ALERT MEMORANDUM

# Supreme Court Holds That Securities Act Class Actions May Be Brought In State Court

*March 27, 2018*

Last week, the unanimous Supreme Court in *Cyan, Inc. v. Beaver County Employees Retirement Fund*, No. 15-1439, 2018 WL 1384564 (U.S. Mar. 20, 2018) held that state courts have subject matter jurisdiction over class actions alleging claims under the Securities Act of 1933 (the "Securities Act") and that such actions may not be removed from state to federal court. *Cyan* resolves a dispute among state and federal courts regarding whether the Securities Litigation Uniform Standards Act of 1998 ("SLUSA") divested state courts of jurisdiction over these actions.

The Supreme Court based its holding on a strict textual reading of SLUSA, concluding that Congress did not clearly express a desire to strip state courts of their historical jurisdiction over Securities Act claims. *Cyan* subjects defendants to increased uncertainty in Securities Act class actions, raising the specter of duplicative litigation in state and federal courts, as well as potentially weakening the procedural protections of the Private Securities Litigation Reform Act of 1995 ("PSLRA"), some of which may not be available in state courts. The decision contains an express invitation to Congress to close this loophole and may prompt additional companies to consider adopting forum selection by-laws.

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## Background

After Cyan's stock declined in value, investors brought a class action alleging solely Securities Act claims (and no state law claims) in California Superior Court.[1] Cyan moved to dismiss the suit for lack of subject matter jurisdiction, arguing that SLUSA stripped the state court of jurisdiction over Securities Act class actions.[2] The California Superior Court denied the motion and the state appellate courts denied review of that ruling.[3] Cyan filed a petition for certiorari, which the Supreme Court granted.[4] In addition to the competing positions of Cyan and the investors—who respectively argued that SLUSA stripped and did not strip state courts of jurisdiction over such actions—the Supreme Court solicited the views of the federal Government, which advanced a third position that SLUSA permits filing Securities Act class actions in state court but enables a defendant to remove those actions to federal court.[5]

Lower courts had struggled to interpret the relevant provisions of SLUSA, resulting in a split among state and federal courts as to whether SLUSA divested state courts of jurisdiction over class actions asserting Securities Act claims and whether such actions could be removed to federal court.[6] Prior to the Supreme Court's decision, there was a "dearth of appellate authority" on the issue because the decisions typically arose in the context of motions for remand following removal to federal court, which are not generally appealable.[7]

## The Supreme Court's Decision

In affirming the state court's decision, the Supreme Court began by explaining the statutory scheme at the root of the dispute. As originally enacted, Section 22(a) of the Securities Act—the jurisdictional provision—provided for concurrent state and federal court jurisdiction over Securities Act claims and barred removal to federal court of any "case arising under this title and brought in any State court of competent jurisdiction."[8]

In 1995, Congress passed the PSLRA to curb "perceived abuses of the class-action vehicle in litigation involving nationally traded securities" by imposing limitations on plaintiffs seeking to bring federal securities class actions.[9] As the Court explained, however, the PSLRA "fell prey to the law of 'unintended consequence[s].' . . . Rather than face the obstacles set in their path by the [PSLRA], plaintiffs and their representatives began bringing class actions under state law. . . . To prevent plaintiffs from circumventing" the PSLRA, Congress passed SLUSA, which amended the securities laws.[10]

The relevant provisions of SLUSA are a tangled web that Justice Alito at oral argument characterized as "gibberish."[11] However, the Court nevertheless found that the case came down to statutory interpretation, holding that SLUSA's amendment to the Securities Act's jurisdictional provision did "nothing to deprive state courts of their jurisdiction to decide class actions brought under the [Securities Act]."[12] According to the Court, the amendment functioned to bar certain class actions based on state law, but said "nothing, and

[1] *Cyan, Inc. v. Beaver Cty. Employees Ret. Fund*, No. 15-1439, 2018 WL 1384564, at *7 (U.S. Mar. 20, 2018).

[2] *Id.*

[3] *Id.*

[4] *Id.*

[5] *Id.*

[6] *Id.* at *7 & n.1; *see also* Mitchell A. Lowenthal & Shiwon Choe, *State Courts Lack Jurisdiction To Hear Securities Act Class Actions, But The Frequent Failure To Ask the Right Question Too Often Produces The Wrong Answer*, 17 U. PENN. J. BUS. L. 739, 760-77 (2015) (collecting cases).

[7] *Schwartz v. Concordia Int'l Corp.*, 255 F. Supp. 3d 380, 383 (E.D.N.Y. 2017).

[8] *Cyan*, 2018 WL 1384564, at *4 (citation omitted).

[9] *Id.* at *5 (citation omitted).

[10] *Id.* (citations omitted).

[11] Transcript of Oral Argument at 11, 41-42, *Cyan, Inc. v. Beaver Cty. Emps. Ret. Fund*, No. 15-1439 (Nov. 28, 2017).

