Discovery Stays under the PSLRA

By Howard S. Suskin and Joseph H. Thompson

Defendants in securities litigation often file a motion to dismiss early in the case with the expectation that discovery will be stayed during the pendency of the motion, which is what the Private Securities Litigation Reform Act (PSLRA) provides. Recently, however, courts have split over what to do when defendants already have disclosed documents to the Securities and Exchange Commission (SEC) or other government agencies and plaintiffs seek those documents while the motion to dismiss is still pending. This article examines how courts have addressed requests by plaintiffs to permit discovery of documents already produced to the government during the pendency of a motion to dismiss.

Congress enacted the PSLRA in 1995 to address perceived abuses in securities fraud class actions. Among those concerns was that the high "cost of discovery often forces innocent parties to settle frivolous securities actions."[1] In addition, Congress sought to prevent private securities plaintiffs from using frivolous lawsuits as a vehicle "to conduct discovery in the hopes of finding a sustainable claim not alleged in the complaint."[2] In furtherance of those goals, the PSLRA provides that "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."[3] Adhering to congressional intent, courts have generally refused to lift the PSLRA discovery stay with respect to documents already produced to the government in the absence of special circumstances.[4]

Worldcom, *Enron*, and Similar Decisions

Nonetheless, private securities plaintiffs sometimes do seek a partial lifting of the PSLRA discovery stay with respect to documents that have previously been disclosed to the SEC or another government entity. Those efforts have intensified in the wake of two prominent cases, *In re Worldcom Securities Litigation*[5] and *In re Enron Securities, Derivative, & ERISA Litigation*,[6] where courts lifted the discovery stays with respect to documents that had already been produced to the government.

Both *Worldcom* and *Enron* arose out of highly publicized financial collapses that led to a slew of civil and criminal actions brought by the SEC and other government agencies as well as private securities actions brought by civil litigants. In both instances, the corporate defendants were in bankruptcy and in the midst of settlement negotiations with the government.

In light of this background, both the *Worldcom* and *Enron* courts held that lifting the PSLRA discovery stay was necessary to prevent undue prejudice to the private plaintiffs. In *Worldcom*, the court held that if it did not allow discovery of the documents already produced to the government, the private plaintiff "would be prejudiced by its inability to make informed decisions about its litigation strategy in a rapidly shifting landscape":

> It would essentially be the only major interested party in the criminal and civil proceedings against WorldCom without access to documents that currently form the core of those proceedings. This is especially troubling given the likelihood that settlement discussions will begin in December . . . and [the private plaintiff] would be severely disadvantaged in those discussions if they are denied access to the documents they now request.[7]

The court further reasoned that production of the documents would not be unduly burdensome on Worldcom, because the documents had already been reviewed, compiled, and produced to the government.[8]

Similarly, in *Enron*, private plaintiffs argued that the court should lift the discovery stay to make available documents that had already been produced to a number of governmental entities, including the SEC and the Department of Justice. The court agreed with plaintiffs that "the burden would be slight because Enron has already found, reviewed, and organized the documents."[9] Thus, "[i]n a sense, this discovery has already been made, and it is merely a question of keeping it from a party because of the strictures of a statute designed to prevent discovery abuse."[10]

A number of courts have followed *Worldcom* and *Enron* and lifted the PSLRA discovery stay to require production of documents already produced to government entities to prevent undue prejudice to the private plaintiffs. One such case was *In re Labranche Securities Litigation*,[11] where the defendant corporation faced ongoing investigations by the SEC and the New York Stock Exchange in addition to a private securities suit. The corporation had already agreed to pay more than $60 million to settle the regulators' claims. In light of this background and echoing the court's ruling in *Worldcom*, the *Labranche* court held that if the stay remained in place, the plaintiffs "will be the only interested party without access to those documents and will be prejudiced by their inability to make informed deci-

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sions about their litigation strategy in this rapidly shifting landscape."[12] Moreover, as in *Worldcom* and *Enron*, the court held that since the private plaintiffs had agreed to pay the production costs, the additional production would not place an undue burden on defendants.

