

Supreme Court to Consider Whether Class Actions Under The Securities Act Of 1933 May Be Brought In State Courts

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The Supreme Court announced last week that it will take up the question of whether state courts have subject matter jurisdiction over class actions under the Securities Act of 1933 (the Securities Act). *Cyan, Inc. v. Beaver Cty. Employees Ret. Fund*, --- S. Ct. ---- No. 15-1439, 2017 WL 2742854, at *1 (June 27, 2017). The first cases to adopt the view that the Securities Litigation Uniform Standards Act of 1998 (SLUSA) divested state courts of jurisdiction over class actions that allege only Securities Act claims were litigated by Cleary Gottlieb over a decade ago. *See Rovner v. Vonage Holdings Corp.*, No. CIV.A. 07-178 (FLW), 2007 WL 446658 (D.N.J. Feb. 7, 2007); *Rubin v. Pixelplus Co.*, No. 06-CV-2964 (ERK), 2007 WL 778485 (E.D.N.Y. Mar. 13, 2007). Over the past two decades, however, federal district courts have been divided over whether SLUSA prohibits federal Securities Act class actions from being brought in state courts. Because state courts do not apply the strict requirements of the Private Securities Litigation Reform Act of 1995 (PSLRA) that are applied in federal court, the divide has resulted in an “inconsistent patch-work of decisions [that] fundamentally undermines the goals animating the PSLRA and SLUSA: consistent federal adjudication of class actions asserting claims arising under federal securities laws.” Mitchell A. Lowenthal et al., *infra*, 17 U. PENN. J. BUS. L. at 745. Further, due to procedural limitations on review of district courts’ decisions to remand a matter to state court, no federal appeals court has addressed the question. The Supreme Court’s decision is thus expected to bring much-needed clarity to this major question of statutory interpretation.

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Background

Cyan, Inc. went public in May 2013.¹ Following the announcement of weaker-than-expected performance, on June 13, 2014 shareholders led by the Beaver County Employees' Retirement Fund ("Beaver County") filed a consolidated complaint on behalf of purchasers of Cyan's IPO stock in California Superior Court.² The complaint asserted claims under sections 11, 12, and 15 of the Securities Act of 1933 (the "Securities Act") and did not raise any state-law claims.³

Statutory Framework and Lower Court Split

Until the enactment of the Securities Litigation Uniform Standards Act of 1998 ("SLUSA"), section 22(a) of the Securities Act provided for concurrent state and federal court jurisdiction over Securities Act claims and barred removal to federal court of any "case arising under this subchapter and brought in any State court of competent jurisdiction."⁴ In 1995, Congress passed the Private Securities Litigation Reform Act ("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.⁵ Consequently, plaintiffs began bringing securities class actions in state courts, where many of the PSLRA reforms do not apply.⁶ In response, Congress passed SLUSA to prevent such actions from "frustrat[ing] the objectives of" the PSLRA.⁷

Among other things, SLUSA amended the Securities Act by adding section 16(b), which precludes plaintiffs

from bringing certain "covered class actions" under state law in either state or federal court, and 16(c), which permits such covered class actions precluded under 16(b) to be removed to and dismissed in federal court.⁸ Section 16(f) defines covered class actions as damages actions on behalf of 50 or more people.⁹

SLUSA also amended section 22(a) to provide for concurrent state and federal court jurisdiction "except as provided in [section 16] of this title with respect to covered class actions" (the "jurisdictional amendment"), and to bar removal "[e]xcept as provided in [section 16(c)]" (the "removal amendment").¹⁰

Lower courts have struggled to interpret these amendments, resulting in a split among district courts as to whether the jurisdictional amendment divests state courts of jurisdiction over class actions asserting claims under the Securities Act and, if not, whether the removal amendment allows such actions to be removed to federal court.¹¹ Contributing to the divide is the lack of federal appellate guidance, as these questions typically arise in the context of a motion for remand following removal to federal court.¹² Due to procedural limitations on review of district courts' decisions to remand a matter to state court, no federal appeals court has addressed the issue.¹³ As a result, the Securities Act has been applied inconsistently depending on the venue in which a class action is heard, creating substantial uncertainty among securities issuers as to how the law may be enforced in

¹ See Brief of Pet'r, *Cyan, Inc. v. Beaver County Employees Retirement Fund*, No. 15-1439, 2016 WL 3040512 (May 24, 2016) (hereinafter "Cyan Br."), at *9.

² *Id.*

³ *Id.*

⁴ 15 U.S.C. § 77v(a) (as amended by Pub. L. 105-353, title I, § 101(a)(3), Nov. 3, 1998, 112 Stat. 3230).

⁵ See *Merrill Lynch, Pierce, Fenner & Smith Inc. v. Dabit*, 547 U.S. 71, 81-82 (2006); 109 Stat. 737 (codified at 15 U.S.C. §§ 77z-1 and 78u-4).

⁶ See *Dabit*, 547 U.S. at 82.

⁷ Pub. L. 105-353, § 2, Nov. 3, 1998, 112 Stat. 3227.

⁸ 15 U.S.C. § 77p(b)-(c).

⁹ See 15 U.S.C. § 77p(f)(2).

¹⁰ 15 U.S.C. § 77v(a).

