Defending Federal Securities Act Claims in Texas State Court

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Matt McGee represents companies, directors, and officers in complex business litigation, class action defense, shareholder derivative suits, securities fraud class actions, and M&A litigation. He is a zealous advocate for his clients and has proven to be a trusted advisor at the highest levels of companies and organizations. Matt has consistently secured favorable results for his clients, including victory on behalf of alleged controlling majority shareholders in the United States Court of Appeals for the Fifth Circuit.

The prospect of defending complex litigation in Texas state court has long struck fear in the heart of many out-of-state defendants. Indeed, we have lost count of how many times sophisticated clients and co-counsel have reacted in shock when we explained there was no traditional motion to dismiss practice in Texas state court.

It has now been a year since the Supreme Court issued its ruling in *Cyan, Inc. v. Beaver County Employees Retirement Fund*, 138 S. Ct. 1061 (2018), allowing securities class action plaintiffs to pursue public offering claims in state courts. In *Cyan*, the Court held that: (i) state courts have jurisdiction to hear class actions brought under the federal Securities Act of 1933 ("1933 Act"); and (ii) the Securities Litigation Uniform Standards Act ("SLUSA") does not empower defendants to remove class actions alleging only 1933 Act claims from state to federal court. The practical effect of the Supreme Court's decision is that more public offering securities are now being litigated in state courts. We are seeing 1933 Act cases filed in state court in Texas, and there has been an uptick in 1933 Act cases in state courts in other states as well.

Leveraging our substantial experience litigating all manner of securities claims in both state and federal courts in Texas, as well as our deep bench of Texas appellate talent, we have given thought to various strategies for how issuers, directors, underwriters, and others can defend 1933 Act suits when they are brought in Texas state court. Although each case will be unique, the various sections of this paper walk through issues that we believe are likely to recur throughout the procedural stages of a case. In the unfortunate event that your company is targeted with a 1933 Act suit in Texas state court, Haynes and Boone would welcome the opportunity to discuss appropriate defense strategies and how we can help.

TABLE OF CONTENTS

I. Removal is Likely to Be Unavailable in Most Cases

After *Cyan*, defendants are generally unable to remove to federal court those 1933 Act suits asserting claims related to nationally-traded securities. The text of the 1933 Act as interpreted by *Cyan* does not leave room for federal question or diversity-based removal of suits arising solely under the 1933 Act. Defendants will still have arguments for removal in some cases, including where (i) the plaintiff brings claims under other laws in addition to the 1933 Act (including claims under the 1934 Act), and/or (ii) the claims are not related to a nationally-traded security. *See, e.g., Katz v. Gerardi*, 552 F.3d 558 (7th Cir. 2009) (holding that the Class Action Fairness Act's removal provisions permitting removal of cases involving non-nationally traded securities control over the 1933 Act's anti-removal provisions). However, we believe that these possibilities for removal are unlikely to apply in the majority of 1933 Act cases filed in state court.

II. Challenging the Sufficiency of the Plaintiff's Pleading

Defendants are accustomed to filing a motion to dismiss 1933 Act claims in federal court. This familiar federal court motion to dismiss practice does not neatly translate to Texas state court, which historically has not had a motion to dismiss. However, there are at least two avenues available for a defendant to seek dismissal of a case on the pleadings.

Rule 91a of the Texas Rules of Civil Procedure, enacted in 2013, allows a defendant to move to dismiss claims that have "no basis in law or fact." The Texas Supreme Court has described Rule 91a as imposing a "factual-plausibility standard," *City of Dallas v. Sanchez*, 494 S.W.3d 722, 724 (Tex. 2016), and several Texas appellate courts have likened Rule 91a to Federal Rule 12(b)(6). *See, e.g., Wooley v. Schaffer*, 447 S.W.3d 71, 75-76 (Tex. App.—Houston [14th Dist.] 2014, pet. denied). But the Rule 91a case law is still developing and trial courts may struggle to apply it correctly without additional guidance from appellate courts. Since *Cyan*, there has been one 1933 Act case in Texas state court where the defendants successfully obtained dismissal pursuant to Rule 91a. *See Rezko v. XBiotech, Inc*., No. D-1-GN-17-003063 (Travis Cnty. Dist. Ct.).

Rule 91a has several unique features that distinguish it from Federal Rule 12(b)(6). One important distinction is that Rule 91a entitles the prevailing party to an award of costs and attorneys' fees as a matter of right. Tex. R. Civ. P. 91a.7. The existence of this provision will require a risk-reward analysis when deciding whether to file a motion to dismiss in Texas state court.

Some courts have held that under Rule 91a, a defendant does not need to respond to discovery prior to the trial court ruling on its motion to dismiss. *See In re Butt*, 495 S.W.3d 455, 463 (Tex. App.—Corpus Christi 2016, no pet.). The case law in this area is still developing, but this could be an especially important feature of Rule 91a in the context of 1933 Act claims if the automatic stay of discovery under the PSLRA is (incorrectly) deemed inapplicable in state court, an issue discussed below.

