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Supreme Court: SLUSA Does Not Prohibit State Court Jurisdiction Over Securities Act Class Actions

In Cyan, Inc., the Justices unanimously decide that state courts have jurisdiction over federal Securities Act class actions.

Key Points:

- Resolves split of authority on whether the Securities Litigation Uniform Standards Act of 1998 (SLUSA) divested state courts of subject matter jurisdiction over "covered class actions" if the plaintiff alleges only federal Securities Act claims.
- Despite commentary at oral argument that statute was "obtuse" and "gibberish" the Supreme Court determined that "SLUSA's text, read most straightforwardly," leaves the state court jurisdiction intact.
- Beyond the textual argument, the Supreme Court also held that the legislative history supports its conclusion because the focus of SLUSA was to limit the conduct of securities class actions under state law.
- The Supreme Court also resolved an issue raised by the Federal Government as *amicus curiae,* concluding that SLUSA does not permit defendants to remove to federal court purported class actions alleging only Securities Act claims.
- While the decision will likely lead to more Securities Act cases being filed in state court, it may reduce forum shopping between those courts in different states.

Introduction

On March 20, 2018, the Supreme Court of the United States delivered a unanimous opinion in the highly anticipated case of *Cyan, Inc. v. Beaver County Employees Retirement Fund*,[1] No. 15-1439, holding that (1) the Securities Litigation Uniform Standards Act of 1998 (SLUSA) does not strip state courts of subject matter jurisdiction in lawsuits solely alleging claims under the Securities Act of 1933 (the Securities Act); and (2) SLUSA does not permit defendants to remove to federal court a purported class action filed in state court alleging only Securities Act claims.

Statutory Background of SLUSA

In 1995, Congress enacted the Private Securities Litigation Reform Act (PSLRA). One of the PSLRA's primary purposes was to curb frivolous securities class actions by imposing heightened substantive and procedural requirements, including the imposition of an automatic stay of discovery and limitations on attorneys' fees. After the PSLRA was adopted, class action plaintiffs hoping to avoid the PSLRA's stringent requirements began filing securities class actions in state court in greater numbers.[2]

In response, in 1998, Congress enacted SLUSA for the stated purpose of vesting federal courts with the exclusive authority to decide certain types of cases involving securities offered nationally.[3] In general, SLUSA provides for the removal of covered class actions, seeking damages on behalf of 50 or more persons, from state to federal court.[4]

While SLUSA provides for the removal to federal court of class actions alleging state law claims,[5] prior to the Supreme Court decision in *Cyan* district courts were split on the question of whether state courts lack subject matter jurisdiction over covered class actions alleging only federal Securities Act claims. Because of the conflict, plaintiffs' attorneys had favored jurisdictions that both permitted state court jurisdiction and prohibited removal — most notably California state court.

Brief Case History[6]

The defendants in this case are Cyan, Inc., a telecommunications company, and its officers and directors (collectively "Cyan").[7] The plaintiffs are three pension funds and an individual who purchased shares of Cyan stock during its initial public offering.[8] Following a drop in the stock price, plaintiffs brought a class action in California state court for damages, alleging only Securities Act claims.[9] In response, Cyan moved to dismiss, arguing that SLUSA's "except clause" divested the state court of concurrent jurisdiction over covered class actions that alleged only federal Securities Act claims.[10] Plaintiffs argued that the Securities Act only prohibits state courts from deciding state law class actions, but has no effect on purely federal claims.[11] The California state courts agreed with plaintiffs and allowed their claims to proceed, and the U.S. Supreme Court granted certiorari.[12]

The groundwork for the *Cyan* appeal was laid six years earlier. In 2011, the defendants in *Countrywide Fin. Corp. v. Luther* had filed a petition for certiorari raising the same issue of state court jurisdiction over Securities Act claims.[13] In that case, the defendants asked the Supreme Court to review a California Court of Appeal decision holding that SLUSA did not permit a defendant to remove a complaint filed in state court alleging only Securities Act claims.[14] In seeking review, the defendants noted that the jurisdictional question would likely not be subject to a federal appeal, despite the fact that the question was "the subject of pervasive disagreement in the district courts."[15] The *Countrywide* defendants also foretold that a lack of resolution of this jurisdictional question would cause plaintiffs to choose California as "the venue of choice for 1933 Act class actions."[16] The Supreme Court denied certiorari in *Countrywide*, allowing the issue to percolate further.

In *Cyan,* the United States filed an amicus brief encouraging the Supreme Court to grant certiorari to decide this dispute despite the lack of an appellate court split, based on the obstacles to appellate resolution and because the question has long "generated confusion in lower courts."[17] On June 27, 2017, approximately six years after denying *certiorari* in *Countrywide,* the Supreme Court granted Cyan's petition.

