Cooley

Supreme Court to Decide If State Courts Have Jurisdiction to Hear IPO Litigation

June 27, 2017

Today the Supreme Court granted a writ of certiorari in *Cyan, Inc. v. Beaver County Employees Retirement Fund*, Case No. 15-1439 (Cyan), to decide whether state courts have subject matter jurisdiction over class actions alleging federal claims under the Securities Act of 1933 (Securities Act). In particular, Section 11 of the Securities Act provides that an issuer and its board, amongst others, may be held liable if the company's registration statement contains "an untrue statement of a material fact or omitted to state a material fact required to be stated therein or necessary to make the statements therein not misleading." 15 U.S.C. § 77k(a). Section 11 class actions are often brought anytime a new public company's stock price falls below its IPO price. Cooley represented a group of the nation's leading securities law professors, who recommended that the Supreme Court grant the writ of certiorari.

Background

In recent years, state court litigation of claims under Section 11 of the Securities Act has exploded, particularly in California. 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. The number increased to 14 in 2015, and in the first five months of 2016 (when the petition was filed), there had already been 10 cases filed. The influx of cases is due at least in part to California district courts determining that state courts have jurisdiction over Securities Act class actions and that these cases are not removable under the Securities Litigation Uniform Standards Act (SLUSA). These decisions stand in stark contrast to the decisions by New York district courts and various other courts, which generally find that state courts lack jurisdiction over Securities Act class actions. The result of this split is that SLUSA, which was meant to provide uniformity in the treatment of securities class actions, has had the perverse result of Section 11 cases in New York and elsewhere being litigated in federal court and cases in California being litigated in state court. This district court split has serious legal and economic implications for securities litigation defendants.

The Litigation History

In June 2014, Cyan investors filed suit in California state court under Section 11 of the Securities Act, alleging that the company's stock price fell as a result of an inaccurate and misleading registration statement, filed in connection with the company's IPO, that failed to disclose anticipated issues related with Cyan's revenue stream. Cyan moved to dismiss the case in August 2015 on grounds that SLUSA divested state court jurisdiction over Securities Act class actions. The trial court denied Cyan's motion to dismiss, and the California Court of Appeals and California Supreme Court declined to take up the issue. On May 24, 2016, Cyan filed a Petition for a writ of certiorari in the US Supreme Court asking the Court to consider the issue.

Law Professors' Brief

In the amicus brief filed on behalf of the law professors, Cooley explained that Congress could not have intended for SLUSA to result in cases brought in some jurisdictions to be litigated in state court and for cases brought in other jurisdictions to be litigated in federal court.

Further, the brief highlighted the significant implications of litigating Securities Act claims in state court versus federal court that can lead to varying outcomes and inconsistent administration of justice. First, state courts do not regularly apply the Private Securities Litigation Reform Act (PSLRA). The PSLRA includes several provisions designed to curb abusive securities litigation and *in terrorem* settlements, including a stay of all discovery during the pendency of a motion to dismiss. Second, the brief highlighted that there are very different outcomes if the cases are litigated in state versus federal court. Specifically, state courts in California dismiss Section 11 cases

only 8% of the time, whereas Section 11 cases brought in federal court are dismissed 29% of the time. As a result, litigation costs are generally higher in state court, and plaintiffs in state court typically obtain much higher settlement amounts.

Implications

This is an important step in resolving a split amongst district courts across the country and hopefully returning Securities Act class actions to federal court. If a company is currently litigating a Securities Act class action in state court, it should consider seeking a stay of the action until the Supreme Court resolves this issue.

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