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State Section 11 Litigation in the Post-Cyan Environment†

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State Section 11 Litigation in the Post-*Cyan* Environment[†]

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Executive Summary

This study analyzes class action litigation in state court under Section 11 of the Securities Act of 1933, which addresses misstatements and omissions in registration statements filed in connection with a public offering of securities. Some state courts have litigated Section 11 cases for several years, but as a result of the Supreme Court’s 2018 ruling in *Cyan, Inc. v. Beaver County Employees Retirement Fund*, these cases may now be heard in state courts nationwide. The result has been a dramatic increase in the filing of Section 11 cases in state court, for which there is often a parallel federal court case filed against the same defendant(s) based on the same allegations.

Litigating Section 11 cases in state court has raised three issues. First, state court pleading standards are generally lower than federal court standards, which suggests that state courts will not dismiss these cases as frequently as federal courts have dismissed them. This raises the concern that cases of questionable merit will survive motions to dismiss in state court. Second, discovery in state courts often begins earlier than it does in federal court, where the Private Securities Litigation Reform Act of 1995 imposes a stay on discovery until a motion to dismiss is denied. The concern here is that defendants will incur discovery costs in low merit state cases. Third, there is no process by which a federal and a state Section 11 case can be consolidated, which means a defendant can be forced to litigate the same allegation in state and federal court simultaneously—a clear waste of judicial and defense resources. The extent to which these concerns will be borne out by experience remains to be seen.

[†] The authors thank Boris Feldman, Doug Greene, Sam Issacharoff and Avi Josefson for their insights.

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We use the Stanford Securities Litigation Analytics¹ database to analyze the experience with Section 11 litigation to date. The following are our basic findings:

- In the year since *Cyan* was decided, 26 Section 11 cases have been filed in state courts, compared to 10 cases filed in the prior year. Most of that increase is attributable to cases filed in New York.
- In the year since *Cyan*, 77% of Section 11 cases have been filed in either state court alone or in both state court and federal court. That is, only 23% have been filed in federal court alone. In the three years prior to *Cyan*, 67% of Section 11 cases were filed in federal court alone.
- In the year since *Cyan*, 48% of Section 11 cases have been filed in both federal and state courts—meaning 48% of defendants have faced litigation for the same alleged violations in both state and federal court simultaneously. That figure for the three years prior to *Cyan* is 16%.
- Motions to dismiss Section 11 cases have been granted in only 19% of state court cases. That figure is 42% in federal court over the same period of time.
- When a parallel pair of cases has been filed, 83% of the time the outcome has been a settlement of one or both cases—that is, dismissal of the pair has occurred only 17% of the time.
- In five out of 20 resolved pairs of parallel cases, the state case settled even though the federal case was dismissed.
- Settlement size in state Section 11 cases has been roughly the same as the settlement size in federal Section 11 cases.
- When a parallel pair of cases includes a federal action with a Section 10(b) claim, the defendant settles the federal case. In some of those settled cases, the defendant enters into a global settlement with the plaintiffs in both the state and federal cases. In others, the state case is dropped.

¹ <https://sla.law.stanford.edu>

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Introduction

In *Cyan, Inc. v. Beaver County Employees Retirement Fund*,² decided roughly a year ago, the Supreme Court held that plaintiffs may bring cases in state court under Section 11 of the Securities Act of 1933, which addresses misstatements and omissions in registration statements filed in connection with a public offering of securities.³ As a result, plaintiffs may now file Section 11 class actions in state court, federal court, or both for the same underlying violations. The *Cyan* decision has made class action litigation under Section 11 considerably more complicated and probably more expensive for defendants, and it raises challenges to courts with respect to judicial efficiency.

In this study, we use the Stanford Securities Litigation Analytics (SSLA) database to analyze what has happened since *Cyan* and what we can expect as post-*Cyan* Section 11 litigation proceeds. We look, first, at the volume of Section 11 class actions filed in state court since *Cyan* compared to pre-*Cyan* volume, when some state courts were already hearing Section 11 cases.

Second, we look at the outcomes of state Section 11 class actions. How do dismissal rates and settlement sizes compare to Section 11 cases brought solely in federal court? It is still early in the post-*Cyan* legal environment, but since some Section 11 cases were filed in state court before *Cyan* was decided, we include those cases in our analysis to answer these questions.

Third, we investigate how Section 11 class actions are litigated when plaintiffs' attorneys bring cases in both federal and state courts based on the same alleged violation. In federal court,

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² *Cyan, Inc. v. Beaver Cty. Emps. Ret. Fund*, 138 S. Ct. 1061 (2018).

³ 15 U.S.C. § 77k.

there is a statutory consolidation process, but there is no process by which to consolidate a parallel federal and state case. One would therefore expect a less orderly litigation process, unless state and federal courts fashion their own ways to impose a degree of order.

I. Background: How Do Rules Differ Between State and Federal Section 11 Litigation?

Section 11 provides a monetary remedy to shareholders who purchase shares directly in a public offering, or shares traceable to a public offering, when there is a material misstatement or omission in a registration statement. It applies not only to initial public offerings and secondary offerings, but to issuances of shares in connection with a merger as well. Typically, a Section 11 suit is brought as a class action, with the class consisting of shareholders who purchased securities issued in the public offering.

Although the substance of Section 11 is the same in state and federal court, differences in procedural rules can have a major impact on the cost to defendants of litigating these cases, on the value of a suit to plaintiffs and their attorneys, and on judicial efficiency. Before empirically analyzing the impact of having Section 11 litigation proceed in state court, we briefly review the key procedural differences that potentially raise concerns regarding *Cyan*.

