020).

Pleading Scienter

The state of mind pleading requirements of the PSLRA are most relevant to fraud claims brought under the Exchange Act, where the plaintiff must plead scienter. In Ernst & Ernst v. Hochfelder, 425 U.S. 185 (1976), the Supreme Court defined "scienter" as the mental state embracing an intent to deceive, manipulate, or defraud. Ernst & Ernst, 425 U.S. at 193 fn.12.

In *Tellabs*, the Supreme Court provided guidance on what is required to allege a "strong inference" of scienter. Tellabs, 551 U.S. at 322-24. On a motion to dismiss a securities fraud case, the court must:

- Accept as true all factual allegations in the complaint
- Consider the complaint in its entirety along with all other sources incorporated in the complaint by reference
- Consider whether "all of the facts alleged, taken collectively, give rise to a strong inference of scienter, not whether any individual allegation, scrutinized in isolation, meets that standard"

Further, the Court held that to determine whether plaintiff has alleged sufficient facts to give rise to a "strong inference" of scienter, "a court must consider plausible, nonculpable explanations for the defendant's conduct, as well as inferences favoring the plaintiff . . . A complaint will survive, we hold, only if a reasonable person would deem the inference of scienter cogent and at least as compelling as any opposing inference one could draw from the facts alleged." Tellabs, 551 U.S. at 324.

In light of *Tellabs*, in responding to scienter allegations on a motion to dismiss, you should marshal any facts that suggest plausible, non-fraudulent explanations for plaintiff's allegations. Consider the following examples:

- In In re UBS AG Sec. Litig., 2012 U.S. Dist. LEXIS 141449, at *71 (S.D.N.Y. Sep. 28, 2012), aff'd sub nom. City of Pontiac Policemen's & Firemen's Ret. Sys. v. UBS AG, 752 F.3d 173 (2d Cir. 2014), the court found that, based on facts as alleged in the complaint, the more compelling inference was that defendants simply did not anticipate the full impact of the then-unfolding mortgage crisis and any alleged failure to disclose was more likely attributable to the financial turmoil occurring in 2007 than any fraud or recklessness.
- In Slayton v. Am. Express Co., 604 F.3d 758, 775 (2d Cir. 2010), the court found that the more compelling inference was that, while defendants knew their high-yield portfolio was likely deteriorating, they did not know the

full extent of the deterioration and subjectively believed the deterioration would lead to lower losses. The fact that defendants ordered an investigation as soon as they learned that their portfolio was deteriorating actually weighed against a strong inference of scienter and suggested that defendants were endeavoring in good faith to ascertain and disclose future losses. Slayton, 604 F.3d at 777.

Inferring Scienter from Allegations of Conscious Misbehavior or Recklessness

In *Tellabs*, the Court did not address whether reckless behavior is sufficient for liability under Section 10(b) and Rule 10b-5. But the Court noted that every Court of Appeals that considered the issue has held that a plaintiff may meet the scienter requirement by showing the defendant acted intentionally or recklessly. The circuits differ, however, on the degree of recklessness required: some courts require a showing of deliberate recklessness that "is actually much closer to one of intent." Cohen v. NVIDIA Corp. (In re NVIDIA Corp. Sec. Litig.), 768 F.3d 1046, 1053 (9th Cir. 2014). Others require a showing of severe recklessness that "is not negligence, but more akin to conscious disregard." Frank v. Dana Corp., 646 F.3d 954, 959 (6th Cir. 2011).

Courts have held that allegations of conscious misbehavior or recklessness that do not specifically allege defendants' knowledge of facts or access to information contradicting their public statements are generally insufficient to raise a strong inference of scienter. Kalnit v. Eichler, 264 F.3d 131, 142 (2d Cir. 2001) (quoting Novak v. Kasaks, 216 F.3d 300, 308 (2d Cir. 2000)).