Rule 91a has several built-in deadlines. For instance, a defendant must file a motion to dismiss under Rule 91a within 60 days of being served with a petition; the plaintiff must respond at least 7 days before any hearing; and the court must grant or deny the motion within 45 days. Tex. R. Civ. P. 91a.3, 91a.4. Rule 91a also requires that a plaintiff amend the petition or withdraw the challenged claims three days before the date of the hearing in order to avoid a decision on a motion to dismiss. Tex. R. Civ. P. 91a.5. While the deadlines could prove helpful in obtaining a speedy resolution, they do not track the typical timeline and briefing schedules used in practice in federal court. In some cases, it may be strategically advantageous to propose that the parties agree to a scheduling order that allows adequate time for the appointment of a lead plaintiff, the filing of a consolidated complaint, and briefing on a motion to dismiss. For the avoidance of doubt about whether the parties can alter Rule 91a deadlines by agreement (an issue that the courts have not clarified), the parties can consider submitting their agreement for court approval.

The second option for attempting to obtain dismissal on the pleadings is to file special exceptions, which we have successfully used several times to obtain dismissal of shareholder derivative claims against boards of large companies, including the board of AT&T. Prior to enactment of Rule 91a, Texas procedure had no formal dismissal procedure. Instead, a defendant would file special exceptions—a procedure used to identify pleading defects. *See* Tex. R. Civ. P. 91. For various reasons, however, including a forgiving pleading standard, special exceptions historically have not been a very effective tool for dismissal. Courts also generally afford plaintiffs several chances to amend their petitions to replead the deficient claims before considering dismissal. Moreover, absent a case or issue-specific reason, courts generally allow discovery to proceed, even when special exceptions are granted, to help a plaintiff replead the deficient claim. With the enactment of Rule 91a, it is unclear whether a challenged pleading would need to meet the "factual plausibility" pleading standard or if a plaintiff could avoid special exceptions by satisfying the more forgiving notice pleading standard traditionally used by Texas courts prior to Rule 91a.

The decision to file a Rule 91a motion to dismiss or special exceptions will be highly dependent on the venue in which the case will be litigated and the strength of possible dismissal arguments. In a favorable venue and where there are strong arguments in support of dismissal, we would generally recommend that a defendant file a Rule 91a motion to dismiss. Understandably, the prospect of having to pay the plaintiff's costs and attorneys' fees if unsuccessful may seem unpalatable, but in many instances, the benefit of achieving an early dismissal would likely justify the risk. In an unfavorable venue and depending on the strength of the dismissal arguments, the calculus might be different.

If a Rule 91a motion to dismiss is denied, the defendant may, as in federal court, be able to take a permissive interlocutory appeal. Defendants wishing to appeal a trial court's interlocutory order on a Rule 91a motion must comply with Section 51.014 of the Texas Civil Practice and Remedies Code ("CPRC"). On a party's motion or *sua sponte*, the trial court may, but is not required to, permit appeal of an interlocutory order if (1) the order involves a controlling question of law on which there is a substantial ground for difference of opinion and (2) an immediate appeal from the order may materially advance the ultimate termination of the litigation. *See* CPRC § 51.014(d). If the trial court permits appeal, the appealing party may file an application for interlocutory appeal under Section 51.014(f), but the court of appeals retains discretion to accept or disallow the appeal. As in federal court, an allowed appeal would not automatically stay discovery in the trial court, so if a stay is desired, defendants will need to obtain that relief separately from either the trial judge or the court of appeals. *See* CPRC § 51.014(e). Aside from a permissive interlocutory appeal, a defendant may be able to obtain review by mandamus of a denial of a Rule 91a motion to dismiss. *See In re Essex Ins. Co.,* 450 S.W.3d 524, 528 (Tex. 2014).

III. Applying Provisions of the Private Securities Litigation Reform Act in State Court, Including the Automatic Stay of Discovery

The *Cyan* opinion made clear that "substantive" aspects of the Private Securities Litigation Reform Act ("PSLRA") apply in state court but left open the question of exactly which provisions of the PSLRA would be deemed substantive. Disputes over the substantive/procedural divide are likely to be battlegrounds in 1933 Act suits in Texas state court.

Perhaps the most important issue for defendants will be whether the PSLRA automatic stay of discovery until a plaintiff survives the pleadings will apply in state court. In our view the automatic stay is applicable. Although this issue was not litigated in the *XBiotech* case, we expect that it will be hotly contested in future 1933 Act cases in Texas state courts, as it has been in state courts around the country.

First, the text of the PSLRA itself reflects that the automatic stay of discovery during the pendency of a motion to dismiss is a substantive protection. Subsection (b), which contains the discovery stay provision, provides that its terms apply "[i]n any private action arising under this subchapter." 15 U.S.C. § 77z-1(b). Any 1933 Act case filed in state court would necessarily still arise under the PSLRA, and so, pursuant to the plain language of the statute, the discovery stay would apply with equal force in both state and federal court. By contrast, subsection (a) begins with the prefatory language "each private action arising under this subchapter that is brought as a plaintiff class action pursuant to the Federal Rules of Civil Procedure." 15 U.S.C. § 77z-1(a). While state court 1933 Act cases would still arise under the PSLRA, they would not be brought "pursuant to the Federal Rules of Civil Procedure." This difference in language demonstrates that the discovery stay in subsection (b) is substantive. Thus, while the discovery stay should be considered a substantive right applicable in state court, the provisions of subsection (a), including the lead plaintiff appointment process, may be deemed procedural and inapplicable outside of federal court.