[12] *Cyan*, 2018 WL 1384564, at *8.

so does nothing, to deprive state courts of jurisdiction over class actions based on *federal law*."[13]

Having found the text controlling, the Court dismissed Cyan's appeals to legislative purpose and history.[14] The Court noted that while SLUSA may not have "entirely" accomplished its stated purpose of "moving securities class actions to federal court," it "largely" did so, including by precluding covered class actions based on state law.[15] The Court acknowledged that it did "not know why Congress declined to require as well that [Securities Act] class actions be brought in federal court," but reasoned that "perhaps it was because of the long and unusually pronounced tradition of according authority to state courts over [Securities Act] litigation."[16] In any event, the Court concluded that it could not alter the statutory language based on purported legislative purpose.[17]

Cyan also argued that the relevant amendment would be pointless and have no function unless it stripped state courts of federal jurisdiction.[18] The Court admitted that it was unsure of the exact function of the amendment, but offered several conjectures as to what Congress may have intended to accomplish in drafting it, such as that it may have been intended as a "fail-safe device" to ensure that certain state law class actions could not be brought at the state level.[19] The Court thus ultimately concluded that the language did not support Cyan's jurisdiction-stripping interpretation.[20]

Finally, the Court rejected as inconsistent with the statutory language the Government's various arguments that SLUSA's amendments permit removal of Securities Act class actions to federal court.[21] The Court reemphasized several times that the only covered class actions that could be removed "are *state-law* class actions alleging securities misconduct" and added that "the Government makes the same mistake as Cyan: It distorts SLUSA's text because it thinks Congress simply must have wanted [Securities Act] class actions to be litigated in federal court. But this Court has no license to 'disregard clear language' based on an intuition that 'Congress must have intended something broader.'"[22] The Court concluded that "[i]f further steps are needed, they are up to Congress."[23]

**Implications**

The Supreme Court's decision, which permits plaintiffs to bring covered class actions alleging Securities Act claims in state court and prevents defendants from removing such actions under SLUSA, may have several important implications.

First, the decision may lead to an increase in the filing of Securities Act class actions in state court where the PSLRA's various procedural protections—including "requirements that would-be lead plaintiffs filing a class action file sworn certifications establishing their bona fides and publish a notice advising other potential class members of the existence of the action and that other potential class members can move to replace the original filer as lead plaintiff, . . . prohibiting lead plaintiffs from receiving 'bonuses' in excess of the recovery of the rest of the class, and barring plaintiffs' lawyers from receiving more than a 'reasonable percentage' of the class's actual recovery"—may not apply.[24] On the other hand, the Court's decision confirms that the PSLRA's substantive provisions—

[13] *Id*.

[14] *Id.* at *10.

[15] *Id.* at *11.

[16] *Id.*

[17] *Id*.

[18] *Id.* at *12.

[19] *Id.* at *12-13.

[20] *Id.* at *13.

[21] *See id.* at *14-16. Although the removal question was "not directly presented because Cyan never attempted to remove the Investors' suit," the Court nevertheless considered the argument because it was related to the parties' jurisdictional arguments and fully briefed and argued by the parties. *Id*. at *7.

[22] *Id*. at *14, *16 (citation omitted).

[23] *Id*. at *16.

[24] Lowenthal, 17 U. PENN. J. BUS. L. at 750-51 (footnotes omitted).

such as the "safe harbor for forward-looking statements" and the PSLRA's automatic stay of discovery—will apply with equal force to class actions filed in state courts.[25]

Second, the decision raises the specter of duplicative Securities Act class actions being filed simultaneously in federal and state court, not to mention any related Exchange Act class actions also being filed in federal court. To minimize the burdens of such duplicative actions, defendants should consider methods of coordinating litigations across jurisdictions[26] or moving to stay one of the proceedings or for consolidation.

Third, defendants should be mindful that other bases may remain available to remove to federal court Securities Act class actions filed in state court, including related to bankruptcy jurisdiction and the Class Action Fairness Act of 2005 ("CAFA").[27]

Fourth, to avoid the negative consequences discussed above, companies may wish to consider adopting forum selection by-laws requiring Securities Act class actions to be filed in federal court. Such by-laws have been adopted by a number of companies and their enforceability is currently being litigated.[28] If such provisions are found to be valid, additional companies may adopt them.

Finally, as the Supreme Court indicated, its decision is an invitation for Congress to address this issue and revise SLUSA's imprecise language to eliminate state court jurisdiction over Securities Act class actions, to clarify that the PSLRA's procedural protections apply in state court, or to provide mechanisms to avoid duplicative litigation across jurisdictions.

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[25] *Cyan*, 2018 WL 1384564, at *10 ("For wherever those suits go forward, the [PSLRA's] substantive protections necessarily apply."); *see also* Lowenthal, 17 U. PENN. J. BUS. L. at 750 & n.31.

[26] *See* Manual for Complex Litigation § 20.3 (4th ed. 2004) (describing techniques for coordinating related litigation across federal and state courts).

[27] *California Pub. Employees' Ret. Sys. v. WorldCom, Inc.*, 368 F.3d 86, 108 (2d Cir. 2004) (holding "that generally nonremovable claims brought under the Securities Act of 1933 may be removed to federal court if they come within the purview of 28 U.S.C. § 1452(a), which confers federal jurisdiction over claims that are related to a bankruptcy case"); *Katz v. Gerardi*, 552 F.3d 558, 562 (7th Cir. 2009) (holding "that securities class actions covered by [CAFA] are removable"); *but see Luther v. Countrywide Home Loans Servicing LP*, 533 F.3d 1031, 1034 (9th Cir. 2008) (holding that "CAFA's general grant of the right of removal of high-dollar class actions does not trump § 22(a)'s specific bar to removal of cases arising under the Securities Act").

[28] *See, e.g.*, *Sciabacucchi v. Salzberg*, No. 2018-0931 (Del. Ch.) (litigating the validity of these clauses under Delaware law).