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U.S. SUPREME COURT: NOTWITHSTANDING SLUSA, STATE COURTS RETAIN CONCURRENT JURISDICTION FOR SECURITIES ACT OF 1933 CLAIMS

In a unanimous March 20, 2018 opinion written by Justice Elena Kagan, the U.S. Supreme Court held that state courts retain concurrent jurisdiction over class action lawsuits alleging only violations of the Securities Act of 1933's ('33 Act) liability provisions, and that these state court class action lawsuits are not removable to federal court. The court's holding resolves a lower court split on the question of whether the Securities Litigation Uniform Standards Act of 1998 (SLUSA) eliminated concurrent state court jurisdiction for these '33 Act class action lawsuits or made the state court '33 Act lawsuits removable to federal court.

As discussed below, the Court's ruling is likely to result in an increase in '33 Act claims in state court, a development that could have unwelcome consequences for corporate defendants and their D&O insurers.

LEGAL BACKGROUND

In 1995, Congress passed the Private Securities Litigation Reform Act (PSLRA), which enacted a number of procedural reforms pertaining to securities class action litigation. In an effort to circumvent the PSLRA's procedural requirements, a number of plaintiffs' lawyers tried to file their clients' lawsuits in state court, often under state law. In 1998, in order to ensure that securities lawsuits remained in federal court and subject to the PSLRA's requirements, Congress passed SLUSA to preempt the state court jurisdiction and to require the "covered" class actions to go forward in federal court.

Even after the enactment of SLUSA, unanswered questions remained with respect to liability actions under the '33 Act. Section 22(a) of the Securities Act of 1933 provides for concurrent state court jurisdiction for civil actions alleging violations of the '33 Act's liability provisions. Section 22(a) further specifies that when an action is brought in state court alleging a '33 Act violation, the case shall not be removed to federal court.

One question, in particular, was whether the provisions of SLUSA, requiring "covered class actions" to be litigated in federal court, pre-empts the concurrent state court jurisdiction provisions in the '33 Act. The various courts that have addressed the question have reached conflicting conclusions.

BACKGROUND REGARDING THE CYAN LAWSUIT

Cyan completed its initial public offering (IPO) in May 2013. Shortly after the IPO, a securities class action lawsuit was filed against Cyan in state court in California. The state court lawsuit alleged violations of the '33 Act. Rather than seeking to remove the lawsuit to federal court, Cyan filed a motion for judgment on the pleadings, in which the company argued that in light of SLUSA, the state court lacked subject matter jurisdiction. The California trial court denied the company's motion. The state's intermediate appellate court denied the company's writ of mandate and/or prohibition. Cyan then sought to pursue a petition of review to the California Supreme Court, which was

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also denied. Cyan then filed a petition for writ of certiorari to the U.S. Supreme Court, which the Court granted.

In its Supreme Court briefs, Cyan argued that SLUSA deprived state courts of concurrent jurisdiction over class actions brought under the '33 Act. For their part, the plaintiffs argued that state courts retain their concurrent jurisdiction over '33 Act liability suits and that SLUSA sought only to eliminate state court litigation under state law, not to eliminate the long-standing state court concurrent jurisdiction over '33 Act suits. The U.S. government, which filed an amicus brief at the court's request, argued a different position, contending that SLUSA had not eliminated concurrent state court jurisdiction for state court lawsuits, but had instead made such cases removable to federal court.

THE MARCH 20, 2018 OPINION

In its unanimous March 20, 2018 opinion, the U.S. Supreme Court affirmed the judgment of the lower court, holding that "SLUSA did nothing to strip state courts of their longstanding jurisdiction to adjudicate class actions alleging only 1933 Act violations," adding that "neither did SLUSA authorize removing such suits from state court to federal court."

In reaching the conclusion about state court jurisdiction, the Court said "SLUSA's text, read more straightforwardly, leaves this jurisdiction intact."

Cyan argued that SLUSA's purpose, as shown by the legislative history, was to eliminate the pursuit of securities claims in state court.

The Court declined to revise its reading of the statute itself based on consideration of the legislative history, saying "We do not know why Congress declined to require…that 1933 Act class actions be brought in federal court; perhaps it was because of the long and unusually pronounced tradition of according authority of state courts over 1933 Act litigation. But in any event, we will not revise that legislative choice, by reading [the relevant statutory language] in a most improbable way." The Court added that "even if Congress could or should have done more, still it wrote the statute it wrote – meaning, a statute going so far and no further."

DISCUSSION

The practical effect of the U.S. Supreme Court's decision is, according to the Skadden law firm's March 20, 2018 memo about the decision, that "state courts are now viable forums for plaintiffs asserting class action claims under the 1933 Act." The decision, the memo adds, is "likely to result in an increase in 1933 Act claims brought in state courts."