Second, legislative history also supports the conclusion that subsection (b)'s discovery stay is a substantive protection under the PSLRA. "The purpose of the discovery stay is to prevent costly in-depth discovery and disruption of the defendants' normal business activities until a court can determine whether a suit which has been filed is meritorious." *Schwartz v. TXU Corp.*, 2004 WL 1732477, at *1 (N.D. Tex. July 30, 2004). In fact, SLUSA's discovery stay provision—which allows a federal court to stay discovery in a related state court action brought pursuant to state law—was adopted with the express purpose of "prevent[ing] plaintiffs from circumventing the stay of discovery under the [PSLRA] by using State court discovery . . . in an action filed in State court." House Report 105-640. For a state court to conclude that the PSLRA stay is a mere procedural tool inapplicable in state court would eviscerate the intent of Congress by allowing plaintiffs to evade the PSLRA's discovery restrictions simply by filing in state court.

Third, an analogy can be made to Delaware's automatic stay of discovery in derivative suits—a rule that Texas state courts have held to be a substantive right and applied in cases implicating Delaware law. *See e.g., In re Crown Castle Int'l Corp.*, 247 S.W.3d 349, 351-56 (Tex. App.—Houston [14th Dist. 2008], orig. proceeding) (discovery is a "substantive" matter that should be controlled by Delaware law as the law of the state of incorporation). Texas courts have acknowledged that Delaware Chancery Court Rule 23.1 requires a plaintiff to meet certain threshold requirements before subjecting the corporation to the expense of discovery and trial. *Connolly v. Gasmire,*

257 S.W.3d 831, 840 n.4 (Tex. App.—Dallas 2008, no pet.) (Chancery Court Rule 23.1 "does not permit a shareholder to cause the corporation to expend money and resources in discovery and trial in the shareholder's quixotic pursuit of a purported corporate claim based solely on conclusions, opinions, or speculation."). The PSLRA affords similar protection to defendants by requiring a plaintiff to survive a motion to dismiss before engaging in discovery. In both situations, the discovery stay operates as a substantive safeguard against harassment based only on conclusory allegations or speculation.

Although we believe these arguments are strong, courts in California (which has allowed 1933 Act claims to proceed in state court for several years) have reached mixed conclusions on the applicability of the stay in state court. *Compare, e.g., Milano v. Auhll,* 1996 WL 33398997, at *2 (Cal. Super. Ct., Santa Barbara Cty. Oct. 2, 1996) ("an intention appears on the part of Congress to apply section 27(a) of the amendment only to class actions in federal court, but to apply section 27(b) to all private actions based on alleged violations of the 1933 Act, regardless of whether they were brought in state or federal court"), *with In re Pacific Biosciences of California, Inc. Sec. Litig.*, Master File No. CIV. 509210 (Cal. Super. Ct., San Mateo Cty. May 25, 2012) ("there is no legal authority for the proposition that the automatic stay applies in state cases arising under the Securities Act").

Texas courts may resort to traditional choice of law principles in determining the applicability of the PSLRA's discovery stay. Local law of the forum generally governs pre-trial practice, including discovery. *See* RESTATEMENT (SECOND) OF CONFLICT OF LAWS § 127 (1971). But under the "reverse-*Erie*" doctrine, federal law will sometimes displace state law in state court in order to protect federally created rights and achieve "desirable uniformity in [their] adjudication." *Brown v. W. Ry.*, 338 U.S. 294 (1949). The Texas Supreme Court has held that this reverse-*Erie* doctrine will preempt state law with respect to substantive, but not procedural, matters. *Exxon Corp. v. Choo,* 881 S.W.2d 301, 305 n.9 (Tex. 1994). So whether the discovery stay—as well as the other provisions in subsections (a) and (b)—is substantive or procedural is likely to be dispositive. As noted above, the discovery stay should be viewed as a substantive protection and not a mere tool of procedure.

In the event that a Texas trial court rules that the PSLRA stay is inapplicable, defendants will want to consider appellate options to prevent discovery from proceeding until the plaintiff survives the pleading stage. When a trial court orders improper discovery, the appropriate remedy is a writ of mandamus. *See, e.g., H.E. Butt Grocery Co. v. Currier*, 885 S.W.2d 175, 177 (Tex. App.—Corpus Christi 1994, no writ); *see also In re Univ. of the Incarnate Word*, 469 S.W.3d 255, 259 (Tex. App.—San Antonio 2015, no pet.); *Simplex Time Recorder Co. v. Hancock*, 1995 WL 243640, at *2 (Tex. App.—Houston [14th Dist.] Apr. 27, 1995, no writ). In the analogous shareholder derivative context where Delaware substantive law prohibits discovery before the court rules on the sufficiency of the complaint, a Texas court has granted mandamus relief to stop discovery from occurring. *Crown Castle*, 247 S.W.3d at 352-56. Defendants have a strong argument that the same reasoning should apply to any improperly ordered discovery in a 1933 Act case.

