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Securities Regulation & Law Report™

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Supreme Court Rules That Securities Act Claims Can Be Brought in State Court

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In recent years, plaintiffs have flooded state courts—particularly those in California—with lawsuits asserting claims under the Securities Act of 1933 (''Securities Act''). Last week's much-anticipated decision by the United States Supreme Court in *Cyan, Inc. v. Beaver County Employees Retirement Fund*, 583 U.S. ___ (2018), has now cleared the path for even more state court litigation of Securities Act claims.

In *Cyan*, issued on March 20, 2018, the Supreme Court unanimously held that state courts have concurrent subject matter jurisdiction over class actions that exclusively allege claims under the Securities Act, and such claims cannot be removed to federal court. The decision will undoubtedly continue the trend of Securities Act claims being filed in state court—where plaintiffs may avoid the more stringent procedural requirements applicable in federal district court—and will likely accelerate filings in state courts in New York and other jurisdictions that previously refused to exercise subject matter jurisdiction over such claims.

Background

From 2010 through 2017, plaintiffs filed a significant number of Securities Act class actions in state courts across California, Massachusetts, and other jurisdictions (including 55 actions in California alone) in an attempt to circumvent the federal procedural requirements of the Private Securities Litigation Reform Act (''PSLRA'') including, in particular, the automatic stay of discovery before a motion to dismiss is decided and the requirement that claims be prosecuted by the most appropriate shareholder interested in doing so (typically, the shareholder with the largest holdings). *See* Cornerstone Research, Securities Class Action Filings 2017 Year in Review (''2017 Year in Review'') at 8, 18, available at: https://www.cornerstone.com/Publications/Reports/Securities-Class-Action-Filings-2017-YIR; *see also* Pub. L. No. 104-67, 109 Stat. 737 (1995). Plaintiffs' ability to bring these suits in state court related to an issue that was hotly contested prior to *Cyan*: whether plaintiffs' ability to bring federal Securities Act claims in state courts had been curtailed by the Securities Litigation Uniform Standards Act (''SLUSA''). *See* Pub. L. No. 105–353, 112 Stat. 3227 (1998).

The Securities Act generally provides that actions can be filed in either state or federal court, and actions filed in state court cannot be removed. 15 U.S.C. § 77v(a). As part of a series of reforms designed to curb frivolous lawsuits and prevent forum shopping, Congress in 1998 passed SLUSA, which amended the Securities Act to bar securities class actions based on state law and to permit removal of ''covered class actions'' (*i.e.*, those involving 50 or more class members) to federal court. *Id.* Since the passage of SLUSA, dozens of federal district courts split on whether SLUSA eliminated state courts' concurrent jurisdiction over Securities Act class actions. For example, district courts in California and Massachusetts found that state courts continue to possess jurisdiction over Securities Act claims after SLUSA, while district courts in New York, New Jersey, and other jurisdictions reached the opposite conclusion. *See* Petition for Writ of Certiorari (''Petition'') at 11-12, Appendices F & G (collecting cases).

Procedural History

The *Cyan* petition arose from a class action lawsuit filed in California Superior Court on behalf of purchasers of Cyan's IPO stock. The complaint alleged claims solely under Sections 11, 12(a)(2), and 15 of the Securities Act. Defendants moved for judgment on the pleadings for lack of subject matter jurisdiction, arguing that SLUSA amended the Securities Act to withdraw state court jurisdiction over class actions alleging only Securities Act claims. The trial court denied the motion and defendants' appeals were also denied. Petition at 1-2, 10.

In May 2016, defendants filed a petition for writ of certiorari with the United States Supreme Court arguing, among other things, that the California courts' interpretation of SLUSA is contrary to the Congressional

 ISSN 0037-0665

intent behind the PSLRA and SLUSA. *Id*. at 1, 2. After the petition was fully briefed, the Acting United States Solicitor General filed an amicus curiae brief in May 2017 supporting the grant of the petition, but arguing for an interpretation of SLUSA different from Cyan—that SLUSA does not divest state courts of jurisdiction over Securities Act class actions, but rather allows such actions to be removed to federal court. Brief for the United States as Amicus Curiae at 6.