There are three differences in procedural rules governing Section 11 class actions in state and federal court that could have a major impact on litigating and resolving these cases. First, in some states, the pleading standard governing motions to dismiss is more plaintiff-friendly than that applied in federal court. Federal courts follow the *Twombly-Iqbal* pleading standard under which, in order to withstand a motion to dismiss, a plaintiff must allege “enough facts to state a claim to relief that is plausible on its face”⁴ in light of “judicial experience and common sense.”⁵ Facial plausibility is satisfied when a complaint permits a “court to draw the reasonable inference that the defendant is liable for the misconduct alleged.”⁶ Conclusory statements are insufficient to demonstrate facial plausibility.⁷ Furthermore, in Section 11 cases that “sound in fraud,” most federal courts apply the higher pleading standard enacted in the Private Securities Litigation Reform Act of 1995 (PSLRA)—that a complaint “state with particularity facts giving rise to a

⁴ Bell Atl. Corp. v. Twombly, 550 U.S. 544, 570 (2007).

⁵ Ashcroft v. Iqbal, 556 U.S. 662, 679 (2009).

⁶ *Id.* at 678.

⁷ *Twombly*, 550 U.S. at 555; *Iqbal*, 556 U.S. at 678.

strong inference that the defendant acted with the required state of mind.”⁸ The *Tellabs* case added a gloss to that standard, requiring that the strong inference “must be more than merely plausible or reasonable—it must be cogent and at least as compelling as any opposing inference of nonfraudulent intent.”⁹ Federal pleading standards in federal court have resulted in 44% of Section 11 cases being dismissed since the year 2008.¹⁰

In contrast, at least in cases not involving fraud, many states follow a more lenient pleading standard than the *Twombly-Iqbal* plausibility standard.¹¹ For example, California—where many Section 11 cases are litigated—merely requires a plaintiff to plead a “statement of the facts constituting the cause of action, in ordinary and concise language.”¹² In New York, which has seen the largest increase in Section 11 filings since *Cyan*, the pleading standard is more stringent than the California pleading standard.¹³ Whether the New York standard is as high as *Twombly-Iqbal* as applied to Section 11 cases remains to be seen. If it is, however, one would expect plaintiffs’ attorneys to file cases in more lenient courts.

A second procedural safeguard available in federal court, but not in state court, is the automatic stay of discovery until a motion to dismiss is denied. This was an important and contested provision of the PSLRA.¹⁴ Although it poses a considerable hurdle for plaintiffs’ attorneys, who must obtain detailed information outside of discovery, it saves defendants the expense of discovery until a plaintiff has alleged a meritorious case. With 44% of Section 11 cases in federal courts dismissed, this rule accounts for substantial savings in litigation expense, though plaintiffs’ attorneys argue that it screens out meritorious cases. State court rules regarding the start of discovery differ but, in some states including California, discovery may start before a

⁸ 15 U.S.C. § 78u-4(b)(2)(A) (2010). *See e.g., In re Fuwei Films Sec. Litig.*, 634 F. Supp. 2d 419, 436 (S.D.N.Y. 2009). Only the Eighth Circuit has consistently declined to apply this heightened standard. Amy L. Craiger, *From Conceivable to Impossible: The Hurdles Plaintiffs Must Overcome When Pleading Section 11 and Section 12(a) Securities Claims*, 5 Brook. J. Corp. Fin. & Com. L. 549, 556, 571 (2011).

⁹ *Tellabs, Inc. v. Makor Issues & Rights, Ltd.*, 551 U.S. 308, 314 (2007).

¹⁰ This excludes cases alleging Section 10(b) claims in addition to Section 11.

¹¹ *See Jane Willis & F. Turner Buford, Pleading Standards in the Federal and State Trial Courts: The Evolving Impact of U.S. Supreme Court Precedent*, Litigation Commentary & Review (August 2009), <https://litigationcommentary.org/2009/2009-august/109-pleading-standards-in-the-federal-and-state-trial-courts-the-evolving-impact-of-us-supreme-court-precedent>. Massachusetts, on the other hand, has explicitly adopted the *Twombly* standard. *Iannacchino v. Ford Motor Co.*, 888 N.E.2d 879, 890 (Mass. 2008).

¹² Cal. Civ. Proc. Code § 425.10 (West 2006).

¹³ N.Y. C.P.L.R. § 3013 (McKinney 2018). *King v. Commercial Ins. Co. of Newark, N. J.*, 275 N.Y.S.2d 975 (N.Y. App. Div. 1966). *See also* Lisa A. Zakolski & Judith Nichter Morris, *Carmody-Wait 2d New York Practice with Forms* § 27:29 (November 2018).

¹⁴ 15 U.S.C. §§ 77z-1(b).

ruling on a motion to dismiss.¹⁵ As a result, defendants bear the cost of discovery even in cases that the state court ultimately dismisses. Defendants may convince a judge to stay discovery on prudential grounds, but there is no assurance that a judge will do so.¹⁶

A third process under the PSLRA that is important to promoting judicial efficiency is the consolidation of class actions and the selection of lead plaintiff and lead counsel.¹⁷ In federal court, there is a relatively orderly process by which related cases are consolidated in one court and plaintiff(s) with the “largest financial interest” in the case are accorded a presumption in the selection of lead plaintiff(s).¹⁸ States have their own consolidation processes when multiple class actions are brought within a single state, but there is no process for consolidation of a state case and a federal case. Where plaintiffs file multiple state cases, the doctrine of *forum non conveniens* may relieve a defendant of the burden of litigating in multiple states, but there is no assurance that a court will provide that relief. Consequently, defendants potentially face lawsuits not only in federal and state court, but possibly in multiple state courts, for the same alleged violation. So far, however, where plaintiffs have filed suits in multiple states, the state courts that have made rulings addressing this situation have stayed those cases pending resolution of the federal case. As a result, the defendant was not forced to litigate those state cases.