Inferring Scienter from Allegations of Motive and Opportunity to Commit Fraud

In *Tellabs*, the Supreme Court held that, while motive can be a relevant consideration, the absence of motive allegations is not fatal. Tellabs, 551 U.S. at 325. The complaint's allegations must be considered collectively and the significance of motive allegations or the lack thereof depends on the entirety of the complaint. Id. Nonetheless, post-*Tellabs*, courts remain divided on the role of allegations of motive and opportunity to commit fraud in pleading scienter. In the Second Circuit, for instance, sufficiently compelling allegations of motive and opportunity may alone be enough to plead a strong inference of scienter. See, e.g., ECA, Local 134 IBEW Joint Pension Trust of Chi. v. JP Morgan Chase Co., 553 F.3d 187, 198 (2d Cir. 2009); accord Podraza v. Whiting, 790 F.3d 828, 836 (8th Cir. 2015). In contrast, in the Third Circuit, which abandoned its pre-*Tellabs* approach, motive and opportunity allegations, standing alone, are no longer sufficient to plead scienter. See Institutional Investors Group v. Avaya, Inc., 564 F.3d 242, 276, 277 (3d Cir. 2009). In other circuits, motive and opportunity allegations must be viewed holistically in light of all other allegations in the complaint. See, e.g., Bondali v. Yum! Brands, Inc., 620 Fed. Appx. 483, 492 (6th Cir. 2015).

In pleading or defending against securities fraud claims, you should thus carefully review the law in the relevant jurisdiction regarding motive and opportunity allegations. The following are some additional key points to keep in mind:

- Allegations of motive that are common to most corporate insiders are generally insufficient to raise a strong inference of scienter, including the motive to maintain an appearance of profitability, keep stock prices higher, hide poor performance of a subsidiary, maintain a high credit rating, avoid personal liability, or keep a seat on the board of directors.
- Allegations of insider trading may support a strong inference of scienter, but the alleged trading must involve unusual or suspicious circumstances. See Novak, 216 F.3d at 307. A number of factors should be analyzed, including:
  - o Whether the corporate insiders sold a significant amount of shares
  - o Whether the corporate insider sold a significant percentage of their overall company holdings
  - o Whether the timing of any sales can be linked to important company actions or events during the class period
  - o Whether some insiders allegedly responsible for the fraud retained substantial holdings
  - o Whether the selling insider had a pattern of divesting shares at similar times or an apparent non-fraudulent reason for the sales, such as where the insider's options were about to expire or the sale was made under a Rule 10b5-1 trading plan

Group Pleading and Collective Scienter

Before the PSLRA was enacted, some courts had recognized two doctrines that loosened the pleading requirements for securities fraud, where the fraudulent conduct allegedly involved multiple corporate employees: group pleading and collective scienter. It is an open question whether these doctrines remain viable under the PSLRA.

- **Group pleading.** Under the group pleading doctrine, allegedly untrue statements or actionable omissions included in written documents prepared by a group of individuals could be attributed to individual members of the group named as defendants. Courts applying this approach nevertheless generally required scienter to be pleaded as to each named defendant.

  Courts are divided on whether group pleading survived the PSLRA. Compare Southland Sec. Corp. v. INSpire

Ins. Solutions, Inc., 365 F.3d 353, 365 (5th Cir. 2004) (holding group pleading is inconsistent with the PSLRA's requirement that plaintiff plead with particularity each defendant acted with the requisite state of mind), with In re UBS Ag Sec. Litig., 2012 U.S. Dist. LEXIS 141449, at *29 (S.D.N.Y. Sept. 28, 2012) (observing that the viability of the group pleading doctrine is an open issue in the Second Circuit but many district courts have applied the doctrine post-PSLRA).

Courts also disagree on whether the group pleading doctrine was further undermined by the Supreme Court's decision in Janus Capital Group, Inc. v. First Derivative Traders, 564 U.S. 135, 142 (2011), which held that only the "maker" of a statement—"the person or entity with ultimate authority over the statement, including its content and whether and how to communicate it"—may be held liable under Section 10(b). After Janus, courts that had continued to recognize the group pleading doctrine post-PSLRA further divided on whether and how the doctrine remained viable. Compare FIH, LLC v. Found. Capital Partners LLC, 176 F. Supp. 3d 52, 71–72 (D. Conn. 2016) (holding "there is no tension between [the PSLRA's] requiring a plaintiff to allege specific facts for individuals and presuming multiple corporate officers may work as a group to produce particular documents" and have joint authority to "make" a statement), with UBS AG, 2012 U.S. Dist. LEXIS 141449, at *32 ("[A] theory of liability premised on treating corporate insiders as a group cannot survive a plain reading of the Janus decision.").