More recently, in *In re Delphi Securities Litigation*,[13] the court held that private plaintiffs "face being left with nothing" if denied access to documents already produced to the government where the defendant corporations had already consented to substantial monetary judgments in an SEC case and were in the midst of settlement negotiations with non-PSLRA parties in a related bankruptcy action.[14] Thus, the court concluded that "[w]ithout discovery of documents already made available to federal authorities and to interested parties in the Delphi bankruptcy action, Plaintiffs would be unfairly disadvantaged in pursuing litigation and settlement strategy."[15]

In two other cases, the courts have lifted the PSLRA discovery stay to allow discovery of materials already produced to the government, even though the corporate defendants were not in the midst of settlement negotiations with other parties or in bankruptcy proceedings. In *Singer v. Nicor*,[16] the court rejected defendants' attempt to distinguish *Enron* and *Worldcom* on the grounds that the defendants in those cases were bankrupt and facing other civil suits in which the PSLRA did not apply:

[E]ven if Nicor is not bankrupt, the concerns expressed by the *Enron* and *Worldcom* courts are valid and present in this case. Plaintiffs here may well be unfairly disadvantaged if they do not have access to the documents that the governmental and other agencies already have, during the pendency of the motion to dismiss.[17]

Similarly, in *In re FirstEnergy Corp. Securities Litigation*,[18] the Northern District of Ohio held that private plaintiffs would be unfairly disadvantaged in pursuing litigation and settlement strategies if not allowed such discovery, despite the fact that there was no pending bankruptcy or settlement discussions with other parties. The court reasoned that "maintaining the discovery stay as to materials already provided to government entities does not further the policies behind the PSLRA" where (1) "FirstEnergy cannot, and indeed does not, allege any burden from providing documents that it has already reviewed and compiled"; and (2) "the court is not convinced . . . that the plaintiffs are using discovery as a fishing expedition to find a sustainable claim."[19] Accordingly, the court partially lifted the PSLRA discovery stay to allow for production of documents already produced to the government.

A common thread among these cases is that, in addition to showing undue prejudice, the plaintiff's request to lift the PSLRA discovery stay was found to be sufficiently "particularized," as the PSLRA requires.[20] Generally, courts have enforced the particularity requirement in allowing requests for a partial lifting of the PSLRA stay to allow for discovery of documents already produced to the government.[21] At least two courts, however, have held that a request is not sufficiently particularized merely because it is limited to documents already produced to the government.[22]

Thus, to maximize the likelihood that the court will grant a partial lifting of the discovery stay to permit access to documents produced to the government, both a showing of undue prejudice and a particularized identification of the documents sought are expected.

Continued Refusal to Lift the Stay

The importance of demonstrating undue prejudice and making a particularized showing of the documents sought cannot be overemphasized. In a series of recent cases, courts have made clear that, absent such showings, the mere fact that a corporate defendant has already produced documents to the government is not sufficient to mandate a partial lifting of the PSLRA discovery stay.

In *Frank v. Dana*,[23] the court rejected the private plaintiffs' argument that the PSLRA stay should be lifted to allow for discovery of materials that had already been turned over to the SEC. The court reasoned that those cases in which the stay had been lifted involved circumstances in which the defendant corporation had already entered into settlement negotiations or in which a large number of other litigants had already obtained such materials, such that failing to level the playing field would adversely affect the plaintiff's ability to recovery.[24] Absent these factors, the court refused to lift the stay: "Where there has been no risk that PSLRA plaintiffs will be frozen out of discovery negotiations, and the case is otherwise 'garden variety,' discovery of documents provided to the SEC has generally not been allowed."[25]

In *Canada, Inc. v. Aspen Technology, Inc.*,[26] the court also refused to lift the stay in the absence of the "'unique circumstances' that were present in *Worldcom*."[27] The court stressed that "the mere fact that the discovery at issue has been provided to non-PSLRA governmental plaintiffs does not alone constitute undue prejudice within the meaning of the PSLRA's stay provision." It went on to explain:

> Whether PSLRA plaintiffs should be subjected to a discovery stay while other parties, who are bringing claims under other causes of action, are not

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> subject to a stay is a question for Congress, and one that Congress has answered. Under the PSLRA, discovery in this action has been stayed. That stay does not apply to government investigations, bankruptcy proceedings, internal investigations, or non-PSLRA actions. The discrepancy between PSLRA actions and other actions is not evidence of undue prejudice, but rather is evidence of Congress's judgment that PSLRA actions should be treated differently than other actions. This Court may not second-guess that judgment.[28]

