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Client Alert Commentary

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Supreme Court Questions "Obtuse" Statute Addressing Jurisdiction Over Securities Act Claims

Justices hear oral arguments on whether Plaintiffs can evade federal jurisdiction over Securities Act claims by exploiting what the Court calls statutory "gibberish" in the Securities Litigation Uniform Standards Act.

Key Points:

- District courts are split on whether the Securities Litigation Uniform Standards Act of 1998 divested state courts of subject matter jurisdiction over "covered class actions" where the plaintiff alleges only federal Securities Act claims.
- At oral argument, several of the Supreme Court justices voiced their view that the statute in question was "gibberish" and "obtuse," expressing doubts that any of the interpretations offered by the parties and *amici* were consistent with the statutory language.
- The Supreme Court may seek a middle ground aligning with the interpretation offered by the United States, as *amicus curiae*, that the Securities Litigation Uniform Standards Act of 1998 did not eliminate state court jurisdiction over Securities Act class actions, yet provided for the removal of such cases to federal court.

Introduction

On November 28, 2017, the Supreme Court of the United States held oral argument in the highly anticipated case of *Cyan, Inc. v. Beaver County Employees Retirement Fund*, No. 15-1439, to decide whether the Securities Litigation Uniform Standards Act of 1998 (SLUSA) divested state courts of subject matter jurisdiction in lawsuits solely alleging claims under the Securities Act of 1933 (the Securities Act). Because of the procedural roadblocks to challenging remand motions in federal court, the Supreme Court took review from an appeal from the California Supreme Court. Defendants/Petitioners argued that state courts did not have jurisdiction over "covered class actions" alleging only federal Securities Act claims, while Plaintiffs/Respondents interpreted the Securities Act to only prohibit state courts from deciding state law class actions.

The Supreme Court invited the Solicitor General to argue for the United States, which took a middle-of-the-road position relative to Petitioners and Respondents. Specifically, while the government agreed with Respondents that SLUSA did not eliminate state court jurisdiction over Securities Act class actions, the government argued that such cases are generally removable to federal court. Justice Kennedy expressly inquired whether the Court could reserve the removal question for a later case in rendering its decision. A decision is expected later this term.

Statutory Background and Genesis of Dispute

In 1995, Congress enacted the Private Securities Litigation Reform Act (PSLRA). The purpose of the PSLRA was to curb frivolous securities class actions by imposing heightened substantive and procedural requirements, including the imposition of an automatic stay of discovery and limitations on attorneys' fees.[1] After the PSLRA was adopted, class action plaintiffs hoping to avoid the PSLRA's stringent requirements began filing securities class actions in state court in greater numbers.[2]

In response, in 1998, Congress enacted SLUSA for the stated purpose of vesting federal courts with the exclusive authority to decide certain types of cases involving securities offered nationally.[3] In general, SLUSA provides for the removal of "covered class actions," seeking damages on behalf of 50 or more persons, from state to federal court.[4]

While SLUSA provides for the removal to federal court of class actions alleging state law claims,[5] district courts have been split on the question of whether state courts lack subject matter jurisdiction over "covered class actions" alleging only federal Securities Act claims. The conflict in the district courts has led to plaintiffs increasingly filing claims under the Securities Act in California state court, where plaintiffs can avoid some of the protections defendants receive under the PSLRA.

This issue generally evaded appellate review because it typically arises in the context of a motion to remand an action removed to federal court back to state court.[6] With few exceptions, orders granting remand are unreviewable, while orders denying remand are only appealable after a final judgment, which is often avoided by a settlement of the litigation.[7]

In 2011, petitioners/defendants in a *writ of certiorari* in *Countrywide Fin. Corp. v. Luther* highlighted this issue.[8] In that case, the petitioners asked the Supreme Court to review a California Court of Appeal decision holding that SLUSA did not permit a defendant to remove a complaint filed in state court alleging only Securities Act claims.[9] In seeking review, petitioners noted that the jurisdictional question would likely not be subject to a federal appeal, despite the fact that it was "the subject of pervasive disagreement in the district courts."[10] Petitioners in *Countrywide* also foretold that a lack of resolution of this jurisdictional question would cause plaintiffs to choose California as "the venue of choice for [Securities] Act class actions."[11]

This proved true, as demonstrated in *Cyan*, in which plaintiffs brought suit against Cyan, Inc. (Cyan) in California Superior Court. Upon the California Superior Court's denial of Cyan's motion for judgment on the pleadings for lack of subject matter jurisdiction and subsequent denials for review by the Court of Appeal and the Supreme Court of California, Cyan petitioned the United States Supreme Court for a *writ of certiorari* to decide the jurisdictional question.[12]

The United States, as *amicus curiae*, encouraged the Supreme Court to grant a *writ of certiorari* to decide this dispute despite the lack of an appellate court split, based on the obstacles to appellate resolution and because the question has long "generated confusion in lower courts."[13] On June 27, 2017, approximately six years after denying *certiorari* in *Luther,* the Supreme Court granted the petition for a *writ of certiorari* to address this question in *Cyan*.