As a result of these procedural rules, commentators have expressed concerns that (a) state courts will fail to filter Section 11 cases at the motion to dismiss stage as vigorously as they do in federal courts, (b) cases of doubtful merit will be filed in state court in anticipation of a lenient bar at the motion to dismiss stage, and (c) defendants will face high litigation costs in simultaneously defending cases in state and federal courts.¹⁹ In the remainder of this study, we

¹⁵ See, e.g., *Beaver Cty. Emps. Ret. Fund v. VHCP Mgmt., LLC*, No. CIV536488 (Cal. Super. Ct. filed Dec. 7, 2015); *Geller v. Morris*, No. CIV537300 (Cal. Super. Ct. filed Feb. 26, 2016).

¹⁶ Doug Greene, Jessie Gabriel, Marco Molina & Brian Song, *The Coming Securities Class Action Storm: Multijurisdictional Litigation After Cyan*, 32 PLUS Journal 1, 6-7 (Third Quarter 2018), https://www.wileyrein.com/media/publication/486_Q32018.pdf; David M.J. Rein & Matthew A. Schwartz, *Expert Q&A on Securities Act Claims and SLUSA After Cyan*, Practical Law 19 (June/July 2018), https://www.sullcrom.com/files/upload/Practical_Law_Rein_Schwartz_May2018.pdf.

¹⁷ 15 U.S.C. § 77z-1(a)(3)(B)(i),(ii); Fed. R. Civ. P. 42(a); David M.J. Rein, Matthew A. Schwartz & John P. Collins, Jr., *Securities Litigation Involving the Private Securities Litigation Reform Act (PSLRA)*, Westlaw Practical Law Practice Note w-010-6738.

¹⁸ 15 U.S.C. § 77z-1(a)(3)(B)(i),(iii). See also Rein & Schwartz, *supra* note 16; Rein et al., *supra* note 17.

¹⁹ Greene et al., *supra* note 16; Rein & Schwartz, *supra* note 16; *The Supreme Court's Cyan Decision and What Happens Next*, Davis Polk Client Memorandum (April 13, 2018), <https://www.davispolk.com/files/2018-04-13-supreme-courts-cyan-decision-what-happens-next.pdf>.

investigate the actual experience with state Section 11 litigation to evaluate the extent that experience supports these concerns thus far.

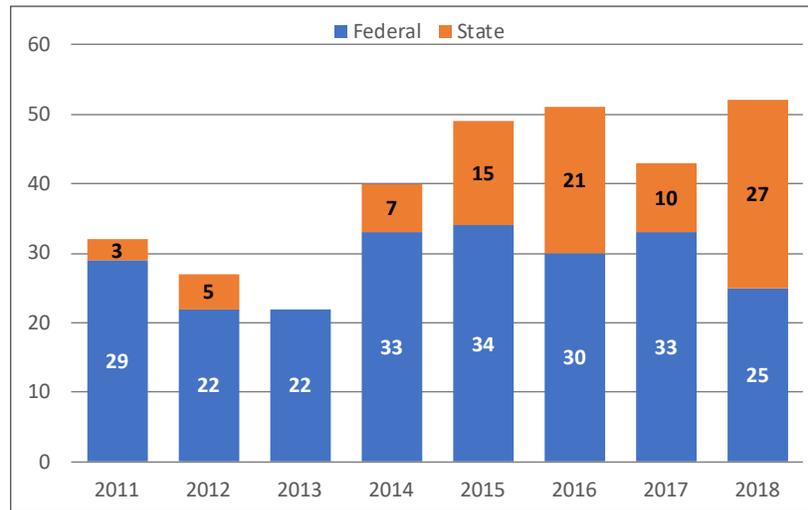
II. State Section 11 Filing Volume Since *Cyan*

The differences between state and federal procedural rules lead to two basic predictions for the post-*Cyan* environment. First, we can expect cases filed in state court to be dismissed less frequently than we see federal cases dismissed. Second, for this reason and because of accelerated discovery in state court, we expect to see an increase in Section 11 cases filed in state court, potentially including cases of questionable merit. Some of the increase in state court filings will take the form of parallel cases litigated in both state and federal court. In the discussion below, we investigate case filing volume, and in Part III, we analyze dismissals and settlements.

Figure 1 shows a sharp increase in the absolute number and the proportion of cases filed in state court in 2018, which reflects the impact of the *Cyan* decision on March 20, 2018. All but one of the state cases filed in 2018 were filed after *Cyan*. Twelve of the 26 cases filed in state court since *Cyan* were filed in New York, where prior to *Cyan*, cases were successfully removed to federal court. These New York cases account for nearly the full difference between the number of state cases filed in 2017 and 2018. Ten cases of the 26 post-*Cyan* filings were in California, which had heard Section 11 cases before *Cyan*.²⁰

²⁰ See the Appendix for an explanation of cases included and excluded from this study.

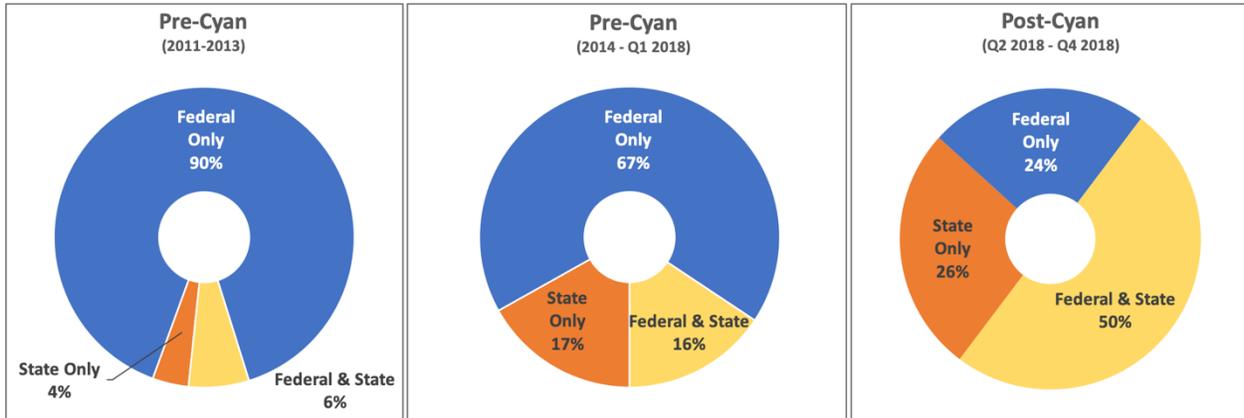
Figure 1: Forum Choice in Lawsuits Filed 2011 – 2018



