Simpson Thacher

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# Report from Washington

## Supreme Court Unanimously Upholds State Court Jurisdiction Over Class Actions Alleging Only Claims Under the Securities Act of 1933

March 21, 2018

*"The critical question for this case is therefore whether [the Securities Litigation Uniform Standards Act] limits state-court jurisdiction over class actions brought under the 1933 Act. It does not."*

*— Justice Kagan, for a unanimous Court*

### Introduction

On March 20, 2018, the Supreme Court in *Cyan, Inc. v. Beaver County Employees Retirement Fund*, No. 15-1439, unanimously held that state courts have jurisdiction over class actions alleging only violations of the Securities Act of 1933.[1] The Court rejected the issuer's argument that the Securities Litigation Uniform Standards Act passed in 1998 eliminated the jurisdiction of state courts to hear such class actions. In resolving a split among state and federal courts, the Court likewise rejected a middle-of-the-road position advanced by the Solicitor General that such actions should be removable from state to federal court.

### Statutory Framework

The Securities Act of 1933 ("the '33 Act") allows persons who acquire a registered security to bring suit against an issuer, underwriter, and numerous others 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 (the "PSLRA" or "the Reform Act") 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 significant changes to class actions brought under federal securities statutes, including the '33 Act. Because these class action reforms generally applied only to cases

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

brought in federal court, however, the PSLRA had an unintended consequence: 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.

*"The statute says what it says—or perhaps better put here, does not say what it does not say. State-court jurisdiction over 1933 Act claims thus continues undisturbed."*

*— Justice Kagan*

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 class actions bringing state law claims involving "covered securities." *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. The question the Court decided on Tuesday was "whether § 77p limits state-court jurisdiction over class actions brought under" the '33 Act.

## Case Background

In 2014, three pension funds and one individual sued Cyan, Inc. ("Cyan" or "Petitioners"), 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 the U.S. Supreme Court) 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, the plaintiff shareholders sued Cyan in California state court on behalf of a putative class, alleging that Cyan violated the '33 Act by misrepresenting 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 '33 Act claims from being heard in state court. After appeals through the California state court system were denied, Cyan petitioned the U.S. Supreme Court for a writ of certiorari, which was granted on June 27, 2017.

*"SLUSA ensured that federal courts play the principal role in adjudicating securities class actions by means of its revisions to the 1934 Act."*

*— Justice Kagan*

## Summary of the Court's Opinion

Justice Kagan, writing for a unanimous Court, found that the provision of SLUSA in dispute does not deprive state courts of their concurrent jurisdiction over class actions alleging violations of the '33 Act. That provision provides that federal district courts "shall have jurisdiction[,] 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 '33 Act. 15 U.S.C. § 77v(a) (2012) (emphasis added). The Court termed the italicized language of this provision the "except

clause," and the central dispute in the case was whether the clause's reference to "covered class actions" pointed to the definition of that term in § 77p(f)(2). If it did, Petitioners argued, state courts would not have jurisdiction over such class actions brought under the '33 Act.

The Court rejected Petitioners' argument for two reasons. First, if Congress had wanted to refer to § 77p(f)(2)—instead of more broadly to § 77p, as it did in the except clause—it would have done so, "just by adding a letter, a number, and a few parentheticals." Indeed, elsewhere in SLUSA Congress did use a pinpoint reference to a subsection of § 77p, Justice Kagan noted. Second, § 77p(f)(2) provides a *definition* (of "covered class action") not an *exception* to concurrent jurisdiction, and Congress is well aware of the difference between those two functions.

Justice Kagan reasoned that, by its terms, § 77p only prevents certain class actions based on state law from being heard in state courts (the statute requires that they be removed to federal court and dismissed), and that nothing in the text prevents a state court from hearing class actions based exclusively on federal law.

Turning from the statutory language, the Court concluded that even if arguments about SLUSA's legislative purpose and history could overcome a plain reading of the statutory text, Cyan failed to account for other ways in which SLUSA furthers Congress's objectives. SLUSA's preamble sets out the statute's goal of "limit[ing] the conduct of securities class actions under State law." In barring class actions brought under state law, SLUSA guarantees that the substantive protections of the federal Reform Act will apply to class actions, regardless of whether they proceed in state or federal court. This objective does not depend on stripping state courts of jurisdiction over '33 Act class actions.

Moreover, Justice Kagan wrote, SLUSA's revisions to the Securities Exchange Act of 1934 ("the '34 Act") served Congress's goal of moving the majority of securities class actions to federal court. As with the '33 Act, SLUSA also amended the '34 Act to bar class actions based on state law, forcing plaintiffs to bring claims under the '34 Act. Because federal courts are vested with exclusive jurisdiction over '34 Act claims, those plaintiffs end up in federal, not state, court. And far more suits are brought under the '34 Act, which regulates all trading of securities, than the '33 Act, which regulates only securities offerings.

Finally, the Court rejected the Solicitor General's "halfway-house position," holding that SLUSA does not permit the removal of class actions alleging only '33 Act claims from state to federal court. Under that interpretation, another provision of § 77p in subsection (c) would

permit the removal of '33 Act class actions to federal court if they allege false statements or deceptive devices in connection with the purchase of a covered security, as listed in § 77p(b). But § 77p(b) refers to *state-law* class actions, which are removable to federal court (after which they are to be dismissed), not *federal-law* class actions asserting '33 Act claims. The Court explained that the government's construction distorted SLUSA's text, and statutory language cannot be ignored "based on an intuition that Congress must have intended something broader."

*"Even assuming clear text can ever give way to purpose, Cyan would need some monster arguments on this score to create doubts about SLUSA's meaning."*

*— Justice Kagan*

## Implications

Plaintiffs have often found greater success litigating '33 Act claims in state court rather than federal court, and the Court's holding that such suits are permissible presumably will result in more '33 Act cases being filed in state courts. The Court has left it to Congress to place any further restrictions on the proper venue for federal securities class action litigation. Proposals to limit the ability of state courts to hear cases involving '33 Act claims may now gain traction in Congress.

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