- **Collective scienter.** Under the collective scienter doctrine, a plaintiff may plead facts sufficient to raise a strong inference of scienter with respect to a corporate defendant, even where the allegations would be insufficient to allege scienter as to any individual corporate officer or employee whose intent can be imputed to the corporate defendant. Some courts require a showing that individuals whose knowledge can be imputed to the corporate defendant have access to information or documents contradicting the company's public statements. See Novak, 216 F.3d at 311 (2d Cir. 2000).

  Courts are split on whether collective scienter remains viable under the PSLRA. Compare Teamsters Local 445 Freight Div. Pension Fund v. Dynex Capital, Inc., 531 F.3d 190, 196 (2d Cir. 2008) (holding that the PSLRA did not impose the rule that "in no case can corporate scienter be pleaded in the absence of successfully pleading scienter as to an expressly named officer"), with Southland, 365 F.3d at 366 ("[W]e believe it appropriate to look to the state of mind of the individual corporate official or officials who make or issue the statement . . . rather than generally to the collective knowledge of all the corporation's officers and employees acquired in the course of their employment.").

Given the split in authority discussed above, in assessing scienter allegations against corporate entities, you should assess whether the group pleading and the collective scienter doctrines remain viable in the relevant jurisdiction under the PSLRA.

Standard for Scienter on Summary Judgment

By its terms, the PSLRA specifies what a complaint alleging an Exchange Act claim must include. Courts are divided on whether the PSLRA's heightened pleading standard for scienter impacts the evaluation of evidence at the summary judgment stage. The First Circuit has held that the requirement that the facts give rise to a "strong inference" that the defendant acted with the required state of mind should be applied in evaluating the evidentiary proof of scienter at summary judgment. See Geffon v. Micrion Corp., 249 F.3d 29, 36 (1st Cir. 2001). In contrast, the Seventh, Ninth, and Eleventh Circuits have concluded that the PSLRA did not change the standard on summary judgment. See Costello v. Grundon, 651 F.3d 614, 636 (7th Cir. 2011); Cohen v. NVIDIA Corp. (In re NVIDIA Corp. Sec. Litig.), 768 F.3d 1046, 1053, fn.7 (9th Cir. 2014); and Mizzaro v. Home Depot, Inc., 544 F.3d 1230, 1238 (11th Cir. 2008).

Other circuits have not squarely addressed the issue. In the absence of authority by the U.S. Court of Appeals for the Third Circuit, district courts in the Third Circuit have reached divergent conclusions on the issue. Compare In re Bristol-Myers Squibb Sec. Litig., 2005 U.S. Dist. LEXIS 18448, at *45–46 (D.N.J. Aug. 17, 2005) (Third Circuit precedent suggests that the PSLRA did not change the evidentiary standard at summary judgment), with Tse v. Ventana Med. Sys., 123 F. Supp. 2d 213, 225 (D. Del. 2000) (3d Cir. 2002) (applying heightened pleading requirements at summary judgment stage).

For additional information on scienter in securities fraud cases, see Scienter Defenses in Securities Fraud Actions.

Safe Harbor for Forward-Looking Statements

The PSLRA's statutory safe harbors protect forward-looking statements that meet one of following two prongs:

- First prong:
  - Statement is accompanied by "meaningful cautionary statements identifying important factors that could

cause actual results to differ materially from those in the forward-looking statement" or is "immaterial."

- Second prong:
  - o Statement is not proven by plaintiffs to have been (1) made with actual knowledge that it was false or misleading or (2) if made by a business entity, made by or with approval of an executive officer of that entity with actual knowledge that the statement was false or misleading.