In Figure 1, state filings include cases brought solely in state court and those state court cases for which there are parallel federal court cases based on the same alleged violation. Figure 2 shows the distribution of Section 11 cases across state and federal courts during two periods prior to *Cyan* and in the period since *Cyan*.²¹ In Figure 2, we separate cases filed only in state court and cases filed in both state and federal court. It is evident that the days of Section 11 cases being litigated largely in federal court are over (absent legislation to address this situation). Since *Cyan*, cases filed exclusively in federal court comprise only 23% of Section 11 filings, and that number will drop if plaintiffs' attorneys file parallel cases in state court. The fraction of cases filed only in state court will drop as well if plaintiffs' attorneys file parallel cases in federal court. Plaintiffs have three years following an IPO to file a Section 11 case.

²¹ The Pre-*Cyan* cohort includes cases filed between January 1, 2011 and March 20, 2018. The Post-*Cyan* cohort includes cases filed between March 21, 2018 and December 31, 2018.

Figure 2: Forum Mix in Securities Act Cases (2011 – 2018)



III. Outcomes of State Section 11 Cases

In the analysis below, we focus on dismissal rates and settlement size in state Section 11 cases. We compare those outcomes to outcomes in federal Section 11 cases. For purposes of these comparisons, we consider federal cases with Section 11 claims only—that is, we omit federal cases with both Section 11 and Section 10(b) claims under the Securities Exchange Act.²² This allows for an apples-to-apples comparison between state and federal cases.²³

A. Dismissal Rate

As explained above, the differences in pleading standards between state and federal courts implies that dismissal rates for Section 11 cases will be lower in state court than in federal court. Figure 3 tests that expectation by comparing final rulings on motions to dismiss in state and federal cases going back to 2011. This tabulation includes only cases in which there has been a final ruling on a motion to dismiss. It does not include cases that have been voluntarily dropped or cases dismissed without prejudice.

²² 15 U.S.C. § 78j(b).

²³ Since 2011, 165 cases with Section 11 and Section 10(b) claims have been filed, whereas only 61 cases with solely Section 11 claims have been filed. During that period, 119 federal cases with Section 11 and Section 10(b) claims have been resolved, and 41 federal cases with only Section 11 claims have been resolved.

Figure 3: Rulings on Motions to Dismiss in Cases Filed 2011 – 2018

	Denied	Granted	Total
State	29 (81%)	7 (19%)	36 (100%)
Federal	18 (58%)	13 (42%)	31 (100%)

The dismissal rate in state court, as expected, is far lower than in federal court—19% compared to 42%.²⁴ These figures include cases filed solely in state court, solely in federal court, and parallel pairs of cases filed in state and federal court. If we exclude the parallel pairs, the dismissal rates are slightly different—26% and 42% in state and federal court, respectively—but still much lower in state court than in federal court. The difference in dismissal rates between cases filed solely in state court and state cases with a parallel federal action may suggest that cases are being filed in state court in anticipation of a lower bar at the dismissal stage. The number of cases involved, however, is too small to support a reliable inference.

In sum, our expectations regarding dismissal rates are confirmed by experience. State courts dismiss Section 11 cases far less frequently than do federal courts.

B. *Settlement*

To the extent dismissal rates in state court are lower than dismissal rates in federal court, settlement rates will be higher in state court. Figure 4 shows settlement rates for cases filed between 2011 and 2018 with two added elements. First, we add a column for cases voluntarily dropped. Second, we break out parallel pairs of cases filed in state and federal court. For parallel pairs of cases, where a case is *either* (i) dismissed in both courts or (ii) dismissed in one court and then dropped in the other, we treat that outcome as a dismissal since, in the latter scenario, the drop is presumably a result of the initial dismissal. In the one parallel pair of cases shown as dropped, both the federal and state cases were dropped. As shown in Figure 4, settlement rates are higher in cases filed solely in state court than in those filed solely in federal court. For cases filed in both courts, settlement rates are much higher than those in state-only or federal-only

²⁴ As noted above, we go back to 2008, the dismissal rate for federal Section 11 cases is 44%.

cases. Again, this may suggest that cases filed solely in state court are of relatively low merit and are being filed in the hope that they will clear the relatively low dismissal bar.

Figure 4: Dismissal Rates in Cases Filed 2011 – 2018

	Dropped	Dismissed	Settled	Total
State Only	2 (9%)	6 (26%)	15 (65%)	23 (100%)
Federal Only	3 (8%)	12 (32%)	22 (59%)	37 (100%)
Parallel Federal & State	1 (4%)	3 (13%)	20 (83%)	24 (100%)

Note: Currently pending cases are omitted. Also, because this chart separates parallel pairs of cases and includes settled and voluntarily dropped cases, the numbers do not match up exactly with those in Figure 3.

With lower dismissal rates in state court than in federal court and discovery potentially beginning before the motion to dismiss has been resolved, we would expect state cases to be more costly to defendants than federal cases—holding constant the merits, shareholder losses, and other extraneous factors. We would also expect state cases to offer higher prospects for plaintiffs, at least until the motion to dismiss is resolved. Based on these factors, we would expect higher settlements in state cases, but only where the comparison is limited to cases that settle before final rulings on motions to dismiss. The differences in procedural rules between state and federal court should not lead to a difference in settlement size.