The Supreme Court's Decision

In a unanimous decision, the Supreme Court affirmed the denial of Cyan's motion to dismiss, finding that state and federal courts possess concurrent jurisdiction over Securities Act claims, and that such claims are not removable to federal court. The decision hinged on what the Court called the ''clear statutory language'' of SLUSA. 583 U.S. ___ (2018) at 7. In particular, the Court focused on the interaction between two sections of SLUSA: § § 77v(a) and 77p. *Id*. at 5. Section 77v(a) allows for concurrent state and federal jurisdiction, providing that ''[t]he district courts of the United States . . . 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 this subchapter.'' *Id*. (emphasis in original). Thus, § 77p limits state courts' ability to exercise jurisdiction over ''covered class actions.'' *Id*. at 8.

Cyan, based on the legislative history and purpose of SLUSA, argued that § 77v(a)'s reference to § 77p was meant to exclude all ''covered class actions''—regardless of whether they were based on state or federal law—from state court jurisdiction. *Id*. at 6. The Court disagreed, finding that § 77p ''altogether prohibits certain securities class actions based on *state law*...[and] authorizes removal of those suits so a federal court can dismiss them'' but that ''the section says nothing, and so does nothing, to deprive state courts of jurisdiction over class actions based on *federal* law.'' *Id*. at 3, 8 (emphasis in original). The Court found the legislative intent behind SLUSA to be equally clear, reasoning: ''[i]f Congress had wanted to deprive state courts of jurisdiction over 1933 Act class actions, it had an easy way to do so: just insert into § 77p an exclusive federal jurisdiction provision (like the 1934 Act's) for such suits.'' *Id*. at 10. It did not. Thus, the *Cyan* court found that state courts continue to have jurisdiction over suits brought under the Securities Act.

The *Cyan* decision also rejected the Solicitor General's position, that even if SLUSA does not deprive state courts of jurisdiction over Securities Act claims, it allows the removal of such claims to federal court. *See id*. at 18-19. The Court found that removal is unsupported by the ''most natural[]'' reading of the statute, which limits removal to covered class actions arising under state law; claims arising under federal law remain subject to the Securities Act's removal ban. *Id*. at 19.

Ramifications

The Court's decision is likely to result in an increase in Securities Act claims, including IPO-related litigation like *Cyan*, brought in state courts. For example, in California, after two years of an increased number of Securities Act claims brought in state court, there was a drop off in 2017, coinciding with the Court's decision to hear *Cyan*. *See* 2017 Year in Review at 8, 18. With *Cyan*, that trend is likely to reverse and lead to increased filings in state courts.

While there certainly will continue to be a significant number of Securities Act cases filed in California, it is likely state courts that previously declined jurisdiction over Securities Act claims—including New York and New Jersey—will now see a marked increase in claims under the Securities Act. This will present significant challenges to public companies, officers, directors, underwriters, and others involved in public securities offerings.

Many state courts do not possess the expertise or familiarity with the Securities Act that their federal counterparts do. This could make it more difficult for defendants to dispose of non-meritorious claims without expending significant resources.

Defendants will be forced to continue to defend claims that may not be subject to the procedural protections of the PSLRA. For example, without the benefit of the PSLRA's automatic stay of discovery pending the resolution of motions to dismiss, defendants could find themselves forced into costly discovery before there has been any initial judicial assessment of the merits of a case. Similarly, in the absence of the PSLRA's lead plaintiff and consolidation process—which protects defendants against duplicative lawsuits—defendants run the risk of having to defend against duplicative lawsuits across both federal and state jurisdictions. Although most state courts offer procedural mechanisms that could be employed to achieve some of the protections of the PSLRA (*e.g.*, discovery stays and consolidation processes), these are largely discretionary and do not provide the automatic protections and certainty offered by the PSLRA. From a purely practical perspective, defendants will find themselves expending significant resources at an earlier stage of litigation, whether it is in discovery or in procedural jousting over consolidation, venue, and the like.

Finally, there is a very real risk that increased uncertainty over Securities Act litigation, especially over IPOs, will lead to an increase in applicable insurance premiums.

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  SRLR ISSN 0037-0665

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