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Phone: +1 646 783 7100 | Fax: +1 646 783 7161 | customerservice@law360.com

High Court Takes Up Forum Shopping In Securities Cases

By **Jordan Eth, Joel Haims, Mark Foster, James Beha and Robert Cortez Webb**

Law360, New York (July 6, 2017, 6:08 PM EDT) -- Recent years have seen significant growth in the number of Securities Act class actions filed in California state courts based on conflicting readings of the Securities Litigation Uniform Standards Act. On June 27, 2017, the U.S. Supreme Court granted a petition for a writ of certiorari in Cyan Inc. v. Beaver County Employees Retirement Fund to consider whether state courts have jurisdiction to hear Securities Act class actions under the SLUSA. While many federal courts have found that the SLUSA stripped state courts of jurisdiction over Securities Act class actions, others, most notably in the Ninth Circuit, have continued to find concurrent federal and state jurisdiction over Securities Act class actions. The result has been a rising tide of duplicative initial public offering (IPO) litigation in California state courts. The Supreme Court's decision in this case may put an end to this duplicative litigation, assuring corporate issuers and underwriters that they need only defend against Securities Act class actions in a single federal court, under federal pleading standards and procedural rules.

Background

The Securities Act of 1933 provides a right of action against issuers, directors and underwriters for materially false or misleading statements in registration statements or prospectuses.[1] As enacted, the Securities Act provided concurrent jurisdiction over Securities Act claims in both state and federal courts and provided that no Securities Act suit filed in state court could be removed to federal court.[2]

In 1995, Congress passed the Private Securities Litigation Reform Act of 1995 (the "Reform Act") to curb abusive private securities lawsuits.[3] The Reform Act sought to curb those abuses by imposing stringent pleading requirements on private securities class actions in federal court.[4]

Plaintiffs seeking to avoid these reforms and bring securities claims in more favorable state court jurisdictions responded both by asserting securities claims under state, rather than federal, law and by bringing Securities Act class actions in state court, rather than federal court, under the Securities Act's concurrent jurisdiction provision.[5]

To close these loopholes, Congress enacted the SLUSA in 1998.[6] Among other changes, the SLUSA eliminated concurrent state court jurisdiction over "covered class actions."[7]

Conflicting Interpretations of SLUSA Lead to a Proliferation of Parallel State and Federal Court Securities Class Actions

From the SLUSA's enactment through 2012, few Securities Act class actions were filed in state courts. Those few cases that were filed were frequently removed to — and subsequently litigated in — federal courts.[8] In a small number of cases, however, federal courts granted motions to remand cases back to state courts, finding that the SLUSA applied only to state securities law class actions and did not alter the Securities Act's concurrent jurisdiction provision.[9]

Federal courts across the country were divided on the question of whether the SLUSA stripped state courts of concurrent jurisdiction over Securities Act class actions. Many of the courts that found concurrent jurisdiction survived — and, as a result, remanded Securities Act class actions to be litigated in state courts — were in the Ninth Circuit. [10] As a result, duplicative state court Securities Act class actions have proliferated in Ninth Circuit states, particularly in California state courts.[11]

Many of those suits have been filed despite having little connection to California. Thus, corporate defendants throughout the country have been faced with Securities Act class actions both in the federal courts where they are based (or the Southern District of New York) and in California state court. In addition to the inherent inefficiency of duplicative litigation, this has led to conflicting rulings, including cases where Securities Act claims have been dismissed in federal court but permitted to proceed in state court.

While many have recognized the split of authority on this important question, because of the particular procedural posture in which in the issue typically arises — a motion to remand a case removed from state court to federal court — the proper interpretation of the SLUSA's jurisdictional provision had not been subject to appellate review in federal courts until the Supreme Court granted cert in Cyan.

The Cyan Litigation

Cyan Inc. was sued in California state court in 2014, approximately a year after the company's May 2013 IPO. Cyan moved for judgment on the pleadings, arguing that, under SLUSA, the court lacked subject matter jurisdiction. The trial court denied Cyan's motion, and Cyan petitioned the California Court of Appeal for a writ of mandate. The Court of Appeal — and then the California Supreme Court — denied Cyan's petition.

In May 2016, Cyan petitioned the United States Supreme Court for a writ of certiorari. Cyan argued that review was appropriate despite a lack of conflicting appellate authority because the issue of state court subject matter jurisdiction over Securities Act class actions has divided lower courts and evades appellate review. Following full briefing, the Supreme Court invited the solicitor general to file a brief as to whether the petition should be granted.[12] On May 23, 2017, the solicitor general filed a brief, recommending that the Supreme Court grant certiorari based on "the frequency with which this issue arises, the ongoing confusion in the lower courts, and the obstacles to appellate resolution of the question presented."[13] On the final day of the 2016 term, the court granted certiorari and agreed to hear the case.[14]

What's Next?

The case will be briefed over the summer and should be argued by the end of 2017, and the Supreme Court should issue a decision by the end of the 2017 term in June 2018.