IV. Challenging Personal Jurisdiction

Because the 1933 Act contains a nationwide service of process provision, defendants usually do not challenge personal jurisdiction in 1933 Act suits filed in federal court. A silver lining of 1933 Act cases in state court will be that defendants may now have additional jurisdictional defenses because the majority view is that the Securities Act's nationwide service of process provision cannot be used to satisfy the requirements of personal jurisdiction in state court. *See, e.g., Kelly v. McKesson HBOC, Inc.*, 2002 WL 88939, at *19 (Del. Super. Ct. Jan. 17, 2002); *Niitsoo v. Alpha Natural Res.*, 2015 W.V. Cir. LEXIS 72, at *3-4 (W. Va. Cir. Ct.—Boone Cty. Jan. 8, 2015).

Under this majority view, personal jurisdiction over each defendant will turn on a familiar minimum contacts analysis as to that defendant's forum-related ties to determine whether either general or specific jurisdiction will exist.

General jurisdiction generally exists only where a corporate defendant is incorporated or has its principal place of business, and where an individual is domiciled. *Daimler AG v. Bauman*, 571 U.S. 117, 137 (2014); *Searcy v. Parex Res., Inc.*, 496 S.W.3d 58 (Tex. 2016). Following *Daimler,* general jurisdiction over a defendant in Texas will ordinarily only be possible for an entity that is incorporated or headquartered in Texas or an individual that lives in Texas.

Specific jurisdiction exists where a (1) defendant purposefully did some act or completed some transaction in Texas that (2) gave rise to the plaintiff's cause of action. *Gen. Elec. Co. v. Brown & Ross Int'l Distribs., Inc.*, 804 S.W.2d 527, 530 (Tex. App.—Houston [1st Dist.] 1991, writ denied). Thus, although a nonresident defendant need not be physically present in the state, it must take some action from which a court can infer a reasonably foreseeable result occurring in Texas. *Siskind v. Villa Found. for Educ., Inc.*, 642 S.W.2d 434, 438 & n.5 (Tex. 1982) (no specific jurisdiction where individual respondents did not personally solicit business in Texas); *but cf. Brown & Ross,* 804 S.W.2d at 532-33 (specific jurisdiction over nonresident individual, even though he made no business trips to Texas, because he solicited business in Texas and knew his conduct would affect customers in the state). Based on this standard, 1933 Act defendants have various avenues through which to challenge a court's jurisdiction. Although personal jurisdiction challenges are highly fact-specific, below are select and potentially recurring examples for 1933 Act defendants.

Corporate Defendants: Corporate defendants can challenge personal jurisdiction where the only ties to a forum are their affiliates. For example, a parent corporation's ties to a forum does not create personal jurisdiction over a subsidiary that is a defendant in a 1933 Act case. *See, e.g., Fields v. Sedgwick Assoc. Risks, Ltd.,* 796 F.2d 299, 302 (9th Cir. 1986); *but cf. PHC-Minden, L.P. v. Kimberly-Clark Corp.*, 235 S.W.3d 163, 175 (Tex. 2007) (jurisdictional veil piercing permitted where parent controls internal business operations and affairs of subsidiary beyond what is normally associated with common ownership and directorship). Conversely, the parent-subsidiary relationship itself is generally not sufficient to establish jurisdiction over the parent entity. *See, e.g., In re Enter. Rent-A-Car Wage & Hour Emp't Practices Litig.*, 735 F. Supp. 2d 277, 317-18 (W.D. Pa. 2010), *aff'd*, 683 F.3d 462 (3d Cir. 2012).

Officers and Directors: For officers and directors, whether a court has personal jurisdiction over a corporation is not determinative of whether a court has personal jurisdiction over that corporation's employee. Courts must test each defendant's contacts with the

forum state separately. *Brown & Ross*, 804 S.W.2d at 532; *In re Royal Ahold N.V. Sec. & ERISA Litig.*, 351 F. Supp. 2d 334, 351 (D. Md. 2004) ("[I]n deciding the personal jurisdiction question, I will not simply examine acts taken by a corporation and attribute them to the corporate executives, but I will consider an individual defendant's actions directed at the forum."). Thus, an individual's employment with a forum-state corporation alone typically does not satisfy the test for personal jurisdiction. *Kabbaj v. Simpson*, 2013 WL 2456108, at *7 (D. Del. June 6, 2013); *LVI Grp. Invs., LLC v. NCM Grp. Holdings, LLC*, 2017 WL 3912632, at *4 (Del. Ch. Sept. 7, 2017) ("[S]imply serving as an officer of a Delaware entity, without more, is insufficient to establish personal jurisdiction" in Delaware). In fact, some Texas courts have held that they cannot exercise jurisdiction over a nonresident corporate officer if the only contacts with Texas are those the defendant made on the employer's behalf. *Garner v. Furmanite Austl. Pty., Ltd.*, 966 S.W.2d 798, 803 (Tex. App.—Houston [1st Dist.] 1998, pet. denied). Thus, not only can officers and directors contest personal jurisdiction where a company or offering had no ties to a forum state, but they can also contest jurisdiction even when a company is incorporated in the forum state if the individual had no challenged conduct or residency there.

