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# New York Appellate Division, First Department Holds That the Automatic Discovery Stay of the PSLRA Applies to Actions in State Court

On November 2, the New York Appellate Division, First Department became the first appellate court in the state to hold that the automatic discovery stay under the Private Securities Litigation Reform Act (“PSLRA”) applies to securities class actions pending in New York state court.<sup>1</sup>

## Background

Congress enacted the PSLRA in 1995 to deter plaintiffs from filing frivolous securities lawsuits and curb abusive discovery practices in such lawsuits before a court has had an opportunity to weigh in on the legal sufficiency of a complaint. Early discovery pressured defendants into quickly settling claims to avoid the expense of litigation, regardless of whether the claim had any merit. To further Congress’s goals, the PSLRA provides in relevant part that “[i]n any private action arising under this subchapter, all discovery and other proceedings shall be stayed during the pendency of any motion to dismiss.”<sup>2</sup>

Following the enactment of the PSLRA, plaintiffs began filing more securities class actions under state law in state courts, where plaintiffs could avoid the exacting federal pleading standards. Plaintiffs could also file parallel state and federal lawsuits, once again increasing early settlement pressure. Congress then enacted the Securities Litigation Uniform Standards Act of 1998 (“SLUSA”), which amended portions of the Securities Act of 1933 and the Securities Exchange Act of 1934 to preempt certain state-law securities claims and to provide for the removal of securities class actions from state court to federal court.<sup>3</sup> In 2018, in *Cyan, Inc. v. Beaver County Employees Retirement Fund*, the Supreme Court held that SLUSA does not divest state courts of jurisdiction over class actions asserting claims under the Securities Act.<sup>4</sup> Once again, following *Cyan*, there was a sharp rise in Securities Act class actions filed in state court.<sup>5</sup> This trend began to slow in 2020, after the Delaware Supreme Court enforced a

<sup>1</sup> *Camelot Event Driven Fund v. Morgan Stanley & Co. LLC*, 2023 WL 7198938 (N.Y. App. Div. Nov. 2, 2023).

<sup>2</sup> 15 U.S.C. § 77z–1(b)(1).

<sup>3</sup> 15 U.S.C. § 77p.

<sup>4</sup> 138 S. Ct. 1061, 1069–70 (2018) (“SLUSA’s text, read most straightforwardly, leaves in place state courts’ jurisdiction over 1933 Act claims, including when brought in class actions.”).

<sup>5</sup> Cornerstone Research, *Securities Class Action Filings 2023 Midyear Assessment* at 15, <https://securities.stanford.edu/research-reports/1996-2023/Securities-Class-Action-Filings-2023-Midyear-Assessment.pdf>.

forum selection clause in a corporate charter that required Securities Act claims to be filed in federal court.<sup>6</sup> Even still, plaintiffs continue to file Securities Act claims in state court, primarily in New York and California.

### The *Camelot* Decision

In *Camelot*, the First Department concluded that the PSLRA automatic discovery stay “applies to any private action, whether brought in state or federal court.”<sup>7</sup> The First Department assessed the plain language of the PSLRA and noted that Congress limited other subsections of the PSLRA to actions brought “pursuant to the Federal Rules of Civil Procedure,” while the automatic discovery stay instead applies to “any private action arising under this subchapter.”<sup>8</sup> The First Department reasoned that its conclusion that the automatic stay applies to state court actions is consistent with Congress’s purpose in enacting the PSLRA to prevent abusive and expensive discovery.<sup>9</sup> However, while the court held that the automatic stay applies while a motion to dismiss is pending, it concluded that the automatic stay does not apply during the pendency of an appeal from the denial of a motion to dismiss.<sup>10</sup>

### Implications

*Camelot* marks the first time a New York appellate court has held that the PSLRA automatic discovery stay applies to securities class actions in New York state court. While *Camelot* is not binding on the other three intermediate appellate courts in the state, the First Department is arguably the most influential appellate court and the most likely intermediate appellate court to hear securities actions given its geographical reach.

The Supreme Court has previously granted certiorari to decide whether the PSLRA’s automatic discovery stay applies in state courts, but the parties settled before the Supreme Court heard argument.<sup>11</sup> It remains to be seen how the law develops in New York and in California, and whether the Supreme Court will have another occasion to weigh in. In the meantime, while state court Securities Act lawsuits are already on the decline, the holding in *Camelot* may further deter such filings.

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<sup>6</sup> *Salzberg v. Sciabacucchi*, 227 A.3d 102, 137 (Del. 2020).

<sup>7</sup> *Camelot*, 2023 WL 7198938, at \*1.

<sup>8</sup> *Id.*

<sup>9</sup> *Id.* at \*2.

<sup>10</sup> *Id.*

<sup>11</sup> *Pivotal Software, Inc. v. Superior Court of Cal.*, 141 S. Ct. 2884 (2021).

This memorandum is not intended to provide legal advice, and no legal or business decision should be based on its content. Questions concerning issues addressed in this memorandum should be directed to:

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