A comparison of settlement size between state and federal cases is further complicated by the possibility that lenient state pleading standards may lead plaintiffs’ attorneys to file state court cases with lower merit or lower shareholder loss than they would file in federal court. Those factors would lead to lower settlements in state courts, all other factors held equal. We therefore have no *a priori* prediction regarding relative settlement size among cases filed in state court and federal court.

Among cases that were not dismissed or voluntarily dropped, Figures 5 and 6 compare settlement size across state-only and federal-only cases. Figure 5 compares raw settlement size, and Figure 6 compares settlement size as a proportion of estimated shareholder losses. Consistent with our analysis of dismissal rates, and to maintain an apples-to-apples comparison, we include

among federal cases only those with solely a Section 11 claim—federal cases that include Section 10(b) claims are omitted in comparing settlement size. In this comparison, we look at cases filed from 2014 onward, rather than going back to 2011. The reason for this is that earlier cases were influenced by the financial crisis and, as seen in Figures 1 and 2, overwhelmingly in federal court. By focusing on cases filed beginning in 2014, we avoid this potential distortion in comparing state and federal settlements.

As shown in Figure 5, the median raw settlement size in state cases is larger than the median in federal cases, but the opposite is true for the means. Both the state and federal settlements are skewed at the high end, but federal settlements are skewed more. Excluding the highest federal settlement brings the federal court mean down to \$7.6 million, slightly lower than the mean in state cases.

Figure 5: Settlement Size

	Median	Mean	N
State Only	7,550,000	8,361,458	12
Federal Only	5,925,000	12,500,000	10

Figure 6 shows the difference in settlement size as a percentage of estimated potential statutory damages. Estimated statutory damages are calculated as the difference between the value of shares issued in a public offering and the market value of those shares at the time of a lawsuit—adjusted by the change in the overall market over the same period of time.²⁵ With this adjustment, settlements in federal cases are essentially the same as settlements in state cases.

Figure 6: Settlement as a Percentage of Estimated Potential Statutory Damages

	Median	Mean	N
State Only	11.29%	11.34%	12
Federal Only	10.82%	11.76%	10

²⁵ The formula for adjusting a change in stock price is: $[(1 + r_f) / (1 + r_m)] - 1$, where r_f is the change in stock price and r_m is the change in the market index over the same period of time. This is a simplified adjustment in that we did not use a four-factor capital asset pricing model or adjust for beta.

In sum, while state Section 11 cases can be expected to settle more frequently than federal Section 11 cases, settlement sizes do not appear to be higher in state court than in federal court. The greater frequency of settlement will mean higher aggregate cost in terms of both settlement payments and litigation expenses.

One might wonder, however, whether average settlement sizes to date understate future settlements in state cases because past cases were settled when uncertainty surrounded the jurisdiction of state courts. Past settlements may therefore reflect some urgency on the part of plaintiffs' attorneys to settle quickly, especially once the Supreme Court granted certiorari in *Cyan*.²⁶ We are still too early in the post-*Cyan* environment to draw any conclusions along these lines; there have been only three state court settlements since *Cyan*. For what it is worth, the mean raw settlement size among these cases is about the same as the pre-*Cyan* mean, but the mean settlement measured as a percentage of estimated statutory losses is larger.

IV. Litigation of Parallel Pairs of State and Federal Cases

In the discussion below, we address the most complex aspect of the post-*Cyan* legal environment: litigating parallel lawsuits in state and federal court. We define a federal case as parallel to a state Section 11 case if it includes a cause of action based on alleged misstatement(s) or omissions in the defendant's registration statement that are the same as those alleged in the state case. The parallel federal case may be a Section 11 action, it may be a Section 10(b) action, or it may contain both Section 11 and Section 10(b) claims. Furthermore, if the federal case includes Section 10(b) claims, those claims typically will include counts based on alleged misstatements or omissions in addition to those in the defendant's registration statement. The plaintiff class, therefore, will include members of the Section 11 class plus additional class members.

Two factors have been, and will continue to be, important in the litigation of parallel pairs of cases. First, the pleading standard and the early start of discovery in the state case will be important. As discussed above, plaintiffs' attorneys will try to bring cases in states where the

²⁶ Only two cases were settled during the time interval between the Supreme Court's grant of certiorari and its decision of *Cyan*. *Geller v. LendingClub Corp.*, CIV537300 (Cal. Super. Ct. filed Feb. 26, 2016); *Luz v. Fitbit, Inc.*, No. CGC16552062 (Cal. Super. Ct. filed May 17, 2016).

pleading standard is relatively low and where discovery begins early in the litigation. The second important factor is whether there is a Section 10(b) count in the federal case.

We expect that state pleading standards and discovery rules will affect litigation of parallel pairs of cases in three ways. First, as we have already seen, there will be a lower rate of dismissal and therefore a higher rate of settlement in state cases as compared to those in federal Section 11 cases. Second, the state case will have to be separately resolved even if the federal case is dismissed because, as a matter of law, a dismissal of one case has no preclusive effect on the other. With a low dismissal rate in state court, this means case states may well have to be settled even if a parallel federal case is dismissed. Third, because discovery may begin early in the state case and expenses may mount quickly, there will be pressure on both parties, especially the defendant, to settle before the federal case reaches a ruling on a motion to dismiss.