In addition, some courts have held that, absent actual conduct or residency in the forum state, signing a registration statement or preparing financial statements of a company incorporated in the forum state is insufficient for personal jurisdiction. *Kelly*, 2002 WL 88939, at *17 ("[S]igning of the Registration Statement in California on behalf of a Delaware corporation does not meet the contacts necessary to establish personal jurisdiction" in Delaware); *LVI Grp.*, 2017 WL 3912632, at *4 (no personal jurisdiction from officer's role in preparing company's allegedly fraudulent financial statements outside of forum); *Niitsoo*, 2015 W.V. Cir. LEXIS 72, at *3-4 (no jurisdiction over nonresident defendants who signed registration statement neither drafted nor filed in the forum state).

Underwriters: For underwriters, merely underwriting an offering in a forum state or for a forum corporation is not fatal. At least some courts have held that "underwriter status alone is not enough to allow for the assertion of personal jurisdiction." *United Heritage Life Ins. Co. v. First Matrix Invs. Servs. Corp.,* 2007 WL 1792333 at *7 (D. Idaho June 20, 2007). Similarly, the fact that securities ended up in the forum state may not confer personal jurisdiction. *In re Deutsche Bank Sec. Inc.*, 2015 WL 4079280, at *7-8 (Tex. App.—Austin July 3, 2015, no pet.) (no personal jurisdiction "through the fact that the securities were purchased by [plaintiffs] after they were placed in the stream of commerce by [the underwriter]" because "'the mere fact that goods have traveled into a state, without more, does not establish'" jurisdiction).

Courts have also held that simply participating in the creation of offering documents or signing a registration statement is insufficient, by itself, for personal jurisdiction. *In re Countrywide Fin. Corp. Mortg.-Backed Sec. Litig.*, 934 F. Supp. 2d 1219, 1236-37 (C.D. Cal. 2013) (no personal jurisdiction where no allegation that "Barclays acted in Nevada in creating the prospectus supplement," "intended its representations to affect parties in Nevada," "consummated any contract . . . in Nevada," or "knew the securities would be sold in Nevada"); *In re Countrywide Fin. Corp. Mortg.-Backed Sec. Litig.*, 2012 WL 1097244, at *13-14 (C.D. Cal. Mar. 9, 2012) (signing a registration statement is insufficient on its own for personal jurisdiction, especially where certificates "were registered with the SEC and disseminated nationally"). Moreover, underwriters can argue that the parent-subsidiary relationship itself is not sufficient to establish jurisdiction over the non-forum entity. *See supra*, "Corporate Defendants."

While personal jurisdiction defenses are fact-specific, and raising them carries a risk of inviting jurisdictional discovery before the court rules on the sufficiency of a plaintiff's pleading, defendants sued in state court should consider the above challenges (among others) to personal jurisdiction at the very beginning of a 1933 Act case.

Defendants can challenge personal jurisdiction in Texas by making a special appearance solely to contest jurisdiction. Tex. R. Civ. P. 120a. The Texas Civil Practice and Remedies Code provides for an interlocutory appeal as a matter of right after a trial court grants or denies a special appearance. CPRC § 51.014(a)(7). In fact, interlocutory appeal is considered the exclusive means for challenging a trial court's denial of a special appearance. *See, e.g., Matis v. Golden,* 228 S.W.3d 301, 305-12 (Tex. App.—Waco 2007, no pet.) (Gray, C.J., concurring) ("[T]he losing party cannot wait until the end of the proceeding and then appeal the denial of the special appearance, but must instead comply with the requisites of timely filing a notice of appeal for the accelerated appeal."). A defendant can also obtain an automatic stay of trial court proceedings, including discovery, pending the appeals court's ruling on an interlocutory appeal, but must be careful to file its special appearance and request submission or hearing no later than the later of (a) the date specified by the trial court for such an appearance, or (b) the 180th day after the defendant files its answer or other responsive pleading. CPRC § 51.014(c).

V. Dealing with Parallel Proceedings

Unfortunately for defendants, 1933 Act suits often do not stand alone. In many cases, the plaintiffs' bar will likely file multiple suits in Texas state court, or some other combination that multiplies proceedings such as a parallel suit in federal court. As a general rule, defendants would prefer to litigate 1933 Act claims solely in federal court, but where this is not possible, it will typically be preferable to litigate only in a single jurisdiction. We have given thought on how to achieve this goal in Texas.

If parallel proceedings exist within Texas state courts, Texas Rule of Judicial Administration ("TRJA") 13 provides for consolidation of related cases. A judge or any party to the matter may request for transfer of the case and related cases to a pretrial court. The judicial panel on multidistrict litigation ("MDL Panel") may order transfer if three members concur that (1) the related cases involve common questions of fact and (2) the transfer will be convenient and promote the just and efficient administration of the related cases. TRJA 13.3(l). Filing a motion to transfer does not automatically stay or suspend proceedings in the court. TRJA 13.4(a). However, the trial court or the MDL Panel may stay all or a part of all proceedings until the MDL Panel makes a ruling. TRJA 13.4(b).