¹¹ Pub. L. 105-353, § 2, Nov. 3, 1998, 112 Stat. 3227; Cyan Br., 2016 WL 3040512 at *12 nn8-9; 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, 760-771 (2015) (collecting cases reaching different conclusions on and formulating different questions to determine the proper forum for Securities Act class actions).

¹² See Lowenthal, 17 U. PENN. J. BUS. L. at 744.

¹³ Cyan Br., 2016 WL 3040512 at *15-*17.

actions brought by private litigants.¹⁴ Indeed, the unresolved conflict over whether state courts retain subject-matter jurisdiction over covered class actions alleging only Securities Act claims exposes litigants on all sides to uncertainty—because parties cannot consent to subject-matter jurisdiction, any state court’s judgment on the merits in such cases is potentially subject to reversal and any settlement is potentially subject to collateral attack.¹⁵

Procedural Background

Cyan moved for judgment on the pleadings for lack of subject matter jurisdiction, arguing that SLUSA eliminated state court jurisdiction over covered class actions that allege only Securities Act claims.¹⁶ The Superior Court denied the motion.¹⁷

Cyan filed a petition for a writ of mandate or prohibition in the California Court of Appeal, First District, which was denied without opinion.¹⁸ Cyan then filed a petition for review in the Supreme Court of California, which was also denied without opinion.¹⁹

On May 24, 2016, Cyan filed a petition for writ of certiorari in the Supreme Court of the United States on the question of “[w]hether state courts lack subject matter jurisdiction over covered class actions that allege only [Securities] Act claims.”²⁰ Cyan argued that, in light of the procedural roadblocks to appellate review of federal courts’ post-removal remand orders, the Court’s guidance is necessary to resolve the inconsistencies across federal district courts.²¹

Beaver County opposed the petition and argued that SLUSA’s amendments to sections 22 and 16 of the Securities Act address only covered class actions asserting state law claims, and so cannot be read to

divest state courts of concurrent jurisdiction over covered class actions under the Securities Act.²²

Amicus Brief of the United States

At the invitation of the Supreme Court, the Acting Solicitor General submitted an *amicus* brief expressing the views of the United States on May 23, 2017.²³

The United States urged the Court to grant certiorari and, in resolving the question of whether state courts retain subject-matter jurisdiction over these claims, to address the scope of section 16(c)’s removal authorization.²⁴ Although Cyan did not seek removal below or raise the question of removal in its petition, the United States pressed the Court to “consider the structure and purpose of the overall statutory scheme,” and to “provide helpful guidance to lower courts” about the scope of the removal authorization.²⁵

On the merits, the United States agreed with Beaver County that SLUSA did not divest state courts of jurisdiction over covered Securities Act class actions, but argued that section 16(c) nevertheless authorizes removal of such actions to federal court for adjudication on the merits in a federal forum.²⁶ Reasoning that just as 16(c) authorized removal of state-law claims that might be precluded under 16(b) because Congress wanted to ensure that federal courts could make the preclusion determination, the United States argued that Congress similarly “would not likely have denied defendants access to a federal forum for

²² Brief of Beaver County, *Cyan, Inc. v. Beaver County Employees Retirement Fund*, No. 15-1439, 2016 WL 4474561 (Aug. 24, 2016), at *13–*17.

²³ *Cyan, Inc. v. Beaver Cty. Employees Ret. Fund*, 137 S. Ct. 268 (Oct. 3, 2016).

²⁴ See Brief of United States as *Amicus Curiae*, *Cyan, Inc. v. Beaver County Employees Retirement Fund*, No. 15-1439, 2017 WL 2333893 (May 23, 2017), at *15 n3.

²⁵ *Id.* The United States also argued that the fact that Cyan did not seek removal should not prevent the Court’s review of that issue, pointing out that if Cyan had sought removal, “the district court’s order might well have evaded appellate review, whether the court granted or denied the removal request.” *Id.*

²⁶ *Id.* at *13–*17.

¹⁴ See *id.* at *28–*29.

¹⁵ See Lowenthal, 17 U. PENN. J. BUS. L. at 745.

¹⁶ Cyan Br., 2016 WL 3040512 at *10.

¹⁷ See *id.*

¹⁸ *Id.*

¹⁹ *Id.*

²⁰ *Id.* at *i.

²¹ *Id.* at *11.

adjudication of the merits of analogous [Securities] Act claims.”²⁷

The Supreme Court’s Grant of Certiorari

On June 27, 2017, the Supreme Court granted Cyan’s petition for a writ of certiorari.²⁸ The Court’s decision will provide guidance on an issue that has divided lower courts and significantly impacted the litigation of securities class actions under the Securities Act.

Despite Congress’s stated goal of “enact[ing] national standards for securities class action lawsuits” through SLUSA, conflicting lower court decisions have created a patchwork of legal standards for Securities Act claims. As a result, issuers of nationally traded securities currently face substantial uncertainty as to how the Securities Act may be applied to them.²⁹ The Supreme Court’s decision will resolve this conflict and bring much-needed clarity to market participants.

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²⁷ *Id.* at *14.

²⁸ *Cyan, Inc. v. Beaver Cty. Employees Ret. Fund*, --- S. Ct. --- No. 15-1439, 2017 WL 2742854, at *1 (June 27, 2017).

²⁹ *See* Brief of the Securities Industry and Financial Markets Association, et al., *Cyan, Inc. v. Beaver County Employees Retirement Fund*, No. 15-1439, 2016 WL 3538389 (June 27, 2016), at *5.