An avenue by which the defendant may be able to alleviate the expense and pressure created by the state case is a motion requesting that the state court stay its proceedings pending resolution of the federal case. Some courts, in the name of judicial efficiency, have granted that motion.²⁷ If the court grants the motion, the state case may still be revived later if the federal case ends in a dismissal. As stated above, that dismissal in federal court will not end the state case. The state court could then hear a motion to dismiss and deny it, in which case the defendant would have to settle the state case despite the federal dismissal. On the other hand, a state court may hesitate to deny a motion to dismiss when a federal court has just granted one based on the same allegations (even if the pleading standards differ). A stay of the state case is nonetheless salutary because it allows the parties to negotiate a settlement without the pressure of mounting discovery costs in the state case. The extent to which state courts will grant stays pending resolution of the federal case remains to be seen.²⁸

²⁷ See *Harper v. Smart Techs. Inc.*, No. CGC11514673 (Cal. Super. Ct. filed Sept. 27, 2011); *West Virginia Laborers' Trust Fund v. Stec, Inc.*, No. 30-2011-00489022 (Cal. Super. Ct. filed July 1, 2011); *Reyes v. Zynga Inc.*, No. CGC12522876 (Cal. Super. Ct. filed Aug. 1, 2012); *Rajasekaran v. Cytrx Corp.*, No. BC541426 (Cal. Super. Ct. filed Apr. 3, 2014); *Boutsikakis v. TCP Int'l Holdings, Ltd.*, No. CV-15-843053 (Ohio Ct. Com. Pl. filed Mar. 27, 2015); *Hsieh v. Snap Inc.*, No. BC669394 (Cal. Super. Ct. filed July 25, 2017); *Birmingham Ret. & Relief Sys. v. ZTO Express (Cayman) Inc.*, No. CV-2017-902004.00 (Ala. Cir. Ct. filed May 16, 2017).

²⁸ Some state courts have also granted motions to stay discovery pending ruling on a motion to dismiss in the state case, which is similar to the process in federal court except for the more lenient state pleading standard. See *Ng v. Kitov Pharm. Holdings Ltd.*, No. 17CIV00620 (Cal. Super. Ct. filed Feb. 10, 2017); *Book v. Pronai Therapeutics, Inc.*, No. 16CIV02473 (Cal. Super. Ct. filed Nov. 18, 2016). Some state courts have also granted stays pending a ruling on a motion to dismiss in federal court. See *Vesey v. Rewalk Robotics Ltd.*, No. 1684CV03336 (Mass. Super. Ct. filed Oct. 31, 2016); *Bucks Cty. Emps. Ret. Fund v. Nanthealth Inc.*, No. BC662330 (Cal. Super. Ct. filed May

Another way a defendant might stop two-track litigation is to ask the federal court to enjoin the state action under the All Writs Act and the Anti-Injunction Act.²⁹ Defendants have made such a motion in at least two pre-*Cyan* Section 11 cases to date, but both were denied.³⁰ It remains to be seen, however, whether this approach will become more successful.

With dismissal in state court less likely than it has been in federal Section 11 litigation, what will settlement dynamics be in parallel state and federal cases? This is where the nature of the federal case becomes important—that is, whether the federal case includes a Section 10(b) claim. If it does, and that claim has already survived a motion to dismiss or has a reasonable chance of doing so, then settling the federal case will be the defendant’s primary objective. A settlement of the federal case will include a release of claims that will cover the state case and thereby terminate the litigation. On the other hand, a settlement and release in the state case will not cover the federal Section 10(b) claim, because the Section 10(b) class is broader than the Section 11 class. The federal case will therefore survive settlement of the state Section 11 claim. Where the federal case includes a reasonably strong Section 10(b) claim, we therefore expect to see that case settle.

If the federal case includes only a Section 11 claim, as is sometimes true, a settlement and release in either case will terminate the other. The defendant can try to negotiate a settlement with whichever plaintiffs’ attorney seems most amenable. It is possible that a defendant can play the state and federal plaintiffs’ attorneys against each other, or that the existence of two cases will create pressure on each lead counsel to settle at amounts lower than they would accept if there were only one case.

22, 2017). These stays are not as effective as a stay pending resolution of the state case, but they do slow down the state case so that it may not get too far ahead of the federal case.

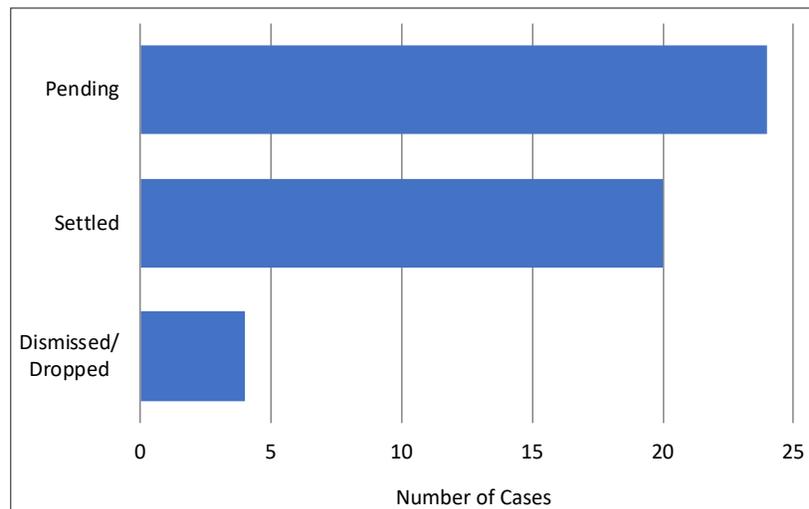
²⁹ Federal courts have the authority under the All Writs Act and the Anti-Injunction Act to enjoin state cases when “necessary in aid of” the federal court’s jurisdiction. 28 U.S.C. §§ 1651(a), 2283. The All Writs Act grants federal courts the expansive power to issue injunctions “necessary or appropriate in aid of” the court’s jurisdiction. The Anti-Injunction Act limits this broad grant of authority, prohibiting federal courts from enjoining state court proceedings unless one of three exceptions are present: express Congressional authorization has been granted, the injunction is “necessary in aid of” the federal court’s jurisdiction, or the injunction “protect[s] or effectuate[s]” the federal court’s judgments. Out of concern for principles of federalism, injunctions are issued under the two Acts only in limited circumstances. *See, e.g.,* *Newby v. Enron Corp.*, 338 F.3d 467 (5th Cir. 2003); *In re DPL Inc., Sec. Litig.*, 2003 WL 25566106, at *1 (S.D. Ohio 2003).

