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Some Courts: PSLRA Stay-Provision Language Ambiguous

Most securities litigators expect that, while a motion to dismiss is pending in any private securities fraud litigation brought under the Private Securities Litigation Reform Act (PSLRA), discovery will be stayed unless a showing of exceptional circumstances can be made.

The basis for this is the PSLRA itself, which states that "all discovery and other proceedings shall be stayed during the pendency of any motion to dismiss." It may be surprising to learn that some plaintiffs argue, notwithstanding this language, that such a stay is not required if only some defendants have a motion to dismiss pending. It may be even more surprising to learn that, at times, plaintiffs win that argument.

In the recent case of *In re Refco, Inc. Securities Litigation*, No. 05 Civ. 8626 (GEL), __FSupp2d__, 2006 WL 23337212 (SDNY Aug. 8, 2006), the U.S. District Court for the Southern District of New York considered an argument by plaintiffs that, where certain defendants have answered the complaint even while others have moved to dismiss it, the discovery stay should be lifted as to the answering defendants. Rather than reject the argument outright, the court did not resolve it because it was improperly raised by plaintiffs subsequent to filing their motion to lift the stay. The court noted, however, that "there is some case law in support of plaintiffs' position," citing *In re Lernout & Hauspie Securities Litigation*, 214 FSupp2d 100, 106 (D. Mass 2002), and invited the plaintiffs to file a new motion if it wished to pursue the point.

The Language of the PSLRA

Section 4(b)(3)(B) of the PSLRA, entitled, "Stay of discovery," states:

> In any private action arising under this title, *all* discovery and other proceedings *shall* be stayed during the pendency of *any* motion to dismiss, unless the court finds upon the motion of *any* party that particularized discovery is necessary to preserve evidence or to prevent undue prejudice to that party. (Emphasis added.)

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In 'Lernout,' the District Court of Massachusetts found that the PSLRA "be read to mean that all discovery against a party must be stayed during the pendency of any motion to dismiss filed by that party."

Most courts have interpreted this language to mean the stay of discovery is automatic—in other words, no matter how many defendants are in the case, and no matter which ones have filed a motion to dismiss and which have answered or had their motions denied, so long as a motion to dismiss by any defendant is pending, discovery is stayed for the entire case. See *Sedona Corp. v. Ladenburg Thalman*, No. 03 Civ. 3120, 2005 WL 2647945, at *9-10 (SDNY Oct. 14, 2005) (collecting cases).

The pendency of any motion to dismiss is, by the statute's own terms, the only precondition for the stay. 15 USC §78u-4(b)(3)(B). Two courts, however, have published decisions holding that the language of the PSLRA's stay provision is ambiguous.

In *Lernout*, the U.S. District Court of Massachusetts found that the statute could "be read to mean that all discovery against *a party* must be stayed during the pendency of any motion to dismiss filed by that party." 214 FSupp2d at 105 (emphasis added). In *In re Global Crossing, Ltd. Securities Litigation*, 322 FSupp2d 319, 352 (SDNY 2004), the judge cited *Lernout* in finding an "ambiguity" in the statute, but did not resolve the ambiguity. Instead, the court found that the plaintiffs demonstrated a need "to prevent undue prejudice and preserve evidence" (both of which are statutory exceptions to the stay) specific to the issue of successor liability "in the wake of the bankruptcy" of one defendant. Because the issue was resolved pursuant to the express exceptions under the statute, the court's finding of an ambiguity regarding the scope of the stay was dicta.

All other courts to consider the issue have rejected any notion of ambiguity in the statute. In *CFS*, for example, the U.S. District Court for the Northern District of Oklahoma performed the simple test of comparing the statute's provision that discovery shall be stayed as to all parties "during the pendency of *any* motion to dismiss" (emphasis in decision) with the fact that at least one motion to dismiss was pending in the action, and held that this "threshold element for a discovery stay under the PSLRA is established." *CFS*, 179 FSupp2d at 1263.

Even decisions in the U.S. District Court for the Southern District of New York, subsequent to *Global Crossing*, have found the statute unambiguous. In *Sedona*, Magistrate Judge Theodore H. Katz noted both the *Lernout* and *Global Crossing* decisions, but concluded "there is no ambiguity in the plain language of the PSLRA's stay provision; the automatic stay applies while 'any motion to dismiss' is pending, just as the statute permits 'any' party to seek particularized discovery upon a showing of need." 2005 WL 2647945, at *10-11.

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In *Refco*—the latest decision on this issue in the Southern District of New York—the plaintiffs filed a motion for a partial lifting of the stay, arguing the exceptions to the statute applied because their inability to take discovery while motions to dismiss were pending "unduly hampered…their preparation of the case." See *Refco* 2006 WL 2337212 at *1. Judge Gerard Lynch found no undue prejudice, however, and denied the motion. While the plaintiffs' motion for a partial lifting of the stay was pending they informed the court that not all defendants filed motions to dismiss the complaint (or to dismiss all claims in the complaint), and asked the court to lift the stay "in its entirety." The plaintiffs cited *Global Crossing* for the proposition that the denial of a defendant's motion to dismiss lifts the PSLRA stay with respect to that specific defendant, but the court noted (correctly) that *Global Crossing* never resolved that issue. The court also decided that, even "to the extent the language of *Global Crossing*" can be read to support that proposition (an issue which Judge Lynch—who wrote the *Global Crossing* decision —also did not resolve), the plaintiffs in *Refco* sought a lifting of the stay in its entirety, which in no way follows from that proposition. As to plaintiffs' apparent last-ditch effort in a "supplemental reply" to argue for a lifting of the stay only as to the nonmoving defendants, the court ruled that it "need not attempt to resolve this question" because it was improperly raised by the plaintiffs. Id. at *4. Judge Lynch did note, however, that "the weight of authority" appears to be against the plaintiffs' position.