15 U.S.C. § 77z-2(c)(1); 15 U.S.C. § 78u-5(c)(1).

Most courts have held that, based on the plain language of the safe harbor (which is written in the disjunctive), the two prongs apply independently, so both need not be satisfied for the safe harbor to apply. For example, a statement accompanied by meaningful cautionary language is insulated from liability under the safe harbor even where it is alleged and proven to have been made with knowledge of its falsity. See Onie v. Conners (In re Cutera Sec. Litig.), 610 F.3d 1103, 1113 (9th Cir. 2010) (collecting cases).

Accordingly, you should consider raising arguments under both prongs of the safe harbor. For the first prong, you should evaluate whether the disclosures contain meaningful cautionary language or are otherwise immaterial. Even if the first prong is inapplicable, you should consider whether plaintiff will be able to prove that the statements were made with knowledge of their falsity.

For additional information on the forward-looking statements safe harbor, see Forward-Looking Statements Safe Harbor Checklist and Forward-Looking Statements Legends (Follow-on Offering).

Forward-Looking Statements

PSLRA defines forward-looking statements as any of the following:

- Statements containing a projection of revenues, income, earnings per share, capital expenditures, dividends, capital structure, or other financial items
- Plans and objectives of management for future operations
- Statements of future economic performance
- Assumptions underlying or related to statements in the prior three bullets
- Any reports issued by an outside review that assess forward-looking statements
- A statement containing a projection or estimate of such other items as specified by SEC rule or regulation

15 U.S.C. §§ 77z-2(i), 78u-5(i).

Statements that use future-tense verbs or conditional terms are typically deemed forward looking, such as expect, anticipate, plan, believe, project, or estimate.

Certain disclosures made under Item 305(d) of Regulation S-K are protected by the statutory safe harbor. See 17 C.F.R. § 229.305(d)(1).

Mixed Historical/Future Statement

Historical, current, or "hard" facts are not covered by the safe harbor, but courts vary in their approach on whether statements that mix historical facts and future projections are covered.

Most courts have held that a mere reference to the future in a mixed statement is not determinative of whether the safe harbor applies. For instance, the First Circuit held that the statement that the company "has on hand . . . sufficient sources of funds to meet its anticipated [needs]" was not protected by the safe harbor because the alleged fraud concerned the company's "present access to funds" rather than its ability to "meet anticipated future needs." See Brody v. Stone & Webster, Inc. (In re Stone & Webster, Inc., Sec. Litig.), 414 F.3d 187, 212 (1st Cir. 2005) (citations omitted); accord City of Miami v. Quality Sys. (In re Quality Sys.) 865 F.3d 1130, 1141–42 (9th Cir. 2017) (observing that the First, Second, Third, Fifth, and Seventh Circuits have all concluded, "where defendants make mixed statements containing non-forward-looking statements as well as forward-looking statements, the non-forward-looking statements are not protected by the safe harbor of the PSLRA").

Some courts have taken a more holistic approach in reviewing mixed statements. See Harris v. Ivax Corp., 182 F.3d 799, 805–06 (11th Cir. 1999) (refusing to "slice" a "laundry list" of factors into separate parts because the "allegation is that the whole list is misleading" and the list is a "unit" that is "either forward-looking or not forward-looking in its entirety").

Meaningful Cautionary Language

To be protected by the first prong of the statutory safe harbor, a forward-looking statement must be accompanied by meaningful cautionary statements identifying important factors that could cause actual results to differ materially from those in the forward-looking statement. Congress explained that "important" factors identified in the cautionary statements must be relevant to the projection and have the potential to actually affect whether the forward-looking statement is realized. H.R. Conf. Rep. No. 104-369, at 43–44. Congress emphasized that the cautionary statements did not need to identify all factors and that failing to include "a particular factor that ultimately causes the forward-looking statement not to come true" will not preclude protection under the safe harbor. H.R. Conf. Rep. No. 104-369, at 44.

In evaluating cautionary language, courts have held that boilerplate, vague, static, and nonspecific warnings are generally not sufficient. See Ark. Pub. Emples. Ret. Sys. v. Harman Int'l Indus. Inc. (In re Harman Int'l Indus., Inc. Sec.