³⁰ *See* *Primo v. Pac. Biosciences of California Inc.*, No. 4:11-cv-06599 (N.D. Cal. filed Dec. 21, 2011); *In re LendingClub Sec. Litig.*, No. 3:16-cv-02627 (N.D. Cal. filed May 16, 2016).

Before looking at the data, we offer one caveat. All parallel pairs of cases that have been resolved to date—both settled and dismissed cases—were filed before *Cyan*. As a result, litigation of state cases included complications that will not be present going forward. For example, there will be no time-consuming removal-and-remand process by which cases bounced between state and federal court, as there was prior to *Cyan*, and of course there will be no stay of a state case pending a decision in *Cyan*, as was common after the Supreme Court granted certiorari in *Cyan*. Nonetheless, the cases that have been litigated so far provide some basis on which to test the expectations described above.

So, what do we see in the data? Figure 7 breaks down the status of the 48 parallel pairs filed between 2011 and 2018. Twenty pairs of cases have been settled, four pairs have been dismissed or dropped, and twenty-four pairs of cases are currently pending. Among the pending cases, there are two instances in which the federal case was dropped and the state action continued.

Figure 7: Parallel Pairs of Cases Filed in State and Federal Court, 2011 – 2018

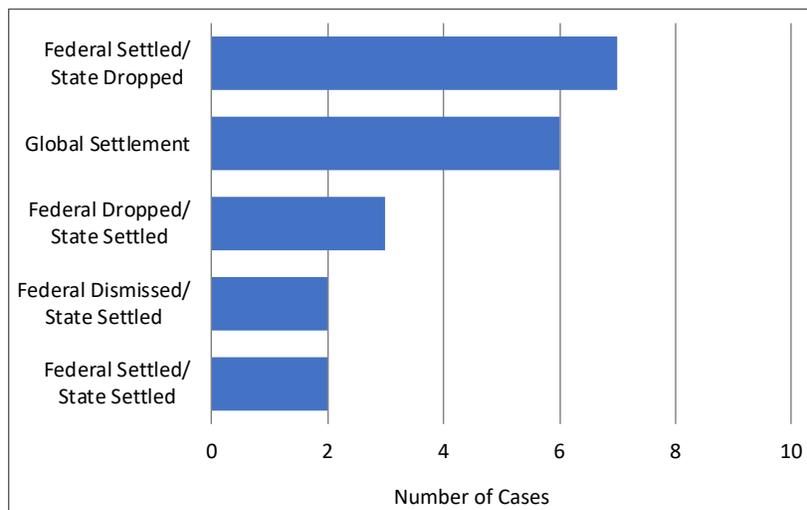


Note: A parallel pair is classified as dropped or dismissed if both cases are either dropped or dismissed. Settled pairs include those in which one case was dismissed and the other settled.

Figure 8 shows how the 20 settled cases were settled. Not surprisingly, we see nearly all possible combinations between the state and the federal case either being settled, dropped or

dismissed. Global settlements are those in which the defendant enters into the same settlement agreement with the state and federal plaintiffs.³¹

Figure 8: Settlement of Parallel Pairs of State and Federal Cases, 2011 – 2018



Although the pre-*Cyan* procedural complications are evident when one looks at the dockets in these cases, many of these outcomes confirm our expectations. First, the low rate of state case dismissal is evident. Out of 24 resolved pairs of cases, only four pairs were dismissed or dropped—a dismissal rate of 16.67%. Furthermore, there are five pairs where the federal case was dismissed or dropped yet the state cases settled.³² A related expectation was that state cases would move into discovery and past the motion to dismiss far ahead of a parallel federal case (unless a state case is stayed), and that discovery-related expenses would create pressure to settle the federal case before a ruling on a motion to dismiss. This expectation is not borne out in cases litigated so far. But the past may not be prologue in this respect. Prior to *Cyan*, many state cases did not move quickly. They were removed to federal court and then remanded back to state court, which took time, and in 2017 some state cases were stayed pending a decision in *Cyan*.

³¹ As stated above, where the federal case includes a Section 10(b) count, the defendant’s priority is to settle with the federal plaintiff. The state plaintiffs’ attorneys may have leverage to join the settlement if they can credibly threaten either to challenge the federal settlement or to represent a class member in opting out of the settlement.

³² See *Pytel v. Sunrun Inc.*, No. CIV538215 (Cal. Super. Ct. filed Apr. 13, 2016); *Greenberg v. Sunrun Inc.*, No. 3:16-cv-02480 (N.D. Cal. filed May 06, 2016); *Young v. Pac. Biosciences of California Inc.*, No. CIV509210 (Cal. Super. Ct. filed Oct. 21, 2011); *Primo v. Pac. Biosciences of California Inc.*, No. 4:11-cv-06599 (N.D. Cal. filed Dec. 21, 2011).