When parallel state and federal cases are pending, and the federal action was filed first, Texas courts can be asked to stay the state court case. The court's ruling on a motion to stay due to a first filed federal proceeding is discretionary. In deciding the motion, courts will consider which suit was filed first, whether the parties and causes of action are the same in both suits, and the effect of a judgment in the second suit on a judgment or order in the first suit. *In re State Farm Mut. Auto. Ins. Co.*, 192 S.W.3d 897, 901 (Tex. App.—Tyler 2006, no pet.). As a matter of comity, the court in which the later action is filed typically stays proceedings until the first action is determined, especially when the suits involve the same issues and seek the same ultimate relief. *See also Space Master Int'l, Inc. v. Porta-Kamp Mfg. Co., Inc.*, 794 S.W.2d 944, 946 (Tex. App.—Houston [1st Dist.] 1990, no writ); *Alpine Gulf, Inc. v. Valentino,* 563 S.W.2d 358, 360 (Tex. Civ. App.—Houston [14th Dist.] 1978, writ ref'd n.r.e.).

Although courts have discretion to stay proceedings or not, Texas courts have referred to it as a custom that has "practically grown into a general rule which strongly urges the duty upon the court in which the subsequent action is instituted to do so." *Mills v. Howard*, 228 S.W.2d 906, 908 (Tex. Civ. App.—Amarillo 1950, no writ).

A federal court might decline to exercise jurisdiction over a suit if an earlier, parallel state court proceeding exists. *Colorado River Water Conservation Dist. v. U. S.,* 424 U.S. 800, 817-18 (1976). Although federal courts have a "virtually unflagging obligation" to exercise the jurisdiction given them by the U.S. Constitution, "wise judicial administration" provides a limited basis upon which federal suits can be dismissed due to concurrent state proceedings. This doctrine, called "Colorado River Abstention," is only applicable for parallel litigation and directs a federal court to abstain in favor of state proceedings after evaluating:

(a) Which court first assumed jurisdiction over property;

(b) Inconvenience of the federal forum;

(c) Desirability of avoiding piecemeal litigation; and

(d) The order in which jurisdiction was obtained by each forum.

Id. at 818. This is a balancing test, not a mechanical checklist. *See Moses H. Cone Mem'l Hosp. v. Mercury Constr. Corp.*, 460 U.S. 1, 16 (1983).

When overlapping suits are filed in a Texas court and another state's court, a defendant may be able to enjoin the plaintiff from proceeding with the suit in the other state's court by applying for an anti-suit injunction. CPRC § 65.011(2). A court has discretion to issue an anti-suit injunction in four circumstances: "(1) to address a threat to the court's jurisdiction; (2) to prevent the evasion of important public policy; (3) to prevent a multiplicity of suits; or (4) to protect a party from vexatious or harassing litigation." *Frost Nat'l Bank v. Fernandez,* 315 S.W.3d 494, 512 (Tex. 2010); *Golden Rule Ins. Co. v. Harper*, 925 S.W.2d 649, 651 (Tex. 1996). However, an anti-suit injunction requires the movant to show that "a clear equity demands" the injunction.

As a general matter, some courts have handled parallel proceedings by requesting a conference between the relevant courts. *See Nierenberg v. CKx, Inc.,* 2011 WL 2185614, at *2 (Del. Ch. May 27, 2011); *In re Allion Healthcare Inc. S'holders Litig*., 2011 WL 1135016, at *4 & n.12 (Mar. 29, 2011). This method requires a high level of cooperation and coordination between several judges, attorneys, and parties, but has the benefit of establishing one court for the proceeding, rather than several.

VI. Issues Regarding Class Certification

Class certification also presents opportunities for defendants in Texas state court. Although Texas's Rule 42 generally follows the familiar Federal Rule 23, there are avenues available to defendants to potentially make class certification more difficult.

Similar to Federal Rule 23, Texas's Rule 42 requires plaintiffs to establish numerosity, commonality, typicality, and adequacy of representation. Tex. R. Civ. P. 42(a). Plaintiffs are also required to satisfy one of the three Texas Rule 42(b) factors, which mirror the Federal Rule 23(b) factors. As is the case with federal class actions, most cases hinge on the issue of predominance. Questions of law or fact common to the class must predominate over questions affecting individual class members. A significant difference in Texas is Rule 42(c)(1)(D), which goes beyond the Federal Rules and supplements the rigorous analysis requirement required to certify a class. This Rule essentially codifies the requirement for detailed trial plans—a requirement for class certification first introduced in by the Texas Supreme Court in *Southwestern Refining, Inc. v. Bernal*, 22 S.W.3d 425 (Tex. 2000).

In *Bernal*, the Texas Supreme Court held that Texas courts should take a "cautious approach to class certification." 22 S.W.3d at 435. Such an approach affords defendants the opportunity to ensure that plaintiffs adequately meet their burden concerning all class certification requirements, including predominance. Trial plans "assure[] that a trial court has fulfilled its obligation to rigorously analyze all certification prerequisites and 'understand[s] the claims, defenses, relevant facts, and applicable substantive law in order to make a meaningful determination of the certification issues." *BMG Direct Mktg., Inc. v. Peake*, 178 S.W.3d 763, 778 (Tex. 2005).