Conclusion

Even though the PSLRA discovery stay reflects Congress's intent to shield defendants facing private securities suits from engaging in discovery pending the court's ruling on motions to dismiss, courts have permitted plaintiffs to avoid the stay in limited instances where the corporate defendant has previously disclosed materials to the SEC or another governmental agency. In considering a request to permit discovery while a motion to dismiss is pending, courts will focus on whether the plaintiffs can demonstrate undue prejudice stemming specifically from the fact that they have been denied discovery of documents already produced to the government, such as where a defendant is in bankruptcy proceedings or other litigants have had access to the documents. Courts also will examine whether the plaintiffs have identified the documents sought with sufficient particularity. The plaintiffs' showing will generally require more than merely alleging that the defendant has produced documents to the SEC or other governmental agency if the request for production is to succeed. ✺

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1. H.R. Conf. Rep. No. 104-369, at 37 (1995), *reprinted in* 1995 U.S.C.C.A.N. 730, 736.
2. S. Rep. No. 104-98, at 14 (1995).
3. 15 U.S.C. § 77z-1(b)(1).
4. *See, e.g.*, Ross v. Abercrombie & Fitch Co., 2006 WL 2869588, at *3 (S.D. Ohio Oct. 5, 2006) (refusing to lift PSLRA discovery stay in a "'garden variety' case where the only thing which has happened, apart from ordinary litigation activities, is that the SEC has opened a formal investigation and requested that documents be produced to it"); Rampersad v. Deutsche Bank Sec., Inc., 381 F. Supp. 2d 131, 133–34 (S.D.N.Y. 2003).
5. 234 F. Supp. 2d 301 (S.D.N.Y. 2002).
6. Civ. A. H-01-3624, 2002 WL 31845114 (S.D. Tex. Aug. 16, 2002).
7. *In re* Worldcom, 234 F. Supp. 2d at 305–6.
8. *Id.* at 306.
9. *Id.* at *2.
10. *Id.*
11. 333 F. Supp. 2d 178 (S.D.N.Y. 2004).
12. *Id.* at 183.
13. 2007 WL 518626 (E.D. Mich. Feb. 15, 2007).
14. *Id.* at *7.
15. *Id.* at *8.
16. No. 02 C 5168, 2003 WL 22013905 (N.D. Ill. Apr. 23, 2003).
17. *Id.* at *2.
18. 229 F.R.D. 541 (N.D. Ohio 2004).
19. *Id.* at 545.
20. 15 U.S.C. § 77z-1(b)(1).
21. *See, e.g.*, Frank v. Dana, No. 3: 05 CV 7393, 2007 WL 1748887, at *2 (S.D. Ohio June 18, 2007) ("A request of documents previously produced in connection with related investigations is particularized under the PSLRA."); *In re* Delphi Corp. Sec. Litig., 2007 WL 518626, at *6 (E.D. Mich. Feb. 15, 2007) ("Lead Plaintiffs have adequately specified the target of the requested discovery: They only request the production of materials that have already been assembled and produced to Delphi's internal investigators and the federal authorities."); *In re* FirstEnergy Corp., 229 F.R.D. at 545 ("The Lead Plaintiff's request is limited to the closed universe of materials that FirstEnergy has already produced for government investigators and the federal grand jury.").
22. *In re* Am. Fund Sec. Litig., 2007 WL 1687528, *4 (C.D. Cal. May 31, 2007) ("'Particularized discovery' has been interpreted as requiring parties to identify with specificity the documents requested. However, in this case, Plaintiffs have not identified specific categories or types of documents sought or how the documents sought will be relevant to the claims Plaintiffs intend to assert in this case."); *In re* Fannie Mae Sec. Litig., 362 F. Supp. 2d 37, 39 (D.D.C. Feb. 23, 2005) ("In this case, the plaintiffs argue that their request is sufficiently particularized because they seek only documents that have already been produced in connection with governmental and regulatory investigations. The documents produced in response to those investigations, however, are voluminous and possibly irrelevant to the claims likely to be raised in the Consolidated Complaint.").
23. No. 3: 05 CV 7393, 2007 WL 1748887 (N.D. Ohio June 18, 2007).
24. *Id.* at *4.
25. *Id.*
26. No. 07 Civ. 1204 (JFK), 2007 WL 2049738 (S.D.N.Y. July 18, 2007).
27. *Id.* at *3.
28. *Id.* at *4. *See also In re* Am. Fund Sec. Litig., 2007 WL 1687528, at *3 (C.D. Cal. May 31, 2007) (after finding that no extenuating circumstances were present, court held that "Plaintiffs have not demonstrated how the PSLRA discovery stay prejudices them merely because the documents they seek have already been produced to a governmental agency").

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