To read the oral argument transcript, please *click here*.

Report from Washington

Supreme Court Considers Whether State Courts Have Jurisdiction Over Class Actions Alleging Only Claims Under the Securities Act of 1933

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Introduction

"Congress chose a rather obtuse way of saying that that federal courts shall have exclusive jurisdiction."

— Justice Ginsburg

The Supreme Court heard oral arguments in *Cyan, Inc. v. Beaver County Employees Retirement Fund*, No. 15-1439, on Tuesday, November 28, 2017, to decide if a class action alleging only violations of the Securities Act of 1933 may be brought in state court.[1] Congress passed the Securities Act of 1933 ("the '33 Act") in the midst of the Great Depression, requiring securities issuers to file registration statements and offering documents with the Securities and Exchange Commission. Pursuant to the '33 Act, persons who acquire a registered security may bring suit against an issuer and, in certain situations, underwriters for materially false or misleading statements or omissions made in a registration statement or offering document. As originally passed, the '33 Act provided for concurrent jurisdiction, meaning that a plaintiff could bring such a claim in either state or federal court.

In 1995, Congress passed the Private Securities Litigation Reform Act ("PSLRA") to combat the "nuisance filings, targeting of deep-pocket defendants, vexatious discovery requests, and 'manipulation by class action lawyers of the clients whom they purportedly represent'" that had become a known feature of private securities litigation. *Merrill Lynch, Pierce, Fenner & Smith Inc. v. Dabit*, 547 U.S. 71, 81 (2006). The PSLRA instituted major changes to class actions brought under the '33 Act and other federal securities statutes. These changes included limiting who could serve as a lead plaintiff, prohibiting discovery prior to a decision on a motion to dismiss, and limiting the amount of attorneys' fees available for plaintiffs' counsel. Because these class action reforms generally applied only to cases brought under the federal securities laws in federal court, the PSLRA had an unintended consequence:

[1] Simpson Thacher filed a brief in this case on behalf of *amici curiae* in support of Petitioners.

"[T]he main purpose of SLUSA was just that, to ensure that claims of this particular type were not covered under state law but covered under federal law . . . what difference does it make who adjudicates the claim if both courts are going to be bound by federal law?"

— Justice Sotomayor

"[I]n Exchange Act actions . . . exclusive jurisdiction was being compromised by the ability of people to bring state law actions. And Congress completely shut that down. So Congress did everything it wanted with respect to Exchange Act actions, which are the lion's share of securities lawsuits."

— Justice Kagan

"I mean, all the readings that everybody has given to all of these provisions are a stretch . . . . Is there a certain point at which we say this means nothing, we can't figure out what it means, and, therefore, it has no effect, it means nothing?"

— Justice Alito

plaintiffs bringing securities fraud class actions could avoid the PSLRA's new restrictions by bringing their claims in state court, asserting claims under state law or under the '33 Act.

Concerned that the intent of the PSLRA was not being fully effectuated, Congress passed the Securities Litigation Uniform Standards Act ("SLUSA") in 1998. SLUSA's "core provision" is § 77p, in which SLUSA divested state courts of the ability to hear state law class action claims involving "covered securities" under the '33 Act. *Merrill Lynch,* 547 U.S. at 82. Generally, a security is a "covered security" if it was listed on a national stock exchange at the time the alleged misrepresentation, omission, or deceptive conduct occurred. In the event such cases were still filed in state court, Congress further allowed for their removal to federal court.

At issue in *Cyan* is whether Congress intended the divest state courts of jurisdiction over *all* class actions brought under the '33 Act. Lower courts are deeply divided on the issue. Some fifty-five federal court decisions have taken divergent positions on whether state courts have subject matter jurisdiction over claims asserting '33 Act claims in the aftermath of SLUSA. In general, federal district courts in California have held that state courts retained jurisdiction over '33 Act claims while many courts outside of California have held that SLUSA eliminated state court jurisdiction over such actions.

Background

In 2014, three pension funds and one individual sued Cyan, Inc., a network support provider, and several of its officers and directors in California Superior Court alleging violations of the '33 Act. The plaintiffs (Respondents in this case) had purchased shares in Cyan's 2013 Initial Public Offering, whereupon the company's stock began to trade on the New York Stock Exchange. After Cyan's stock price dropped in 2014, certain shareholders sued Cyan in California state court on behalf of a putative class, alleging that Cyan misrepresented the company's reliance on certain projects and the impact of those projects on future sales in its offering documents. Cyan moved for judgment on the pleadings, arguing that the California state court did not have jurisdiction over class actions that assert claims exclusively under the '33 Act. The court denied the motion, pointing to California precedent holding that SLUSA did not prohibit such claims from being heard in state court.