The Court has found trial plans inadequate where the trial court did not provide a rigorous analysis of a wide-variety of issues including how the case would be tried, the specific causes of action at issue in the case, substantive issues that would control, or how it would try damages. *State Farm Mut. Auto. Ins. Co. v. Lopez*, 156 S.W.3d 550, 557 (Tex. 2004); *Nat'l W. Life Ins. Co. v. Rowe*, 164 S.W.3d 389, 392 (Tex. 2005). Additionally, courts have found trial plans inadequate when the trial court failed to conduct an adequate choice-of-law analysis; failed to meaningfully address pleaded defenses; or failed to resolve a significant misunderstanding of the law. *Citizens Ins. Co. of Am. v. Daccach*, 217 S.W.3d 430, 463 (Tex. 2007); *Brigham Expl. Co. v. Boytim*, 2014 WL 4058965, at *4 (Tex. App.—Austin Aug. 15, 2014, no pet.); *BMG Direct Mktg.*, 178 S.W. 3d at 777; *Denton Cty. Elec. Coop., Inc. v. Hackett*, 368 S.W.3d 765, 774 (Tex. App.—Fort Worth 2012, pet. denied).

Defendants may also be able to more easily bifurcate class and merits discovery than they would in federal court, although whether this would be a wise strategy would vary from case to case. The Texas Supreme Court has rejected blanket rules that (1) all discovery should be stayed until class certification and, (2) full discovery should be conducted prior to certification, instead holding that trial courts should limit precertification discovery to the particular issues governing certification. *In re SCI Tex. Funeral Servs., Inc.*, 236 S.W.3d 759, 760 (Tex. 2007); *see also In re Alford Chevrolet-Geo,* 997 S.W.3d 173, 180-82 (Tex. 1999). Precertification discovery should consider factors including "the importance, benefit, burden, expense, and time needed to produce the proposed discovery." *Id.* As in federal court, the discovery required to adequately address issues of commonality, typicality, or predominance is "frequently [] enmeshed

with the merits." *Id.* As a result, defendants may be subject to limited merits discovery prior to class certification.

Unlike in federal court, parties have the absolute right to take an interlocutory appeal of a trial court's class certification decision. *See* CPRC § 51.014(a)(3). The purpose "is to ensure that the costly process of a class action, with its attendant potential for irremediable harm to a defendant, does not proceed when there is no basis for certifying a class." *Bally Total Fitness Corp. v. Jackson,* 53 S.W.3d 352, 365 (Tex. 2001) (Owen, J., dissenting). Any interlocutory appeal of a class certification order also automatically stays all trial court proceedings pending the court of appeals' decision. CPRC § 51.014(b).

VII. Obtaining Early Summary Judgement

Unlike in many federal courts, Texas state courts generally have no limitations on how many summary judgment motions a defendant may file. The ability to move for summary judgment early and often can give defendants a unique opportunity to try to bring an early end to or narrow cases that survive the pleadings. We believe that a few dispositive arguments that often arise in 1933 Act cases are good candidates for defendants to seek early summary judgment while minimizing plaintiffs' ability to argue that they need more discovery to oppose the motion. This paper does not attempt to catalogue all possible bases for summary judgment in 1933 Act cases, and there may be other grounds for seeking early summary judgment in appropriate cases, but in our experience, the grounds below are most likely to be appropriate for early resolution.

Standing: The Securities Act "is concerned with the initial distribution of securities," and only the "narrow class of persons" who purchased the specific securities that are the "direct subject" of the challenged registration statement and/or prospectus have standing. *Krim v. pcOrder.com, Inc.*, 402 F.3d 489, 495 (5th Cir. 2005); *Rosenzweig v. Azurix Corp.*, 332 F.3d 854, 861 (5th Cir. 2003). Thus, summary judgment is appropriate where defendants can show that the plaintiffs did not purchase stock directly in a challenged offering.

Section 11 standing exists only for persons who acquire securities issued in the offering, including aftermarket purchasers who can "trace" their shares "for which damages are claimed to the specific registration statement at issue." *Krim*, 402 F.3d at 495-96. Because it is "virtually impossible" for plaintiffs to meet this requirement when shares from multiple registration statements have been issued, defendants can move for summary judgment where plaintiffs cannot show that they acquired offering shares, such as when they purchased shares in the aftermarket. *See, e.g.*, *id.* at 492, 496-502; *In re Ariad Pharms., Inc. Sec. Litig.* 842 F. 3d 744, 755-56 (1st Cir. 2016); *In re Alamosa Holdings, Inc.,* 382 F. Supp. 2d 832, 864 (N.D. Tex. 2005).

Statutes of Repose and Limitations: To the extent Defendants cannot get untimely claims dismissed on the pleadings, they should consider asserting two timeliness defenses, where applicable, to 1933 Act claims in early summary judgment motions: the three-year statute of repose and the one-year statute of limitations.

Statute of Repose: Section 13 of the Securities Act states that a claim must be brought no "more than three years after the security was bona fide offered to the public." 15 U.S.C. § 77m. This repose period is "absolute," "admits of no exception," and "forecloses

the extension of the statutory period based on equitable principles." *Cal. Pub. Emps.' Ret. Sys. v. ANZ Sec., Inc.*, 137 S. Ct. 2042, 2049-51 (2017) ("CalPERS"). Accordingly, a shareholder bringing a 1933 Act claim more than three years after the challenged offering has little or no ability to salvage its claim, particularly because *American Pipe* tolling—which generally tolls statutes of *limitations* for shareholders between the filing of a putative class action complaint and a decision on class certification—does not apply. *Id.*

Statute of Limitations: Securities Act claims also must be filed within "one year after the discovery of the untrue statement or the omission, or after such discovery should have been made by the exercise of reasonable diligence." 15 U.S.C. § 77m. The limitations period begins to run when the plaintiff knows—or "with the exercise of reasonable diligence" should have known—"the basis of the claims asserted." *DeBenedictis v. Merrill Lynch & Co.*, 492 F.3d 209, 218-19 (3d Cir. 2007). Defendants can therefore move for summary judgment where the so-called "truth" regarding the alleged misstatements in the offering documents was revealed more than one year before a claim was first brought. *See Alamosa*, 382 F. Supp. 2d at 863-64; *Rahr v. Grant Thornton LLP*, 142 F. Supp. 2d 793, 796-97 (N.D. Tex. 2000).

