

Securities Litigation Alert

March 22, 2018

Key Points

- The United States Supreme Court held that certain securities class actions affecting issuer defendants may be brought in state court and may not be removed to federal court.
- The decision will likely extend or expand the trend of plaintiffs bringing class actions based on the Securities Act of 1933 in state courts—particularly those that are perceived as plaintiff-friendly.
- Issuer defendants, such as newly public companies, will likely be under increased pressure to defend themselves in state courts.



The Supreme Court Holds that State Courts Have Jurisdiction over Certain Securities Class Actions

Summary

The U.S. Supreme Court on Tuesday issued a unanimous decision that will likely have a plaintiff-friendly effect on class actions brought under the Securities Act of 1933 (the “1933 Act”). In *Cyan, Inc., et al. v. Beaver County Employees Ret. Fund et al.*, No. 15-1439, the Court held that the Securities Litigation Uniform Standards Act of 1998 (SLUSA) does not strip state courts of jurisdiction over class action law suits brought under the 1933 Act. The Court also held that SLUSA does not permit defendants to remove class actions alleging only 1933 Act claims to federal court.

Issuer defendants should be aware that class actions alleging only 1933 Act claims are now likely to be brought and fully litigated in state court—particularly in jurisdictions, such as California, that are perceived to be plaintiff-friendly.

Background

The case stemmed from a class action brought in California state court by investors who purchased Cyan stock in an initial public offering. The investors alleged that Cyan’s offering documents contained material misstatements in violation of the 1933 Act. The investors did not assert any claims based on state law.

Cyan moved to dismiss for lack of subject-matter jurisdiction, arguing that § 77v(a) of SLUSA stripped state courts of the power to adjudicate 1933 Act claims in covered class actions. The California state court denied Cyan’s motion, and the California state appellate courts denied review of that ruling.

The Court granted certiorari, attracting briefs from numerous amicus curiae, including the United States, the Chamber of Commerce, former SEC Commissioners, the New York Stock Exchange, Business

Roundtable, DRI – The Voice of the Defense Bar and legal scholars in favor of Cyan’s position, as well as institutional investors, plaintiff-side securities lawyers and a consumer advocacy group in support of the respondent investors.

Opinion

Justice Kagan, writing for a unanimous Court, delved into SLUSA’s legislative origins, tracing back to the 1929 stock market crash and Congress’s response via the 1933 Act (relating to enforcement of obligations pertaining to securities offerings), the Securities Exchange Act of 1934 (regulating the trading of securities) and eventually the Private Securities Litigation Reform Act of 1995 (PSLRA), which included substantive and procedural reforms to limit perceived abuses in securities class action litigation. SLUSA, the Court noted, was enacted to fix an “unintended consequence” of the PSLRA because plaintiffs were dodging the PSLRA’s procedural obstacles by bringing class actions under state law. SLUSA thus barred certain securities class actions that were based on state securities laws.

The 1933 Act contained a general rule permitting concurrent state and federal court jurisdiction over claims to enforce the 1933 Act. At issue in *Cyan* was SLUSA’s amendment to that general rule, which the Court called the “except clause,” permitting concurrent state and federal jurisdiction “except as provided in section 77p of this title with respect to covered class actions.”

In analyzing SLUSA’s statutory language (which the Court found to be clear), the Court determined that the except clause does not deprive state courts of jurisdiction to decide class actions brought under the 1933 Act. By its plain terms, the except clause refers to only § 77p, which limits securities class actions based on state law and authorizes removal of those suits to federal court for dismissal. Because § 77p does not expressly refer to jurisdiction over claims brought under the 1933 Act, the Court concluded that the except clause cannot limit such state court jurisdiction. The Court found Cyan’s “alternative reading” of the clause overreaching, unpersuasive, and in conflict with the rest of the statutory language.

Looking to legislative history, the Court observed that SLUSA’s primary objective was to bar state law class actions and that there was no clear congressional purpose to limit state court jurisdiction over 1933 Act class actions. The Court reasoned that, if another objective of SLUSA was generally to move securities class actions to federal court, that objective was “largely” fulfilled in that most securities class actions (including those alleging 1934 Act claims) must proceed in federal court, although those alleging 1933 Act claims may proceed in state court. The Court acknowledged possible questions as to Congress’s purpose for drafting the except clause, but declined to read the statute beyond its plain language.

The Court also rejected the United States’ position, which was that SLUSA allows removal of 1933 Act class actions to federal court as long as they allege the kinds of misconduct listed in § 77p(b), such as false statements in connection with a covered security’s purchase or sale. The Court noted that § 77p(b) referred to only state law class actions alleging securities misconduct and not federal lawsuits. The Court declined to adopt the government’s reading of the SLUSA because it preferred the natural reading of the statute only to bar state law class actions.

Finally, the Court summarized *Cyan* and the government's position as "distort[ing] SLUSA's text because [they think] Congress simply must have wanted 1933 Act class actions to be litigated in federal court." Declining to depart from the text, the Court concluded that, "[i]f further steps are needed, they are up to Congress."

Impact

Cyan will likely extend or expand the trend of plaintiffs bringing class actions alleging only violations of the 1933 Act (i.e., relating to securities offerings) in state court, particularly in jurisdictions that are perceived to be plaintiff-friendly, such as California. After all, the amicus brief of law professors observed that, between 2011 and 2016, federal courts dismissed 31 percent of cases bringing only 1933 Act claims, whereas state courts in California dismissed without leave to amend in only three of 47 such cases. The plaintiffs' bar is also incentivized to bring 1933 Act class actions in state court to avoid procedural protections associated with federal court litigation, such as the PSLRA's discovery stay, as well as to take advantage of lower pleading standards in many state courts.

After *Cyan*, issuer defendants will likely be under increased pressure to defend themselves in state court, increasing litigation expenses and the costs of settlement.

Contact Information

If you have any questions regarding this alert, please contact:

M. Scott Barnard

sbarnard@akingump.com
214.969.4299
Dallas

Peter I. Altman

paltman@akingump.com
310.728.3085
Los Angeles

Jeffery A. Dailey

jdailey@akingump.com
215.965.1325
Philadelphia

Neal Ross Marder

nmarder@akingump.com
310.728.3740
Los Angeles

Michelle A. Reed

mreed@akingump.com
214.969.2713
Dallas

Daniel S. Park

dspark@akingump.com
214.969.4223
Dallas