The court's decision to grant review in Cyan is consistent with a recent trend of jurisdictional decisions

addressed at perceived forum shopping by plaintiffs, particularly by bringing cases in state court jurisdictions perceived as favorable to plaintiffs. For example, in TC Heartland LLC v. Kraft Food Brands Group LLC, a unanimous court reversed the Federal Circuit's interpretation of patent venue and held that a patent defendant may only be sued in its state of incorporation or where it has committed acts of infringement and has a "regular and established place of business."[15] And in Bristol-Myers Squibb Co. v. Superior Court of California, the court rejected, by an 8-1 majority, the California Supreme Court's "sliding scale" approach to specific jurisdiction.[16]

Given the uncertainty that Supreme Court review in Cyan raises about the continued viability of Securities Act class actions in state courts, defendants facing securities class actions in state courts may have an opportunity to slow or stay those cases pending a ruling by the court.

Jordan Eth, based in San Francisco, and Joel C. Haims, based in New York, are partners at Morrison & Foerster LLP and co-chairmen of the firm's securities litigation, enforcement and white collar criminal defense group. Mark R.S. Foster is a partner in Morrison & Foerster's San Francisco office. James Beha II is a partner in the firm's New York office. Robert L. Cortez Webb is an associate in San Francisco.

[1] See 15 U.S.C. §§ 77 k and 77 l.

[2] 15 U.S.C. § 77v(a).

[3] See Merrill Lynch Pierce Fenner & Smith Inc. v. Dabit, 547 U.S. 71, 81-82 (2006).

[4] See, e.g., 15 U.S.C. § 77z-1.

[5] See S. Rep. No. 105-182, at 3 (1998); see also H.R. Conf. Rep. No. 105-803, at 14-15 (1998) ("[S]ince passage of the Reform Act, plaintiffs' lawyers have sought to circumvent the [Reform Act's] provisions by exploiting differences between Federal and State laws by filing frivolous and speculative lawsuits in State court, where essentially none of the Reform Act's procedural or substantive protections against abusive suits are available.") H.R. Rep. No. 105-640, at 10-11 (1998) ("[T]he migration to State court was fueled by a desire to circumvent the more stringent requirements of the heightened pleading standard adopted under the Reform Act.").

[6] 15 U.S.C. § 77v(a) (1998). As the House Conference Report stated, "[SLUSA] makes Federal court the exclusive venue for most securities class action lawsuits. 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. Conf. Rep. No. 105-803, at 13 (1998); H.R. Rep. No. 105-640, at 8-9 (1998); id. at 9 (1998) ("Under [SLUSA], 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).").

[7] 15 U.S.C. § 77p(f) defines a "covered class action" as any single lawsuit in which damages are sought on behalf of 50 persons or prospective class members.

[8] See, e.g., Knox v. Agria Corp., 613 F. Supp. 2d 419, 425 (S.D.N.Y. 2009).

[9] See, e.g., W. Va. Laborers Trust Fund v. STEC Inc., No. 11-01171-JVS (MLGx), 2011 WL 6156945 (C.D. Cal. Oct. 7, 2011).

[10] See, e.g., Elec. Workers Local 357 Pension and Health & Welfare Tr. v. Clovis Oncology Inc., 185 F. Supp. 3d 1172 (2016). Outside the Ninth Circuit, federal district courts are split on this issue. In 2016, federal district courts in New York, Delaware and Tennessee denied motions to remand Section 11 class actions to state courts, finding that the SLUSA divested state courts of concurrent jurisdiction for securities class actions. See, e.g., Hung v. iDreamsky Tech. Ltd., No. 15-CV-2514 (JPO), 2016 WL 299034, at *2 (S.D.N.Y. Jan. 25, 2016); Iron Workers Dist. Council of New England Pension Fund v. MoneyGram Int'l Inc., No. 15-402-LPS, 2016 WL 4585975 (D. Del. Sept. 2, 2016); Gaynor v. Miller et al., Case No. 3:15-cv-545-TAV-CCS, 2016 WL 6078340 (E.D. Tenn. Sept. 8, 2016).

[11] In 2013, one Securities Act class action was filed in California state court. That number expanded to five new filings in 2014, 15 in 2015, and 18 in 2016. Cornerstone Research, Securities Class Action Filings, 2016 Year in Review, at 16, https://www.cornerstone.com/Publications/Reports/Securities-Class-Action-Filings-2016-YIR. Notably, San Mateo County, situated between San Francisco and San Jose, and with a population of under 800,000, has become the epicenter of IPO litigation. In 2014, 20 percent of the California state court Securities Act class actions were filed in San Mateo Superior Court. In 2015, that share increased to 50 percent, and in 2016 to 78 percent. Id.

[12] Oct. 3, 2016 Order List.

[13] Cyan Inc. v. Beaver Cnty Emps. Ret. Fund, No. 15-1439, Brief for the United States as Amicus Curiae at 19, May 23, 2017.

[14] June 27, 2017 Order List.

[15] TC Heartland LLC v. Kraft Food Brands Group LLC, 137 S. Ct. 1514, 1516-1517 (2017).

[16] Bristol-Myers Squibb Co. v. Superior Court of California, 137 S. Ct. 1773 (2017).