On November 28, 2017, the Supreme Court heard oral argument in *Cyan*, in which counsel for Cyan, plaintiffs, and the United States participated. Justices Sotomayor and Kagan led the questioning of Cyan. In response to questioning from Justice Ginsburg, Cyan's counsel agreed that the statutory language was an "obtuse" way of signaling exclusive federal jurisdiction of Securities Act claims.[18]

Other justices questioned whether any sense could be made of the statutory language at all. Both Justices Alito and Gorsuch pressed defendants regarding the text of SLUSA, asking whether Congress' adopted language was simply "gibberish."[19] Justice Alito expressly noted that he thought "all the readings that everybody has given to all of these provisions are a stretch."[20] In response to these questions, plaintiffs expressed their belief that this interpretation was consistent with Congress' intent.[21]

Justice Kennedy directly asked plaintiffs' counsel whether the Court might decide the jurisdictional issue while "reserv[ing]" the removal question for resolution in the future. In response, plaintiffs' counsel responded that "I have learned that the answer to the question can the Supreme Court do X is always yes."[22]

The Supreme Court's Decision

On March 20, 2018, the Supreme Court unanimously sided with the investor plaintiffs in *Cyan*. Justice Elena Kagan's opinion for the Court addressed two questions. First, does SLUSA strip state courts of jurisdiction over class actions alleging only Securities Act violations?[23] Second, even if not, does SLUSA empower defendants to remove such actions from state to federal court?[24]

The Supreme Court Found the Text and Purpose of SLUSA Support State Court Jurisdiction.

In answering the first question, the Supreme Court broke the analysis into two pieces — an analysis of the text of SLUSA and of its legislative history.

SLUSA amended § 77v(a) of the Securities Act — the provision providing state courts with jurisdiction to hear 1933 Act claims — to add the italicized language below:

> The district courts of the United States ... shall have jurisdiction of offenses and violations under [the Securities Act] ... and, concurrent with State and Territorial courts, *except as provided in section 77p of this title with respect to covered class actions*, of all suits in equity and actions at law brought to enforce any liability or duty created by [the Securities Act].[25]

The Supreme Court referred to the italicized language above as the "except clause."[26] The Supreme Court then posited that "the critical question for this case is therefore whether § 77p limits state-court jurisdiction over class actions brought under the 1933 Act. It does not."[27]

In agreeing with the *Cyan* investor plaintiffs, the Court noted that SLUSA's amendment to § 77v(a) of the Securities Act did not divest state courts of concurrent jurisdiction. Specifically, § 77v(a)'s reference to § 77p relates to the entirety of § 77p, rather than simply to the definition of covered class actions in § 77p(f)(2).[28] Therefore, § 77p bars certain securities class actions based only on state law.[29] Because § 77p "says nothing, and so does nothing, to deprive state courts of jurisdiction over class actions based on *federal* law . . . the background rule of § 77v(a) . . . continues to govern."[30]

The Supreme Court rejected Cyan's argument that the reference in the except clause to "covered class actions" mandates the application of § 77p(f)(2)'s broad definition of that term.[31] There, the term "covered class actions" applies to all such class actions, regardless of state or federal court. Cyan argued, therefore, that this exempts all sizable class actions from "§ 77v(a)'s conferral of jurisdiction on state courts."[32] The Supreme Court reasoned that if Congress wanted to refer to the definition in § 77p(f)(2) alone, it could easily have done so by "adding a letter, a number, and few parentheticals."[33] Moreover, the Court noted that § 77p(f)(2) provides only a definition, and it would be unprecedented for Congress to cross-reference an exception to a rule with a cross-reference to only a definition.[34]

The Supreme Court also agreed with plaintiffs that SLUSA's amendment to § 77v(a) is a mere "conforming amendment," which should not be understood to obliquely divest state courts of concurrent jurisdiction over federal law class actions.[35] The Supreme Court noted that state courts have enjoyed

concurrent jurisdiction over federal class actions for almost 65 years before SLUSA, and that Congress would not have "upended that entrenched practice" by means of a technical or conforming amendment.[36]

The Supreme Court rejected Cyan's interpretation that Congress intended for SLUSA to shift all federal securities class action litigation to federal court. Specifically, the Supreme Court emphasized that the purpose of SLUSA is to preclude state-law class actions.[37] "That object – which SLUSA's text actually reflects – does not depend on stripping state courts of jurisdiction over 1933 Act class suits, as Cyan proposes."[38] The Supreme Court's overall sentiment regarding Cyan's arguments surrounding the reason and purpose of the language in the except clause concluded with a resounding "[it] does not matter" because the language of the except clause does not support Cyan's broad interpretation.[39]

The Supreme Court Also Rejected the Federal Government's Proposed Middle-Ground Permitting the Removal of Securities Act Class Actions.

