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Eliminate state jurisdiction over federal securities class actions

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Cyan v. Beaver County Employees Retirement Fund
Oral argument: TBD

Congress acted to eliminate state court jurisdiction over securities class actions.

On the last day of the October 2016 term, the U.S. Supreme Court granted certiorari in *Cyan v. Beaver County Employees Retirement Fund* to resolve an issue that has split the federal district courts. In *Cyan*, the court will decide whether the 1998 amendments to the Securities Act of 1933 eliminated state court jurisdiction over class actions arising exclusively under federal law, and regarding securities traded on national exchanges. (The court may also address whether, notwithstanding concurrent jurisdiction, covered class actions may be removed to federal court. In his brief in support of granting certiorari, the U.S. solicitor general argued that such cases may be removed to federal court where they will be subject to uniform federal standards. The parties did not raise this issue below.)

Cyan, which arises in the unusual context of an interlocutory order of a California state trial court, may — and should — end the recent California gold rush for securities class action plaintiffs.

The Securities Act prohibits false or misleading statements in connection with securities offerings, and is frequently invoked whenever a company's stock trades below its IPO price in its first three years as a public company. As enacted in 1933, the Securities Act provided for concurrent state and federal court jurisdiction. In 1995, Congress overrode a presidential veto and enacted the Private Securities Litigation Reform Act in response to widespread abuses by the plaintiffs' securities class action bar. *See Merrill Lynch, Pierce, Fenner & Smith, Inc. v. Dabit*, 547 U.S. 71 (2006). The Reform Act provided for, among other things, orderly rules for the resolution of securities class actions, a mandatory stay of discovery pending resolution of challenges to pleadings, and procedures to ensure that plaintiffs — and not their lawyers — controlled the litigation. But the Reform Act had an unintended consequence: Enterprising attorneys began shifting litigation from federal courts to state courts to evade the protections enacted by Congress.

In 1998, Congress sought to end this end-run around the Reform Act by enacting the Securities Litigation Uniform Standards Act. Congress stated the purposes of SLUSA in the statutory text as a preamble. Among these stated purposes was the need to stem the shift "from Federal to State courts" of "securities class action lawsuits." Congress found that this shift was preventing the Reform Act "from fully achieving its objectives."

Statements of individual legislators on both sides of the aisle made this purpose even more clear. Rep. Thomas J. Bliley Jr., R-Va., said, "[t] he premise of this legislation is simple: lawsuits alleging violations that involve securities that are offered nationally belong to Federal Court." Rep. Zoe Lofgren, D-Calif., said SLUSA would, "finally slam the door on strike suits by establishing Federal court as the exclusive venue for securities class actions." Sen. Dianne Feinstein, D-Calif., said SLUSA provided for "the shifting of securities lawsuits filed in state court into the more appropriate federal court." And Sen. Phil Gramm, R-Texas, said "[w]hat our bill does is very simply this. It sets national standards for stocks that are traded on the national markets. What it says is that in the case of class-action suits, and class-action suits only, if a stock is traded on the national market, if it is a national stock, then the class-action suit has to be filed in Federal court."

Congress sought to accomplish this purpose in two ways. First, SLUSA preempts and provides for the removal of securities class actions brought under state law. Second, SLUSA amended the jurisdictional provision of the Securities Act to carve out state court jurisdiction over covered class actions. As amended by SLUSA, the jurisdictional grant of the Securities Act now reads, in relevant part, "The district courts of the United States … shall have jurisdiction of offenses and violations under this subchapter … concurrent with State and Territorial courts, *except as provided in section 77(p) 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." In arguing that concurrent state court jurisdiction survived SLUSA, plaintiffs frequently argue that this italicized language refers to actions brought under *state* law. Of course, actions brought under state law do not arise under "this subchapter," i.e., the Securities Act. Thus, the text of the SLUSA amendment must be read to eliminate state court subject matter jurisdiction over Securities Act class actions.

However, due to conflicting interpretations of SLUSA by lower courts — and procedural quirks that largely prevent appellate review on this issue — SLUSA's goals have recently been subverted. Despite the language, history and intent of SLUSA, since 2012 numerous California federal district courts, as well as the California Court of Appeal, have held that state courts retain jurisdiction over some class actions arising under the Securities Act. *See Luther v. Countrywide*, 195 Cal. App. 4th 789 (2011); *Elec. Workers Local #357 Pension &*

Class actions exclusively under federal law

Health & Welfare Trusts v. Clovis Oncology, Inc., 185 F. Supp. 3d 1172 (N.D. Cal. 2016) (collecting cases finding state court subject matter jurisdiction).

Meanwhile, other federal district courts have held that the 1998 amendments stripped state courts of jurisdiction over these actions. *See, e.g., Hung v. iDreamsky Tech. Ltd.*, 15-CV-2514 (JPO), 2016 WL 299034 (S.D.N.Y. Jan. 25, 2016) (collecting cases finding no state court subject matter jurisdiction); *Gaynor v. Miller*, 205 F. Supp. 3d 935, 945 (E.D. Tenn. 2016) (same).

The consequences of these decisions are unsurprising. Securities plaintiffs have rushed to California state courts, taking advantage of early (and generous) discovery, practically non-existent dismissal rates, and procedural rules that are perceived as more favorable to plaintiffs than the corresponding federal rules. These differences between state and federal courts become clear when parallel actions proceed in both state and federal courts. And since 2011, at least 23 companies have faced parallel or overlapping securities class actions simultaneously in California state courts and federal courts. These parallel suits are inefficient, increase costs and create a risk of inconsistent rulings.

Notably, this rush to California state courts has affected companies and individuals with little connection to the state. For example, Xbiotech Inc. is headquartered in Austin, Texas; NRG Yield in Princeton, New Jersey; ProNAi Therapeutics in Vancouver, Canada; Terraform Global in Maryland; and Alibaba Group Holdings Ltd. in Hangzhou, China. All of these issuers have been sued in California state courts.

The history, purpose and text of the SLUSA amendments to the Securities Act all agree — Congress acted to eliminate state court jurisdiction over securities class actions. The Supreme Court should act quickly to give force to this legislation and end the conflicting rulings, multiplicity of litigation, and unwarranted settlement pressure that recent California state and federal decisions have reintroduced in California securities class actions.

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