March 23, 2018

U.S. Supreme Court Confirms State Court Jurisdiction Over Securities Act Class Actions

Earlier this week, the United States Supreme Court held that the Securities Litigation Uniform Standards Act of 1998 ("SLUSA") does not divest state courts of jurisdiction over class actions asserting claims under the Securities Act of 1933 ("Securities Act"). The Court's decision in *Cyan, Inc.* v. *Beaver County Employees Retirement Fund*,[1] which resolved a disagreement among the lower courts, ruled that the language of the statute did not alter the historic scheme granting concurrent jurisdiction over claims under the Securities Act to state courts. In addition, the Court held that SLUSA did not alter the bar on removal of cases under the Securities Act from state to federal court. In light of this decision, we expect that shareholders will continue to file class actions asserting only claims under the Securities Act in state courts across the country.

Overview of the Statutes at Issue

SLUSA was enacted three years after Congress passed the Private Securities Litigation Reform Act ("PSLRA"). The PSLRA imposed additional requirements on plaintiffs in class actions asserting claims under the Securities Act and the Securities Exchange Act of 1934 ("Exchange Act"). In response, plaintiffs often sought to evade those requirements by filing class actions under state law and in state courts. Congress enacted SLUSA to address these efforts at evasion. SLUSA curbed state-law class actions concerning certain securities disputes principally by

- prohibiting class actions asserting certain securities-related claims under state law;[2] and
- permitting the removal to federal court of class actions asserting certain securities-related claims originally brought in state court and the dismissal of those claims by the federal court.[3]

As relevant here, SLUSA added two amendments to the Securities Act's jurisdictional and removal provisions. First, and most important to the Supreme Court's decision in *Cyan*, SLUSA amended the provision in the Securities Act granting concurrent jurisdiction to state courts over suits under the Securities Act. The amendment qualified that grant of jurisdiction by adding the phrase "except as

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1 *Cyan, Inc.* v. *Beaver County Employees Retirement Fund*, No. 15-1439 (U.S. Mar. 20, 2018).

2 15 U.S.C. § 77p(b).

3 15 U.S.C. § 77p(c).

provided in section 77p of this title with respect to covered class actions" (the "except clause").[4] Section 77p is one of the SLUSA provisions that prohibits the filing of class actions asserting securities-related claims under state law.

The "except clause" gave rise to competing interpretations by plaintiffs' counsel and defendants' counsel—and to a conflict among the lower courts, because each side of the argument attracted some judicial support. Plaintiffs argued that the "except clause" was intended to emphasize that the grant of concurrent jurisdiction to state courts over suits arising under the Securities Act was not intended to modify the SLUSA provision precluding class actions asserting securities-related claims under state law. On this reading, the "except clause" did not affect the concurrent jurisdiction of state courts over class actions asserting claims under the Securities Act.

Defendants argued that this reading did not make sense, because the SLUSA provision precluding class actions asserting securities-related claims *under state law* could not logically function as an "exception" to a grant of jurisdiction over cases *under the Securities Act*. Defendants therefore proposed that the "except clause" should be read to refer specifically to the definition of a "covered class action" in Section 77p(f)(2). That SLUSA provision defines a covered class action without any reference to state or federal law. Defendants' reading would thus have created a real exception to the jurisdiction of state courts over suits under the Securities Act: on this reading, the "except clause" would have deprived state courts of jurisdiction over class actions asserting claims under the Securities Act. This reading would have given genuine meaning—in fact, a great deal of highly important meaning—to the "except clause."

Second, SLUSA amended the Securities Act's removal bar. The amended provision states that no case under the Securities Act may be removed from state to federal court "except as provided in 77p(c)." Section 77(p)(c) is the removal provision of SLUSA.[5] *Cyan* resolved a dispute concerning whether these provisions, construed together, permitted removal only of class actions asserting securities-related claims *under state law*, or whether the provision also permitted removal of class actions asserting claims *under the Securities Act*.

Procedural Background

Shareholders of Cyan, Inc. ("Cyan"), a telecommunications company, brought a class action in California state court asserting claims under the Securities Act based on alleged misrepresentations in the offering documents for Cyan's initial public offering.[6] Cyan moved to dismiss for lack of subject matter jurisdiction. Cyan argued, in keeping with the defense position described above, that SLUSA had

4 15 U.S.C. § 77v(a).

5 15 U.S.C. § 77v(a).

6 *Cyan*, slip op. at 6.

deprived state courts of jurisdiction over class actions asserting claims under the Securities Act.[7] The California trial court denied Cyan's motion on the ground that SLUSA precluded only class actions asserting securities-related claims under state law.[8] California's intermediate appellate court affirmed the trial court's decision. The U.S. Supreme Court granted certiorari.