Litig.), 791 F.3d 90, 101–03 (D.C. Cir. 2015) (observing that meaningful cautionary language encompasses "substantive company-specific warnings" based on a "realistic description of the risks applicable to the particular circumstances").

While most courts, including the Second Circuit, will resolve the question whether cautionary statements are adequate at the pleading stage, the Seventh Circuit has suggested that this issue is inappropriate for resolution on a motion to dismiss before plaintiff has had the benefit of discovery. Compare Rombach v. Chang, 355 F.3d 164, 176 (2d Cir. 2004) (holding cautionary statements satisfied the safe harbor, though some were "formulaic"), with Asher v. Baxter Int'l Inc., 377 F.3d 727, 734 (7th Cir. 2004) (holding there is "no reason that a court can accept at the pleading stage, before plaintiffs have access to discovery" whether cautionary language was sufficiently adequate).

Disclosing Known Risks That Have Already Materialized

Courts have recognized that neither the PSLRA's safe harbor nor the related, common law bespeaks caution doctrine (discussed below) will protect the disclosure of the risk of events that have already happened or are almost certainly going to happen. In other words, the doctrines provide "no protection to someone who warns his hiking companion to walk slowly because there might be a ditch ahead when he knows with near certainty that the Grand Canyon lies one foot away." In re Prudential Sec. Ltd. Pshps. Litig., 930 F. Supp. 68, 72 (S.D.N.Y. 1996); see also Plumbers & Pipefitters Nat'l Pension Fund v. Davis, 2020 U.S. Dist. LEXIS 66016, at *34 (S.D.N.Y. Apr. 14, 2020) (noting that this limitation applies to both the statutory safe harbor and the bespeaks caution doctrine).

Actual Knowledge of Falsity or Misleading Nature

The second prong of the safe harbor generally applies if plaintiff fails to prove the forward looking statement was made with actual knowledge of its falsity or misleading nature. The actual knowledge requirement cannot be satisfied by a showing of mere recklessness.

Courts have held that actual knowledge must be pleaded, as well as proven, where a claim is based on forward-looking statements. In Institutional Investors Group v. Avaya, Inc., 564 F.3d 242, 274 (3d Cir. 2009), the Third Circuit held that, because allegations did not identify the "precise means" by which defendant knew his statements were false, it was more likely that the forward-looking statements were the product of recklessness or other nonculpable ignorance. Following the Third Circuit's approach, the Second Circuit has held that, in the absence of allegations supporting motive, allegations supporting merely a plausible inference that defendants had no reasonable basis for their forward-looking statements were insufficient to plead the defendants knowingly misled investors. Slayton v. Am. Express Co., 604 F.3d 758, 775–76 & n.9 (2d Cir. 2010).

Oral Statements

The PSLRA safe harbor applies to oral as well as written forward-looking statements. An oral statement is covered by the safe harbor if it is accompanied by an oral cautionary statement that identifies the particular statement as forward-looking and states that actual results might differ materially from those projected. 15 U.S.C. §§ 77z-2(c)(2)(A), 78u-5(c)(2)(A).

If an oral statement references a written document that contains additional cautionary language, it must identify the written document, and the document must be readily available and contain meaningful cautionary language. 15 U.S.C. §§ 77z-2(c)(2)(B), 78u-5(c)(2)(B). Documents filed with the SEC are deemed readily available. 15 U.S.C. §§ 77z-2(c)(3), 78u-5(c)(3).

Exclusions to the Safe Harbor

The safe harbor does not apply to forward-looking statements made:

- With respect to a business or operations of an issuer who, during the preceding three years, was either:
  - Convicted of any felonies or misdemeanors based on certain violations of the Exchange Act
  - Subject to a judicial or administrative decree arising from governmental action that prohibits or orders the issuer to cease and desist from violating the anti-fraud provisions of the securities laws or determines the issuer violated such laws
- In connection with the offering of securities by a blank check company
- By an issuer of penny stock
- In connection with a rollup transaction
- In connection with a going private transaction
- In a financial statement prepared in accordance with generally accepted accounting principles (GAAP)
- In connection with a tender offer
- In connection with an IPO
- In connection with an offering by or relating to the operations of a partnership, limited liability company, or direct participation investment program
- In a disclosure of beneficial ownership report

15 U.S.C. §§ 77z-2(b), 78u-5(b).

You should thus be cognizant that not all forward-looking statements are protected by the PSLRA's statutory safe harbor. But, as discussed below, statements that are not protected by, or are excluded from, the safe harbor may still be protected by the common law bespeaks caution doctrine.