From the perspective of corporate defendants, there are a number of seriously negative implications from this outcome. For instance, it means that defendants could face the prospect of having to litigate '33 Act class action securities claims in multiple jurisdictions – including facing suits in both state and federal court, or even facing suits in multiple state courts. In its most recent annual report on securities class action lawsuit filings, Cornerstone Research specifically noted that of the state court '33 Act class action lawsuits filed in California state court in 2017 (where these kinds of suits have proliferated in recent years), all of them involved parallel federal court lawsuits – so the defendants' risk of facing multi-forum securities class action litigation clearly is for real.

The prospect of having to defend state court '33 Act class action lawsuits presents a related negative consequence, which is, as the Court itself noted in the Cyan opinion, that many of the PSLRA's procedural protections are available only to defendants in federal court securities class action lawsuits. Congress enacted these protections in the PSLRA precisely because it viewed the risk and reality of securities lawsuits as a significant problem for many corporations; yet the practical outcome of the Court's holding in Cyan is that many of those protections will not be available for litigants now forced to defend themselves in state court class action litigation under the '33 Act.

Another potential problem for defendants is that the state courts are unfamiliar with the nuances of lawsuits based on federal

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securities laws. Among other things, defendants could have a more difficult time extricating themselves from unmeritorious claims. The Cornerstone Research report details that '33 Act claims filed in California state court in recent years were dismissed at a lower rate than are '33 Act claims in federal court.

With respect to currently pending cases, the Court's decision in Cyan may present an interesting conundrum. Many of the '33 Act securities class action lawsuits filed in state courts in recent years were removed to federal court, where they are now pending. Can the plaintiffs in these removed proceedings, armed with the U.S. Supreme Court's Cyan decision, now seek to have these cases remanded back to state court? We suspect that there are going to be a number of cases in which the plaintiffs now try to have the cases remanded. This could prove chaotic in cases that have been proceeding for some time in federal court. (To be sure, any plaintiff trying to raise this argument would likely face the defendants' contention that legal questions about whether or not the case was properly removed are properly heard on appeal, after the entry of judgment at the district court level, along with any other legal issues appealed.)

We are surprised by the Court's decision in this case — not based on careful analysis of the relevant statutory language on which the Court relied, but rather on a more common sense notion that the whole reason Congress enacted SLUSA was to prevent plaintiffs from circumventing the PSLRA by filing securities class action lawsuits in state court. It would be quite an anomaly if it were to be held that Congress required state law securities lawsuits to be filed in federal court, but at the same time continued to permit federal law securities lawsuits (at least those under the '33 Act) to continue to be filed in state court. Yet, as it turns out, that is exactly what the Court held here – and further, the Court expressly addressed the questions raised by SLUSA's purposes, basically saying that the Court was not going to challenge the statutory language based on conjecture about what Congress might have intended.

Regardless of whether SLUSA's purposes and legislative history were in the end relevant to the Court's analysis in this case, SLUSA's purposes and legislative history remain relevant to consideration of where we are now.

As the Cyan court expressly recognized, the whole point of SLUSA was to prevent plaintiffs from making an end run around the PSLRA's procedural protections, yet the outcome of Cyan is that at least plaintiffs filing '33 Act claims can indeed circumvent the PSRLA by filing their lawsuit in state court. This outcome may simply be the result of the poor job that Congress did in conforming the '33 Act jurisdiction provisions to SLUSA.

We are of the opinion that Congress intended SLUSA to require all securities class action lawsuits to be filed in federal court, in order to eliminate the circumvention of the PSLRA's procedural requirements and protections. Congress did not intend that litigants could, notwithstanding SLUSA and its purposes, continue to file '33 Act claims in state court and thereby circumvent the requirements of the PSLRA. The outcome of the Cyan case is the anomalous result of poor statutory drafting. We are hopeful that Congress acts quickly to resolve this issue.

Companies may try to adopt their own remedial measures. For example, a March 20, 2018 Wall Street Journal article about the Cyan decision quotes Stanford Law Professor Joseph Grundfest as saying that this decision may encourage companies to adopt corporate bylaws designating federal court as the exclusive forum for shareholder suits. (This idea, while interesting, raises the complicated question of whether a bylaw can eliminate a Congressional grant of jurisdiction.) The Court's ruling in Cyan could also provide added fuel to the idea circulating in certain circles that companies should be able to adopt corporate bylaws requiring shareholder disputes to be arbitrated.

In any event, the Cyan decision has potentially serious implications for D&O insurers and the way they price IPO companies. IPO companies in California were already paying

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relatively higher D&O insurance premiums, compared to IPO companies based in other jurisdictions, because of the increased risk of securities litigation in state court. As a result of the Supreme Court's decision in Cyan, IPO companies in every state now face this heightened risk. This clearly could affect D&O pricing for all IPO companies, regardless of where they are located. These same concerns could apply to companies renewing their premiums in the early years after their IPOs, as well. This same line of analysis could also apply to companies conducting follow on offerings.

We will continue to monitor developments surrounding this Supreme Court ruling,

ABOUT THE AUTHOR

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