The Federal Government, in an *amicus curiae* brief, attempted to find middle ground. The government agreed with plaintiffs that nothing in § 77p divested state courts of jurisdiction over a covered class action that asserted only claims under the Securities Act.[40]

The government claimed, however, that SLUSA provided other statutory mechanisms for giving defendants access to federal courts in class actions involving Securities Act claims. Specifically, the United States pointed to SLUSA's amendment to the anti-removal provisions in the Securities Act that permits the removal of any covered class action (whether state or federal) that "contains allegations of the type specified in Section 77p(b)(1) and (2) (*i.e.*, false statements, omissions, or deceptive conduct in connection with the purchase or sale of a covered security)."[41]

The Supreme Court disagreed with the Federal Government's arguments. Citing its prior holding in *Kircher v. Putnam Funds Trust*,[42] the Supreme Court held that SLUSA provides that state law claims can be removed (and then dismissed), but the federal claims cannot.[43] The Court again emphasized that Cyan's and the Federal Government's argument that Congress must have wanted all Securities Act claims to be litigated in federal court is not a basis to disregard the clear language of the statute.

Conclusion

The Supreme Court's opinion in *Cyan* has been highly anticipated by securities litigation practitioners, investors, and companies who deal with securities litigation matters. The Court's summarized the law as follows: "Under our reading of SLUSA, all covered securities class actions must proceed under federal law; most (*i.e.,* those alleging 1934 Act claims) must proceed in federal court; some (*i.e.,* those alleging 1933 Act claims) may proceed in state court."[44] The Court noted that it had no authority to "revise that legislative choice, by reading a conforming amendment and a definition in a most improbable way, in an effort to make the world of securities litigation more consistent or pure."[45]

Moving forward, it is likely that plaintiffs' firms will rush to file Securities Act claims in state court, as the lead plaintiff application process in the PSLRA only applies to federal court. Moreover, an increase in state court litigation may raise new issues in terms of the application of other procedural protections of PSLRA to state court litigation.

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Endnotes

[1] *Cyan, Inc. v. Beaver Cty. Employees Ret. Fund*, No. 15-1439 (U.S. Mar. 20, 2018)

[2] *See* Br. for the United States as *Amicus Curiae* in Supp. of Granting Writ of Cert. at 2.

[3] *See* 144 Cong. Rec. H11019-01, H11020 (1998) ("The premise of this legislation is simple: lawsuits alleging violations that involve securities that are offered nationally belong to Federal court."); H.R. Rep. No. 105-803 ("The purpose of this title is to prevent plaintiffs from seeking to evade the protections that Federal law provides against abusive litigation by filing suit in State, rather than in Federal, court."); H.R. Rep. No. 105-640 (1998) ("Under the legislation, class actions relating to a 'covered security' . . . alleging fraud or manipulation must be maintained pursuant to the provisions of Federal securities law, in Federal court (subject to certain exceptions).").

[4] 15 U.S.C. § 77p(f)(2).

[5] 15 U.S.C. § 77p(b)-(c).

[6] A complete summary of the background of the dispute is detailed in the Client Alert dated December 4, 2017. Joshua G. Hamilton, James H. Moon & Tanya Syed, *Supreme Court Questions "Obtuse" Statute Addressing Jurisdiction Over Securities Act Claims*, Latham & Watkins LLP, https://www.lw.com/thoughtLeadership/lw-supreme-court-questions-obtuse-statute-addressing-jurisdiction-over-securities-act-claims (Dec. 4, 2017).

[7] *Cyan*, slip op at. 6.

[8] *Id.*

[9] *Id.*

[10] *Id.*; *see* 15 U.S.C. § 77v(a).

[11] *Cyan*, slip op. at 6.

[12] *See id.*

[13] Pet. for Writ of Cert., *Countrywide Financial Corp. v. Luther*, 2011 WL 7039415 (U.S.).

[14] *Id*. at *1.

[15] *Id*. at *2.

[16] *Id*. at *21.

[17] Br. for the United States as *Amicus Curiae* in Supp. of Granting Writ of Cert. at 6.

[18] Transcript of Oral Argument at 5, *Cyan, Inc. v. Beaver Cty. Employees Ret. Fund*, 583 U.S. ____ (2018) (No. 15-1439).

[19] *Id*. at 11, 47.

[20] *Id.* at 41.

[21] *Id*. at 59.

[22] *Id*. at 45.

[23] *Cyan*, slip op. at 1.

[24] *Id.*

[25] 15 U.S.C. § 77v(a).

[26]*Cyan*, slip op. at 8.

[27] *Id.*

[28] *Id.* at 8-9.

[29] *Id.* at 8.

[30] *Id.*

[31] *Id.* at 8-9.

[32] *Id.*

[33] *Id.* at 9.

[34] *Id.* at 9-10.

[35] *Id.* at 11.

[36] *Id.* at 11-12.

[37] *Id.* at 13.

[38] *Id.* at 14.

[39] *Id.* at 18.

[40] Br. for the United States as *Amicus Curiae* at 6.

[41] *Id*. at 9.

[42] 547 U. S. 633, 643-644 (2006).

[43] *Cyan*, slip op. at 20.

[44] *Id.* at 14-15.

[45] *Id.* at 15.