Thus, while two courts to address the issue have found the statute ambiguous, and one—in *Refco*—has apparently left the question open, most courts to address this issue have found no ambiguity in the statute.

Legislative Purposes

In a summary report on the PSLRA from the Senate Committee on Banking, Housing, and Urban Affairs, S. Rep. No. 104-98 (1995), the committee "determined that discovery should be permitted in securities class actions only after the court has sustained the legal sufficiency of the complaint," in order to prevent fishing expeditions by plaintiffs hoping to find evidence supporting a claim after the complaint is filed. In the later House and the Senate Conference Committee Report, H. Rep. No. 104-369 (1995), as reprinted in 1995 U.S.C.C.A.N. 13692, 13699, the Conference Committee railed against "the abuse of the discovery process to impose costs so burdensome that it is often economical for the victimized party to settle." For these reasons, the discovery stay was enacted.

Only the court in *Lernout*, after finding the statute ambiguous on this issue, went on to base its decision on an analysis of Congress' intent in enacting the discovery stay. The court found that Congress did not seem to consider "the scenario of multiple defendants with multiple motions to dismiss." *Lernout*, 214 FSupp2d at 106. But the court determined that, because it denied the motions to dismiss of four defendants, the case could no longer be considered a "fishing expedition" which forced innocent defendants to bear unnecessary discovery costs. It thus allowed limited discovery as to those four defendants.

Every court besides *Lernout* to consider the legislative history—albeit in dicta—has found it to support the position that the discovery stay should remain in place as to all parties while any defendant's motion to dismiss is still pending.

The court in *Sedona* stated that "courts have noted that one purpose of the stay provision is to prevent a plaintiff from utilizing discovery to formulate a claim." 2005 WL 2647945, at *11. Even though the plaintiff in that case survived the motions to dismiss filed by some defendants, the court stated, it would run counter to the PSLRA's rationale for the plaintiff to take discovery from those defendants in order to look for a claim against other defendants, whose motions to dismiss were granted.

The question is whether the terms "all discovery," "shall" and "any motion" in the statute mean what they say. Most courts analyzing this language have concluded that they do.

Other reasons exist to support reading the statute to require a stay of discovery as to all parties. For one, the statute uniformly has been held to stay discovery sought not just from parties but also from nonparties. See, e.g., *In re Carnegie Int'l Corp. Sec. Litig.*, 107 FSupp2d 676, 680 (D. Md. 2000). Thus, the argument that discovery should proceed as a matter of right against any defendant for which no motion to dismiss is pending is not well-placed.

Second, unless discovery is stayed even as to non-moving defendants, "the PSLRA's stay would be of little benefit to those defendants who do move to dismiss," because each moving defendant will still "want to monitor the discovery occurring between plaintiffs and the non-moving defendants to insure that its rights are not prejudiced." See *CFS*, 179 FSupp2d at 1263-64.

A third reason is efficiency. In *CFS*, the defendant company answered the complaint, but faced cross-claims by some individual defendants who filed motions to dismiss the plaintiffs' complaint. By subjecting the company to "multiple rounds of discovery requests," first by the plaintiffs and later by the individual defendants once the stay is lifted, the court and the parties would be deprived of the opportunity to coordinate efficient discovery in securities litigations. See id.

Finally, Congress was not inflexible in providing for the discovery stay; it provided explicit grounds for a court to lift the stay for discrete purposes, namely, if the proponent of the discovery would be unfairly prejudiced or if evidence would be lost if discovery is delayed. Congress ostensibly drafted the statute in this manner because it intended the stay to be automatic unless a party would be unduly harmed by the stay for these specific reasons.

The legislative history, therefore, supports reading the statute to impose an automatic stay of all discovery while a complaint is still at the motion to dismiss stage, and not to provide for an automatic lifting of the stay as soon as one motion is denied or one party answers.

Conclusion

At bottom, the question is whether the terms "all discovery," "shall" and "any motion" in the statute mean what they say. Most courts analyzing this language have concluded that they do. Thus, according to the express terms of the statute, as long as a motion to dismiss by any defendant is pending, discovery is stayed for the entire case. The analysis should end there.

Those who bypass this step in the analysis and argue that Congress' intent is upheld by allowing discovery against those defendants whose motions to dismiss are denied (and thus for whom the complaint is found to be nonfrivolous) are putting the cart before the horse.

In other words, the statutory language is clear, and it does not provide that the stay may be lifted simply because one defendant's motion is denied. In any event, most courts have held that the statute's requirement of an automatic stay is buttressed by the legislative history, which illuminates Congress' intent to hold all unnecessary discovery at bay while a court determines whether, and in what shape, a case should proceed. The full contours of the case about which the parties are to take discovery will not be determined until all motions to dismiss are decided.

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