KING & SPALDING

Client Alert

Shareholder and Securities Litigation Practice Group

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U.S. Supreme Court's *Cyan* Decision Confirms State Courts' Jurisdiction Over Securities Act of 1933 Class Actions

On March 20, 2018, the United States Supreme Court issued a unanimous decision in *Cyan, Inc. v. Beaver County Employees Retirement Fund*.[1] *Cyan* resolves a nearly two-decades-long split among state and federal courts concerning state courts' jurisdiction over securities class actions that exclusively allege claims under federal law, specifically, the Securities Act of 1933 (the "1933 Act"). Among other things, the 1933 Act bestows private rights of action on certain purchasers in securities offerings. However, since the passage of the Securities Litigation Uniform Standards Act of 1998 ("SLUSA"), federal and state courts across the country have disagreed about SLUSA's jurisdictional impact with respect to 1933 Act claims. Some courts held that, after SLUSA, federal courts have exclusive jurisdiction over class actions asserting only 1933 Act claims.[2] Other courts, by contrast, concluded that SLUSA left intact state courts' concurrent jurisdiction over such actions.[3]

In a 9-0 opinion penned by Justice Elena Kagan, the Supreme Court in *Cyan* held that state and federal courts have concurrent jurisdiction over class actions alleging only 1933 Act claims and that such claims are *not* removable to federal court.[4] This is a significant development for public companies engaging in securities offerings (and their directors and officers), underwriters, and investors who purchase in such offerings. It will also impact their respective advisors, including attorneys who practice in this area, and affect the allocation of judicial resources necessary to adjudicate such class actions.

Background

The dispute in *Cyan* stemmed from Congress's amendment of the 1933 Act and the Securities Exchange Act of 1934 (the "1934 Act") through the enactment of the Private Securities Litigation Reform Act of 1995 ("the PSLRA") and, later, SLUSA in 1998. The PSLRA made certain procedural and substantive changes to the federal securities laws, targeted at "perceived abuses of the class-action vehicle in litigation involving nationally traded securities."[5] For example, the PSLRA imposed heightened pleading standards, established a procedure for appointing lead plaintiffs, provided for a stay of discovery pending adjudication of a motion to dismiss, and created a safe harbor for forward-looking statements. In an effort to skirt the PSLRA's strictures, plaintiffs' law firms began avoiding federal courts, and instead filing securities class actions in state courts.

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Congress responded by enacting SLUSA in 1998, which, as its very title makes clear, was meant to promote uniformity in the adjudication of class actions that implicate the 1933 Act or the 1934 Act. Toward that end, SLUSA amended Section 16(b) of the 1933 Act to add what is now known as the "state-law class-action bar," which prohibits investors from bringing a "covered class action" (*i.e.*, a lawsuit on behalf of 50 or more people) in *any* court, be it state or federal, to pursue a *state-law claim* alleging untruth or manipulation in connection with the purchase or sale of a "covered security."[6] SLUSA also amended Section 16(c) of the 1933 Act to provide for removal of such cases so that the federal courts can dismiss all cases precluded by Section 16(b).[7] In addition, SLUSA made conforming amendments to Section 22(a) of the 1933 Act, making clear that the grant of concurrent jurisdiction over 1933 Act claims is limited: "***except as provided*** in [Section 16] with respect to covered class actions."[8]

Debate over the import of this "except clause" fostered uncertainty as to whether SLUSA preserved or eliminated state court jurisdiction over actions asserting only 1933 Act violations. This was the central question in dispute in *Cyan.*[9] Investors who bought shares of Cyan stock in its initial public offering sued Cyan in California state court after the Company's stock declined in value, alleging that Cyan's offering documents contained material misstatements in violation of the 1933 Act.[10] The California court denied Cyan's motion to dismiss the purchasers' lawsuit for lack of subject matter jurisdiction, agreeing with the purchasers that SLUSA left intact state courts' concurrent jurisdiction over class actions alleging only 1933 Act claims.[11] The state appellate courts denied review of the trial court's ruling, and the United States Supreme Court granted Cyan's petition for certiorari to resolve the clear divide among the lower courts (both state and federal).[12]

