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Supreme Court Allows Securities Act Class Actions to Remain in State Court

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Last Tuesday, the Supreme Court issued its opinion in ***Cyan Inc. v. Beaver County Employees Retirement Fund***. The opinion by Justice Elena Kagan for a unanimous court answered two questions: Did the Securities Litigation Uniform Standards Act of 1998 eliminate state court jurisdiction over class actions pursuing claims under the Securities Act of 1933, and, even if not, under SLUSA, can defendants remove these state court actions to federal court? SCOTUS said no in both cases: "SLUSA did nothing to strip state courts of their longstanding jurisdiction to adjudicate class actions alleging only 1933 Act violations. Neither did SLUSA authorize removing such suits from state to federal court."

Background

The Private Securities Litigation Reform Act, adopted in 1995 to stem perceived abuses of class actions, imposed a number of requirements in connection with class actions under the federal securities laws, such as heightened pleading standards and selection criteria for lead plaintiffs. To circumvent those requirements, many plaintiffs instead began to bring their class actions in the state courts. That shift to the state courts led to the adoption, in 1998, of the Securities Litigation Uniform Standards Act. Congress enacted SLUSA 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."

Nevertheless, even after SLUSA, some courts (such as the state courts and federal district courts in California) continued to permit plaintiffs to file class actions seeking relief under the Securities Act in state court. Generally relying on SLUSA's text, those courts concluded that irrespective of SLUSA's intent, its language simply did not prevent plaintiffs from litigating Securities Act class actions in state court. In response to these decisions, the number of Securities Act class actions filed in state court exploded. Before 2011, Securities Act class actions were filed in California at a rate of one case every two years. In 2014, five cases were filed in California state court. That number increased to 14 in 2015, and to 18 in 2016.

This case was one of those class actions. Cyan moved to dismiss the case, arguing that SLUSA had stripped the California state court of subject matter jurisdiction. The California courts disagreed, and the case eventually made its way to the Supreme Court, where Cyan again argued that the state court lacked jurisdiction to hear the case.

The other issue before the Court was raised by the Federal Government in an *amicus* brief. The Government took the position that, while SLUSA did not divest the state court of jurisdiction over a Securities Act case, it did authorize *removal* of a Securities Act case. The Government argued that its interpretation would also promote Congress's intent by ensuring that securities class actions were litigated in federal court.

The decision

The Supreme Court relied heavily on the statutory text and rejected both arguments. Ultimately, the Court concluded that the "recalcitrant statutory language" could not be used to strip state courts of jurisdiction over Securities Act claims or permit those claims to be removed to federal court. According to Justice Kagan, the "statute says what it says – or perhaps better put here,

does not say what it does not say." The Court could not "disregard clear language based on an intuition that 'Congress must have intended something broader.'"

The Court also rejected Cyan's reliance on SLUSA's purposes. According to Cyan, Congress intended that SLUSA would "make good" on the promises of the PSLRA, which included a number of procedural protections that apply only in federal court. To promote that purpose, *all* covered class actions, including Securities Act claims, had to be litigated in federal court. The Court, however, relied on SLUSA's other goals to reject that contention. It held that Congress also intended for SLUSA to protect the heightened substantive standards of the PSLRA and ensure that all class actions pursuing claims under the Securities Exchange Act of 1934 would be filed in federal court. Because there is no question that SLUSA accomplished both of those goals, the Court believed that SLUSA had "largely accomplished" its purposes even if it did not adopt Cyan's position. The Court did "not generally expect statutes to fulfill 100% of all of their goals."

Implications

California's experience suggests that, as a result of *Cyan*, plaintiffs in other jurisdictions will be much more likely to file Securities Act class actions in state court. After *Cyan*, to avoid state court litigation of Securities Act claims, some companies may look to adopt "exclusive forum" bylaw provisions that designate the federal courts as the exclusive forum for litigation under the Securities Act. Delaware law expressly permits the adoption of bylaws that designate Delaware as the exclusive forum for adjudicating "internal corporate claims," such as derivative claims, arising under the Delaware General Corporation Law and claims of breach of fiduciary duty by current or former directors or officers or controlling stockholders of the corporation, or persons who aid and abet those breaches. However, federal securities class actions are not expressly included. The enforceability of "exclusive federal forum" bylaw provisions is currently being challenged in the Delaware courts in a case, *Sciabacucchi v. Salzberg et al.*, where the plaintiff is seeking a declaratory judgment to invalidate the exclusive federal forum bylaw provisions included in the Delaware Certificates of Incorporation of three companies. After Cyan, that Delaware case now takes on much greater significance.

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