In late 2015, Cyan filed a petition for a writ of mandate, prohibition, or other relief in the California Court of Appeal (First District) seeking to overturn the lower court's decision. The court summarily denied the petition. Cyan then filed a petition for review in the Supreme Court of California, which was also denied without an opinion. Cyan petitioned the U.S. Supreme Court for a writ of certiorari, which was granted on June 27, 2017.

Oral Argument Highlights

The oral argument focused heavily on the proper reading of § 77v(a). Cyan argued that the text, structure, and purpose of SLUSA reveal Congress's intent to divest state courts of jurisdiction over class action cases alleging '33 Act claims. Under this reading, SLUSA should be read to provide exclusive jurisdiction to federal courts over '33 Act class actions, bringing it into line with the treatment of claims asserted under the Securities and Exchange Act of 1934 ("the '34 Act"). To Cyan, the "natural[ ]" reading of the statute demonstrates that Congress intended to amend the '33 Act in order to curtail the efforts to evade the dictates of the PSLRA. Cyan also argued that SLUSA's legislative history reflected Congress' intent to make federal court the "exclusive" and "only" venue for hearing federal securities class actions.

The United States, participating as *amicus curiae*, argued for a more limited reading than Cyan, but one that would nonetheless allow state court suits asserting exclusively '33 Act claims to be removed to federal court. According to the Solicitor General, nothing in SLUSA prevents state courts from maintaining concurrent jurisdiction over covered class actions that only allege '33 Act claims. The Solicitor General argued, however, that § 77p(c) permits the removal of "[a]ny covered class action brought in any State court involving a covered security, as set forth in subsection(b)." Therefore, the government took the position that though state courts retain concurrent jurisdiction to hear covered class action that allege only violations of the '33 Act, such cases may nevertheless be removed to federal court if the defendant so chooses.

Respondent investors argued that SLUSA was intended to prohibit the filing of certain securities class actions under state securities laws, not to prohibit the litigation of '33 Act claims in state court. Respondent further argued that the provisions of SLUSA limiting state court jurisdiction and allowing removal apply only to cases asserting both state law claims and '33 Act claims, not to those asserting exclusively '33 Act claims. In other words, Respondent argued that the "carefully drawn" language of SLUSA was written to root out the most abusive practices of securities class actions, not to prevent state courts from hearing these cases at all. Respondent pointed out that Congress could have clearly and easily eliminated concurrent jurisdiction for '33 Act claims had it wished to do so. Because the language of SLUSA does not contain such clear language and instead is far more limited, Respondent explained, SLUSA clearly provided that state courts should retain concurrent jurisdiction for class actions brought exclusively under the '33 Act.

During intense colloquy, the one conclusion that the Justices appeared to reach was that the relevant language in SLUSA was far from clear. Indeed, Justices described Congress's language as "obtuse" and "gibberish."

Other than agreeing that SLUSA's language was unclear, the Court appeared to offer divergent views on how to construe the language in question. Within the first several minutes of Cyan's argument, Justice Sotomayor casted doubt on whether SLUSA's purpose was to divest state courts of jurisdiction over all '33 Act claims, as opposed to only removing its jurisdiction over claims asserting both '33 Act and state law claims. Justice Sotomayor also appeared to reject the contention that it was necessary to keep all '33 Act claims in federal court in order to apply a uniform set of standards for those cases. Justices Kagan and Ginsberg appeared to agree with Justice Sotomayor's position.

By contrast, Justice Gorsuch pressed Respondent to explain why, if the language was so carefully drawn, Respondent's position would treat one of the "except" clauses in § 77v(a) as superfluous.

Justice Alito began his questioning by referring to the statute as "gibberish." However, he then appeared to take issue with the interpretations being proposed by all sides.

Finally, Justice Breyer appeared intrigued by the position taken by the Solicitor General that Congress did not deprive state courts of concurrent jurisdiction over suits asserting only '33 Act claims, but provided for the removal of those claims to federal court.

Implications

The impact of any decision in *Cyan* is expected to be highly significant. There is no question that plaintiffs are meeting with greater success litigating '33 Act claims in state court rather than federal court. The Supreme Court may allow that practice to continue, which would be a major victory for the securities litigation plaintiffs' bar and would lead to an even greater proliferation of '33 Act litigation in state court. Alternatively, the Court may accept the positions of either Cyan or the Solicitor General, in which case state court litigation of exclusively '33 Act claims will be largely eliminated. Based on the colloquy at oral argument, it is difficult to predict how the Court will rule.

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