The Supreme Court's Opinion

In *Cyan*, a unanimous Supreme Court held that state courts have concurrent jurisdiction over federal securities class actions asserting only claims under the 1933 Act. Although SLUSA bars certain securities class actions based on *state* law, and expressly authorizes removal of such actions so that they may be dismissed by federal courts applying SLUSA, the Supreme Court held in *Cyan* that SLUSA's except clause "says nothing, and so does nothing to deprive state courts of jurisdiction" to decide class actions brought under the 1933 Act.[13] As Justice Kagan succinctly stated, SLUSA "says what it says—or perhaps better put here, does not say what it does not say."[14] The decision observed further that Congress does not make radical changes through conforming amendments like Section 22(a)'s "except clause." "Congress does not 'hide elephants in mouseholes," wrote Justice Kagan, quoting the late Justice Scalia.[15] That means the "background rule" of allowing state courts to hear 1933 Act claims "continues to govern."[16]

The Court also rejected the "halfway-house" position advanced by the Federal Government—that 1933 Act class actions may be filed in state court, but can be removed to federal court.[17] Again, the Court looked to SLUSA's text, which sets forth the "covered class actions" that can be removed to federal court—*state-law* class actions alleging securities misconduct. "So those state-law suits are removable. But conversely, ***federal-law*** suits like this one—alleging only 1933 Act claims—are not '[covered] class actions'" and thus "remain subject to the 1933 Act's removal ban."[18]

Key Takeaways

The *Cyan* decision obviously will have the greatest impact in states where courts previously construed SLUSA to provide for exclusive federal court jurisdiction (or at least the removability) of claims under the 1933 Act. Courts in those states can expect a rise in 1933 Act filings, a phenomenon that has notably persisted for several years in California, which previously recognized its state courts' jurisdiction over 1933 Act claims. *Cyan* may also increase the odds that defendants in 1933 Act cases may face litigation in multiple forums, with plaintiffs now free to file in state or federal courts.

Defendants litigating 1933 Act claims in state court will still be able to rely on many protections afforded by the PSLRA, including the stay of discovery pending adjudication of a motion to dismiss.[19] In addition, defendants litigating 1933 Act claims in state court may wish to explore the availability of a specialized "business" court or division within the forum state. Many states have such "business" or "complex litigation" divisions staffed by judges who are likely to be more familiar with complex business disputes of the type presented by 1933 Act cases.[20]

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[1] Slip. Op. No. 15-1439 (U.S. Mar. 20, 2018).
[2] *See, e.g.*, *Knox v. Agria Corp.*, 613 F. Supp. 2d 419, 425 (S.D.N.Y. 2009).
[3] *See, e.g.*, *Luther v. Countrywide Financial Corp.*, 195 Cal. App. 4th 789, 797-98, 125 Cal. Rptr. 3d 716, 721 (2011).
[4] *Cyan*, Slip. Op. at 1.
[5] *Id.* at 2 (quoting *Merrill Lynch, Pierce, Fenner & Smith Inc. v. Dabit*, 547 U.S. 71, 81 (2006)).
[6] 15 U.S.C. § 77p(b); *Cyan*, Slip. Op. at 3-4.
[7] 15 U.S.C. § 77p(c); *Cyan*, Slip. Op. at 4.
[8] 15 U.S.C. § 77v(a) (emphasis added).
[9] *Cyan*, Slip. Op. at 6.
[10] *Id.*
[11] *Id.*
[12] *Id.*
[13] *Id.* at 8.
[14] *Id.* at 7.
[15] *Id.* at 12 (quoting *Whitman v. Am. Trucking Assns., Inc.*, 531 U. S. 457, 468 (2001)).
[16] *Id.* at 8.
[17] *Id.* at 18.
[18] *Id.* at 19.
[19] 15 U.S.C. § 77z-1(b).
[20] *See* http://www.ncsc.org/Topics/Special-Jurisdiction/Business-Specialty-Courts/State-Links.aspx?cat=Business%20Courts%20and%20Complex%20Litigation