Bespeaks Caution Doctrine

The PSLRA did not do away with the judicially created bespeaks caution doctrine, under which forward-looking statements are deemed immaterial and thus non-actionable when they "bespeak caution," meaning they are accompanied by cautionary language that adequately addresses the risks involved in the investment. This common-law doctrine is most often used to challenge the materiality of economic projections, earnings guidance, and optimistic statements accompanied by cautionary warnings. Before the PSLRA, a majority of the circuits had adopted this doctrine. Although Congress based aspects of the PSLRA's safe harbor on the bespeaks caution doctrine, Congress did not intend to replace the bespeaks caution doctrine or foreclose further development by the courts. H.R. Conf. Rep. No. 104-369, at 46. Accordingly, statements (such as those listed above) that are not entitled to protection under the statutory safe harbor (e.g., due to an exclusion) may still be protected by the bespeaks caution doctrine.

For additional information on the bespeaks caution doctrine, see Safe Harbors for Forward-Looking Statements.

Damages

The PSLRA provides several limits on plaintiff's damages and defendant's liability for damages in cases brought under the Exchange Act. Note that neither of these sections discussed below apply to Securities Act cases.

You should consider retaining economic experts or consultants early in the litigation. Experts can provide useful analysis of stock price movements, loss causation, market efficiency, damages, and other issues.

90-Day Look-Back Provision

For cases under the Exchange Act, where damages are sought by reference to the market price of the security, the PSLRA caps the plaintiff's damages at the difference between the plaintiff's purchase price for the security and the "mean trading price of that security during the 90-day period beginning on the date on which the information correcting the misstatement or omission that is the basis for the action is disseminated to the market." 15 U.S.C. § 78u-4(e)(1). The 90-day look-back period is measured from the date of the last corrective disclosure. See, e.g., In re Vivendi Universal, S.A. Sec. Litig., 123 F. Supp. 3d 424, 440 (S.D.N.Y. 2015). This provision does not apply to claims under the Securities Act.

No Joint and Several Liability

The PSLRA largely eliminated joint and several liability in private actions under the Exchange Act in favor of a proportionate liability scheme. 15 U.S.C. § 78u-4(f). The defendant is subject to joint and several liability for damages only if the court or jury finds that the defendant knowingly violated the securities laws. 15 U.S.C. § 78u-4(f)(2)(A).

These proportionate liability provisions apply to "covered persons," defined as defendants in private actions brought under the Exchange Act as well as defendants who are outside directors named in private actions brought under Section 11 of the Securities Act. 15 U.S.C. § 78u-4(f)(2)(A), 78u 4(f)(10)(C). Other parties named as defendants in actions brought under Section 11 of the Securities Act remain subject to joint and several liability. 15 U.S.C. § 78u-4(f)(1).

The PSLRA requires trial courts to determine the percentage of responsibility of each defendant through the use of special interrogatories if the case is presented to a jury or by making specific findings in a bench trial. 15 U.S.C. § 78u-4(f)(3). The PSLRA specifies:

- The topics of the special interrogatories or findings
- The content of the responses to the special interrogatories or findings
- The factors to be considered in determining the percentage of responsibility

15 U.S.C. § 78u-4(f)(3).

A covered person who becomes jointly and severally liable for damages may recover contribution from any other person who, if joined in the original action, would have been liable for the same damages. 15 U.S.C. § 78u-4(f)(8). This contribution claim is to be determined based on the percentage of responsibility of the claimant and of each person against whom a claim for contribution is made. Id.