Materiality: For liability to attach under the Securities Act, there must be a misstatement or omission of a material fact in a registration statement or prospectus that "would have misled a reasonable investor about the nature of his or her investment." *Rubke v. Capitol Bancorp Ltd.*, 551 F.3d 1156, 1161 (9th Cir. 2009); *see* 15 U.S.C. §§ 77k(a), 77l(a)(2). There is no materiality unless the alleged misrepresentation or omission "'would have altered the way a reasonable investor would have perceived the total mix of information available in the prospectus as a whole.'" *Kapps v. Torch Offshore, Inc.,* 379 F.3d 207, 213-14 (5th Cir. 2004).

Materiality is often a mixed question of law and fact; "[n]o shortage of cases, however, make clear that materiality may be resolved by a court as a matter of law." *Greenhouse v. MCG Capital Corp.,* 392 F.3d 650, 657 (4th Cir. 2004). Defendants should consider attacking materiality early in the case where: (i) the allegedly omitted fact was otherwise available through "language [in the prospectus that] fully disclosed the risk of investment and was specific enough to warrant a reasonable investor's attention"; (ii) the alleged undisclosed truth or fact was publicly available; or (iii) it is the "Complaint's portrayal" of the offering disclosures "which distorts reality." *Olkey v. Hyperion 1999 Term Trust, Inc.*, 98 F.3d 2, 9 (2d Cir. 1996); *see also Parnes v. Gateway 2000, Inc.*, 122 F.3d 539, 549 (8th Cir. 1997); *Braun v. Eagle Rock Energy Partners, L.P.*, 223 F. Supp. 3d 644, 650-51 (S.D. Tex. 2016); *In re Computervision Corp. Sec. Litig.*, 869 F. Supp. 56, 60 (D. Mass. 1994). Courts have also found certain alleged financial overstatements or understatements "immaterial" within the context of other financial information in the issuer's offering documents. *See, e.g., Romine v. Acxiom Corp.*, 296 F.3d 701, 706-07 (8th Cir. 2002); *Parnes,* 122 F.3d at 546 (2% overstatement of assets immaterial).

Damages: Defendants can move for summary judgment where plaintiffs have no cognizable damages. Section 11(e) sets forth three possible damage calculations depending on whether and when the plaintiff sold the securities that are traceable to the challenged registration statement. 15 U.S.C. § 77k(e).

For plaintiffs who sold their securities prior to suit, their maximum damages are equal to "the difference between the amount paid for the security (*not exceeding the price at which the security was offered to the public*) and . . . the price at which such security shall have been disposed of in the market before suit." *Id.* § 77k(e) (emphasis added); *Krim v. PcOrder.com, Inc.*, 2003 WL 21076787, at *3 (W.D. Tex. May 5, 2003). If the plaintiff has sold her shares pre-suit for more than the offering price, she has no conceivable statutory damages—even though she may have lost money on the investment—and summary judgment may be appropriate. *See In re IPO Sec. Litig.*, 241 F. Supp. 2d 281, 351 (S.D.N.Y. 2003).

For plaintiffs who have not sold their securities prior to suit, the maximum statutory recovery is the difference between the purchase price (if not greater than the offering price) and whichever of the following yields the lesser amount of damages: (1) the "value" of the security at the time of suit; or (2) the amount received by the plaintiff in any sale of the securities during the pendency of the suit. 15 U.S.C. § 77k(e)(1), (3); *In re Cendant Corp. Litig.*, 264 F.3d 201, 228 & n.8 (3d Cir. 2001). Accordingly, where the market price on the day of suit was equal or greater to the offering price, there are no statutory damages.

Finally, there is also a good argument in Texas that a trial court is required to rule on any pending dispositive motions before ruling on whether a class can be certified. *In State Farm Mutual Automobile Insurance Company v. Lopez*, the Texas Supreme Court reversed certification of a Texas-only class because the trial court had not ruled on dispositive motions before it, stating that "dispositive issues should be resolved by the trial court before certification is considered." 156 S.W.3d at 557. In cases where defendants have better arguments on the merits than they do for opposing class certification, they may be able to seek pre-certification rulings on the named plaintiffs' claims as a way to dispose of cases before a class is certified and the exposure increases.

VIII. Conclusion

Although litigating 1933 Act cases in Texas state court is a relatively new frontier, and it will still take some time to sort out the law through the Texas trial and appellate courts, numerous strategies are available to successfully defend these cases. Haynes and Boone's extensive securities litigation and appellate experience is particularly well suited for a robust defense of these cases on all levels. We would welcome the opportunity to discuss with you further.