The Supreme Court's Opinion

In a unanimous opinion written by Justice Kagan, the Supreme Court held that SLUSA's "except clause" did not deprive state courts of jurisdiction to adjudicate class actions under the Securities Act. The Supreme Court also held that SLUSA did not create an exception for class actions to the general prohibition in the Securities Act on removal from state to federal court of actions asserting claims under the Securities Act.[9]

Interpreting the text of SLUSA, the Supreme Court held that the "except clause" did not, "[b]y its terms," strip state courts of jurisdiction to decide Securities Act class actions.[10] According to the Court, the "except clause" refers to section 77p "as a whole," as opposed to just the term "covered class actions."[11] Viewed holistically, 77p only "bars certain class actions based on *state* law."[12]

The Court rejected Cyan's argument that the "except clause" referred specifically to the definition of the term "covered class action" in section 77p(f)(2), rather than to the entirety of section 77p. The Court reasoned that a definition cannot reasonably constitute an exception; a definition merely "gives meaning to a term."[13] In addition, the Court pointed out that under Cyan's interpretation, state courts would be stripped of jurisdiction to hear *all* class actions under the Securities Act, even if those class actions did not involve a nationally traded security. That result would "strip state courts of jurisdiction over suits about securities raising no particular national interest."[14]

The Court then turned to Cyan's policy arguments. Cyan argued that Congress intended SLUSA to eliminate state court jurisdiction over class actions under the Securities Act in order to enforce the

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7 *Id.*

8 *Id.*

9 *Id.* at 18, 24.

10 *Id.* at 7–8.

11 *Id.* at 9.

12 *Id.* at 8.

13 *Id.* at 9.

14 *Id.* at 11.

requirements of the PSLRA.[15] The Court responded by noting that even in state court, defendants are afforded the protections of the PSLRA's substantive rules, although not all of the PSLRA's procedural protections apply in those courts.[16] In any event, as the Court repeatedly stated, the purpose of SLUSA was to preclude class actions alleging securities-related claims *under state law*. That goal, the Court explained, is not undermined by allowing class actions *under federal law* to proceed in state court.[17]

Second, the Court considered whether, as the Solicitor General argued, SLUSA authorizes removal of class actions under the Securities Act from state to federal court. This issue was not presented by the facts of *Cyan*, but the Court elected to address it nonetheless. The Court determined that class actions under the Securities Act may not be removed.

Conclusion

For class actions asserting solely Securities Act claims, the *Cyan* decision essentially restores the pre-SLUSA jurisdictional and anti-removal provisions of the Securities Act. This decision thus undermines what many defendants have argued was Congress's intent when it required, through the enactment of the PSLRA and SLUSA, the application of more rigorous standards to claims under the federal securities laws. In the view of those defendants, SLUSA should have been read to prevent plaintiffs from evading those standards by relying on class actions asserted either under state law or in state court.

Under statutory provisions that were not at issue in *Cyan*, class actions asserting claims under the Exchange Act will remain exclusively in federal court. Plaintiffs, however, may increasingly bring class actions asserting claims relating to registration statements solely under sections 11 and 12 of the Securities Act in order to avoid federal court. Such class actions are likely to generate additional expense and distraction for underwriters and regular issuers of public securities, as these defendants will be required to litigate in state courts across the country. Legislative reform may be the only remedy. As Justice Kagan wrote, "SLUSA did quite a bit to make good on the promise of the Reform Act . . . . If further steps are needed, they are up to Congress."[18]

Defendants in securities class actions have generally preferred federal court for several reasons. For one, federal courts are viewed as being more receptive to motions to dismiss. In its amicus brief in *Cyan,* the Securities Industry and Financial Markets Association estimated that federal courts dismiss approximately 32% of complaints in class actions asserting securities claims. According to the same amicus brief, over the past seven years California state courts have involuntarily dismissed only about 5%

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15 *Id.* at 12–13.

16 *Id.* at 13.

17 *Id.* at 13–14.

18 *Id.* at 24 (internal citations omitted).

of class action complaints alleging claims under the Securities Act.[19] When Congress enacted the PSLRA and SLUSA, it intended defendants to have a meaningful opportunity to obtain dismissal of meritless claims. These statistics suggest that the *Cyan* decision will undermine that objective.

Another reason defendants prefer federal court is that the statutes and rules governing procedure in federal courts provide mechanisms for the transfer, consolidation, and coordination of duplicative claims, including claims filed in federal courts sitting in multiple states. In state courts, claims often cannot be transferred at all, and defendants are forced to make applications—often left to the discretion of the state court judges—to stay or dismiss duplicative cases. *Cyan* leaves defendants without any general ability to obtain dismissal for lack of jurisdiction or removal to federal court of class actions in state courts asserting claims under the Securities Act. In some instances, defendants could instead be compelled to defend multiple class actions in the courts of multiple states. Multiple actions of this kind can create many challenges for defendants, including the potential application of issue preclusion arising from rulings of the first court to adjudicate such actions.

Finally, there is likely to be continued litigation over the applicability of the PLSRA provisions to state court actions. As the *Cyan* Court noted, certain procedural protections of the PSLRA, such as the requirement that plaintiffs submit sworn certifications concerning their stock purchases, are not applicable in state court.[20] But many of the PSLRA's protections apply to state court actions as well as federal court actions, such as the safe harbor for forward-looking statements (as the *Cyan* Court noted). We anticipate that defendants in class actions brought under the Securities Act in state court will press the state courts to apply these standards in a way consistent with the approach typically taken by federal courts.

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[19] Brief for Securities Industry and Financial Markets Association et al. as *Amici Curiae* Supporting Petitioners at 9.

[20] *Cyan*, slip op. at 12–13.

This memorandum is not intended to provide legal advice, and no legal or business decision should be based on its content. Questions concerning issues addressed in this memorandum should be directed to:

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