Uncollectible Share

Upon motion made no later than six months after final judgment, if the court determines that all or part of the share of the covered person is not collectible against that covered person, then each other covered person will be liable for that uncollectible share. 15 U.S.C. § 78u-4(f)(4)(A).

If the plaintiff's net worth is less than $200,000 and their recoverable damages under the final judgment are more than 10% of that plaintiff's net worth, then each other covered person will be jointly and severally liable for the uncollectible share. 15 U.S.C. § 78u-4(f)(4)(A)(i).

For all other plaintiffs, each covered person will be liable for the uncollectible share in proportion to each covered person's percentage of responsibility, but not more than 50% of that covered person's proportionate share as determined by the special interrogatories or findings. 15 U.S.C. § 78u-4(f)(4)(A)(ii).

If a covered person has to make a payment for the uncollectible share, that covered person may recover contribution from any of the following:

- The covered person originally liable for the payment
- Any covered person jointly and severally liable for the payment
- Any covered person held proportionately liable who is liable to make the same payment and has paid less than their proportionate share
- Any other person responsible for the conduct giving rise to the payment who would have been liable to make the same payment

15 U.S.C. § 78u-4(f)(5).

Bar Orders and Damages Offset in Settlements

To protect settling parties from claims of contribution from non-settling parties, the PSLRA requires the court, upon entry of judgment, to enter a bar order discharging settling defendants from all claims for contribution brought by or against any other person. 15 U.S.C. § 78u 4(f)(7)(A).

The PSLRA provides that the final verdict or judgment shall be reduced by the greater of:

- The amount that corresponds to the percentage of responsibility of the settling defendant
- The amount paid to plaintiff by the settlement defendant

15 U.S.C. § 78u-4(f)(7)(B).

For additional information on damages in securities litigation, see Liability under the Federal Securities Laws for Securities Offerings.

Loss Causation

In securities fraud cases under the Exchange Act, the PSLRA provides that plaintiff shall have the burden of proving that the alleged act or omission caused the loss for which plaintiff seeks recovery of damages. 15 U.S.C. § 78u-4(b)(4). Loss causation is not an element of Securities Act claims, although the absence of loss causation is an available defense.

Mandatory Review for Abusive Litigation and Mandatory Sanctions

Congress intended for the PSLRA to give "teeth" to FRCP 11 sanctions, observing that FRCP 11 had not deterred abusive securities litigation, courts rarely imposed FRCP 11 sanctions, and the amount of sanctions imposed were insufficient to make the victim whole. H.R. Conf. Rep. No. 104-369, at 39.

Under FRCP 11, the court may make its own determination that FRCP 11 has been violated and impose sanctions on a party, or a movant may make a separate motion for sanctions only after the movant serves the opposing party with the papers and provides a 21-day safe harbor for the opposing party to withdraw or correct the challenged papers. FRCP 11(c). U.S.C.S. Fed Rules Civ Proc R 11(c).

In contrast to FRCP 11's permissive standard, the PSLRA (for Securities Act and Exchange Act claims) mandates that the court both:

- Make and include specific findings regarding parties' compliance with FRCP 11
- Award sanctions if the court makes a finding that a party violated FRCP 11

15 U.S.C. §§ 77z-1(c), 78u 4(c). For instance, in Rombach, 355 F.3d at 164, after observing that the district court did not make any of the Rule 11 findings mandated by the PSLRA at the end of a private securities action, the Second Circuit remanded to the district court for compliance with the PSLRA. Rombach, 355 F.3d at 178.

An award to the prevailing party of attorney's fees and costs is presumptively the appropriate sanction for filing a complaint that violates FRCP 11. 15 U.S.C. §§ 77z-1(c)(3)(A), 78u 4(c)(3)(A). This presumption may be rebutted if the attorney against whom sanctions are to be imposed establishes either of the following:

- The award of attorney's fees and costs will impose an "unreasonable burden" and would be "unjust" and failure to award the sanctions would not impose a greater burden on the other party.
- The violation of FRCP 11 was de minimis.