A second expectation described above is that, where a federal case includes a Section 10(b) claim, and that claim is not dismissed, the defendant's primary goal must be to settle that case, as opposed to the state case. This expectation is borne out in 11 of the 20 settlements. All six of the global settlements, where the federal and state cases settled together, involved federal cases with Section 10(b) claims, and six of the seven pairs in which the federal case settled and the state case was dropped had federal cases with Section 10(b) claims.³³

In five of the seven pairs in which the federal case settled and the state case was dropped, the state court had granted defendants a stay pending a resolution of the federal case. Four of those were California cases, and the fifth was an Ohio case.³⁴

Among pairs of cases in which the federal case had only a Section 11 claim, a defendant could achieve litigation peace by settling either the state or federal case under these circumstances. Among settled cases, there are only three pairs in which the federal case included a Section 11-only claim. One was among those described above where the federal case settled and the state case was then dropped.³⁵ Neither of the other two parallel pairs were clear situations in which a settlement of the state case ended the litigation.

The final empirical question that many would like to see answered is whether post-*Cyan* settlements of parallel pairs will be larger than past settlements. Unfortunately, we cannot answer that question because all but three of the settled pairs involved federal cases with Section 10(b) claims. Cases with Section 10(b) claims generally settle for more than those with only Section 11 claims. Moreover, as explained above, where the federal case has a viable 10(b) claim, the

³³ See, e.g., *Ng v. Kitov Pharm. Holdings Ltd.*, No. 17CIV00620 (Cal. Super. Ct. filed Feb. 10, 2017) (global settlement); *Pilgaonkar v. Kitov Pharm. Holdings Ltd.*, No. 1:17-cv-00917 (S.D.N.Y. filed Feb. 7, 2017) (same); *Boutsikakis v. TCP Int'l Holdings, Ltd.*, No. CV-15-843053 (Ohio Ct. Com. Pl. filed Mar. 27, 2015) (federal case settled, state case dropped); *Sohal v. TCP Int'l Holdings, Ltd.*, No. 1:15-cv-00393 (N.D. Ohio filed Mar. 2, 2015) (same). In some cases where the federal case settled and the state case was dropped, the state case was dropped before the federal settlement. A likely explanation is that as the federal case headed toward settlement, the pre-*Cyan* process of removal and remand took so much time that the state case was far behind the federal case.

³⁴ See *Harper v. Smart Techs. Inc.*, No. CGC11514673 (Cal. Super. Ct. filed Sept. 27, 2011); *West Virginia Laborers' Trust Fund v. Stec, Inc.*, No. 30-2011-00489022 (Cal. Super. Ct. filed July 1, 2011); *Reyes v. Zynga Inc.*, No. CGC12522876 (Cal. Super. Ct. filed Aug. 1, 2012); *Rajasekaran v. Cytrx Corp.*, No. BC541426 (Cal. Super. Ct. filed Apr. 3, 2014); *Boutsikakis v. TCP Int'l Holdings, Ltd.*, No. CV-15-843053 (Ohio Ct. Com. Pl. filed Mar. 27, 2015). State courts have accomplished the same outcome relying on the doctrine of *forum non conveniens*. *Elec. Workers Local #357 Pension & Health & Welfare Trs. v. Clovis Oncology, Inc.*, No. CIV537068 (Cal. Super. Ct. filed Jan. 22, 2016); *Vesey v. Rewalk Robotics Ltd.*, No. 1684CV03336 (Mass. Super. Ct. filed Oct. 31, 2016).

³⁵ See *Harper v. Smart Techs. Inc.*, No. CGC11514673 (Cal. Super. Ct. filed Sept. 27, 2011); *McKenna v. Smart Techs., Inc.*, No. 1:11-cv-07673 (S.D.N.Y. filed Oct. 28, 2011).

defendant's focus will be on settling that case. Consequently, the influence of the parallel state Section 11 case may not be very significant.

Conclusion

Filings of Section 11 cases in state court have increased dramatically since the Supreme Court's ruling in *Cyan*. Most of that increase has come from cases filed in New York. The increase in state filings includes cases filed solely in state court and parallel pairs of cases filed in both state and federal court. While the size of settlements in state court has been comparable to federal court settlements, the dismissal rate in state court is much lower than that in federal court. Consequently, the proportion of cases that settle is much higher. In addition, there is some evidence that lower-merit cases have been filed in state court.

Parallel pairs of cases present challenges to both plaintiffs and defendants. Some state courts have used their discretion to stay proceedings pending a parallel federal case and thereby have achieved some efficiency. The extent to which state courts adopt this approach will be important in determining the efficiency of Section 11 litigation in the post-*Cyan* environment.

The uptick in post-*Cyan* state litigation will increase the cost of Section 11 litigation to defendants and their insurers. It will also increase the cost to plaintiffs to the extent they are litigating the same alleged violations in both state and federal court.

Appendix: Rules for Inclusion and Exclusion of Cases in the Study

Identifying Section 11 cases litigated in state court is not straightforward. Not only is it difficult to track some state court dockets and obtain state court filings, it is difficult to identify whether a case was actually litigated in state court, as opposed to being filed in state court and then successfully removed to federal court, at which point the case may be consolidated with a pending related action. There is also a risk of double counting if plaintiffs file cases in multiple state courts against the same defendant for the same alleged violations.

For this study, we include securities class actions filed in federal or state court against publicly-traded companies between January 1, 2011 and December 31, 2018 that allege misstatements or omissions in a registration statement filed pursuant to a public offering of securities.

State actions removed to federal court without a subsequent remand back to state court are excluded. Parallel lawsuits filed in multiple state courts are counted as one case, and the state in which the earliest related action was filed is credited in the forum count. Parallel state and federal cases are also counted as one case in our tally of federal, state and parallel federal/state cases. With respect to events in, or the status of, each case we report information as of January 15, 2018. More recent developments in the cases are not reflected in the data presented here. In some instances, state court documents are not electronically available, in which case we rely on company disclosures and other information sources to fill in missing information.

Finally, we exclude (i) actions related to Initial Coin Offerings (ICOs), which raise new issues unrelated to the advent of state Section 11 litigation and which would confound comparisons, (ii) cases involving solely unregistered securities, and (iii) cases that name only third-party defendants, such as underwriters and auditors.