15 U.S.C. §§ 77z-1(c)(3)(B), 78u 4(c)(3)(B).

Settlement

The vast majority of securities class actions are either dismissed at the pleadings stage or resolved through settlement. Securities class actions rarely make it to trial.

The PSLRA provides several disclosure requirements with respect to any final proposed settlement:

- The amount of the settlement proposed, determined in the aggregate and on an average per share basis
- A statement on the average amount of potential damages per share if the parties agree on the amount or, if the parties do not agree, a statement of issues on which the parties disagree

- A statement indicating which parties or counsel intend to make an application for an award of attorney's fees or costs, the amount of fees and costs that will be sought, and an explanation supporting the fees and costs
- The name and contact information of lead counsel who can answer questions in the notice
- A brief statement explaining why the parties are settling
- Any other information as required by the courts
- A cover page summarizing the above information

15 U.S.C. §§ 77z-1(a)(7), 78u-4(a)(7).

Further, FRCP 23 and the Class Action Fairness Act of 2005, 109 P.L. 2, 119 Stat. 4 (CAFA) impose additional requirements and procedures on settling class actions. For instance, under CAFA, within 10 days of filing a proposed class action settlement, each defendant participating in a proposed settlement must serve a notice of settlement on the appropriate official in each state in which a class member resides and the appropriate federal official. See 28 U.S.C. § 1715(b).

Practical Considerations

When defending class action claims under the PSLRA, you should consider the following procedural and strategic matters at various stages of litigation:

- **Early stages of the litigation.** As discussed throughout this note, once the initial complaint is filed, you should consider promptly taking the following steps:
  - o Instituting a litigation and document preservation hold
  - o Retaining experts and consultants to get an early assessment of analysis of stock price movements, loss causation, market efficiency, and damages
  - o Conducting an internal investigation to assess the merits of the claims raised in the complaint, including speaking with current and/or former employees to identify any potential confidential witnesses
- **Lead plaintiff appointment process.** Although defendants do not typically play a role in the Appointment of Lead Plaintiff and Lead Counsel process, you should nonetheless consider whether there are any procedural or substantive issues with any motions for appointment brought by candidates for lead plaintiff.
- **Consolidation.** If the initial class action complaint is followed by multiple additional complaints—sometimes filed in different districts or even states—these cases may be consolidated before a single judge. You should keep in mind that the court will not appoint a lead plaintiff before resolving pending motions for consolidation.
  - o Following appointment, lead plaintiff will typically file a consolidated amended complaint. The parties usually agree that the defendants need not respond to the initial complaints, but instead will answer or file a motion to dismiss in response to the consolidated amended complaint, filed after lead plaintiff is appointed. The courts tend to approve such agreements.
  - o The consolidated complaints are often significantly more detailed than the initial complaint or complaints. The lead plaintiff and lead counsel typically add additional allegations in an effort to comply with the heightened pleading requirements discussed above in Heightened Pleading Standards.
- **Motion to dismiss.** The motion to dismiss is often the main event of a securities litigation class action. On a motion to dismiss, defendants have a high chance of success under the PSLRA and FRCP 9(b)'s stringent pleading standards (for Exchange Act cases) and benefit from the automatic stay of discovery (for all federal securities cases brought in federal court and potentially federal securities cases brought in state court depending on the jurisdiction).
  - o As discussed in detail above in Heightened Pleading Standards, failure to plead a strong interference of scienter is one common ground for dismissal in a securities fraud case where proof of scienter is required (e.g., for Exchange Act claims).
  - o Another common ground for dismissal is that the allegedly false or misleading statements are protected by the PSLRA's safe harbor (i.e., they are forward-looking statements either accompanied by meaningful cautionary language (or immaterial) or not made with actual knowledge of their falsity or misleading nature). Even if the safe harbor does not apply to the statements, they may be protected by the bespeaks caution doctrine.

For additional information and practical guidance, see Defense Strategies under the Securities Act and Section 11 Elements and Defenses under the Securities Act.

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Chris Malloy has extensive experience representing public and private companies, financial institutions and individuals in complex commercial disputes, securities class actions and shareholder derivative suits, as well as corporate control disputes and commercial real estate litigation.

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