The Parties' Briefing

1. The Petitioners argued that SLUSA divested the state court of concurrent jurisdiction over class actions alleging only Securities Act claims.

Petitioners were sued in state court following a drop in Cyan's stock price in 2014 based on alleged material misstatements and omissions in Cyan's registration statement and prospectus. In response, Petitioners argued that SLUSA divested the state court of concurrent jurisdiction over class actions alleging only Securities Act claims.[14]

SLUSA amended Section 77v(a) of the Securities Act — the provision providing state courts with jurisdiction to hear 1933 Act claims — to add the italicized language below:

> The district courts of the United States ... shall have jurisdiction of offenses and violations under [the Securities Act] ... and, concurrent with State and Territorial courts, *except as provided in section 77p of this title with respect to covered class actions*, of all suits in equity and actions at law brought to enforce any liability or duty created by [the Securities Act].[15]

Petitioners argued that the reference to Section 77p of the Securities Act referred to the definition of "covered class actions," which is provided in Section 77p(f)(2) of the Securities Act. That definition includes Securities Act claims under federal law. Thus, Petitioners argue that the SLUSA amendment created an exception to the general rule of concurrent state-court jurisdiction with respect to Securities Act claims.[16]

Petitioners also argued that SLUSA's amendment to the jurisdictional provision must be considered in the overall context of the statute. Specifically, SLUSA included additional amendments relating specifically to (1) state law class actions, and (2) "mixed" class actions involving both claims under federal and state law. With respect to state law class actions, SLUSA introduced a "preclusion" provision, which required all such class actions to be dismissed outright, whether brought in state or federal court.[17] With respect to mixed class actions, SLUSA introduced an amendment to the "anti-removal provision," which allowed removal to federal court of all mixed class actions.[18] Thus, unless the jurisdictional provision addressed class actions involving purely federal claims (by removing concurrent state court jurisdiction over such claims), there would be an apparent anomaly in Congress' legislative scheme: whereas class actions alleging only state law claims would be subject to dismissal, and mixed class actions would be subject to removal to federal courts, class actions alleging only violations of federal securities laws would be left to linger in state courts.

Petitioners argued that their interpretation of the text and structure of the law aligned with Congress' intent to make federal court the exclusive venue for class actions involving national securities.[19] Petitioners pointed to the preamble of SLUSA, which states that Congress sought to "stem the 'shift [] from Federal to State courts' of filings of 'securities class action lawsuits'" and to "enact national standards for securities class action lawsuits involving nationally traded securities."[20]

2. The Respondents posited the theory that SLUSA prevented state courts from deciding state law class actions.

In contrast, Respondents argued that SLUSA's amendment to Section 77v(a) of the Securities Act did not divest state courts of concurrent jurisdiction. Specifically, Respondents argued that the reference to Section 77p in Section 77v(a) relates to the entirety of Section 77p rather than simply to the definition of

"covered class actions" in Section 77p(f)(2).[21] The "core provision" of Section 77p authorizes the removal from state to federal court of only certain "covered class actions" that are based upon state law (as opposed to federal law).[22] Thus, Respondents argued that the amended language in Section 77v(a) simply reinforces that core provision by preventing state courts from deciding state law class actions, which are already subject to removal.

Respondents further argued that SLUSA's amendment to Section 77v(a) is a mere "conforming amendment," which should not be understood to obliquely divest state courts of concurrent jurisdiction over federal law class actions.[23] State courts have enjoyed concurrent jurisdiction over federal class actions for almost 85 years, and "nothing Congress did in PSLRA or in SLUSA altered that well-settled understanding."[24]

Respondents also rejected Petitioners' interpretation that Congress intended for SLUSA to shift all federal securities class action litigation to federal court. Specifically, Respondents noted that in *Merrill Lynch, Pierce, Fenner & Smith v. Dabit*, the Supreme Court had commented that SLUSA "'carefully exempts from its operation' various class actions that remain within the jurisdiction of the state courts — provisions that 'evince[] congressional sensitivity to state prerogatives in this field.'"[25] Based on Respondents' interpretation, Congress was "not particularly concerned" about uniformity of venue, but merely sought to encourage legal uniformity by forcing class action plaintiffs to file claims under the federal securities laws (whether in state or federal court).[26]

3. The United States took the middle-of-the-road position that state courts retain jurisdiction, but defendants are afforded an opportunity to remove Securities Act class actions to federal court.

The United States, in an *amicus curiae* brief, attempted to find middle ground. The government agreed with Respondents that nothing in Section 77p divested state courts of jurisdiction over a covered class action that asserted only claims under the Securities Act.[27]

The government claimed, however, that SLUSA provided other statutory mechanisms for ensuring defendants access to federal courts in class actions involving Securities Act claims. Specifically, the United States pointed to SLUSA's amendment to the anti-removal provisions in the Securities Act that permitted the removal of any covered class action (whether state or federal), that "contains allegations of the type specified in Section 77p(b)(1) and (2) (*i.e.*, false statements, omissions, or deceptive conduct in connection with the purchase or sale of a covered security)."[28]

Based on this interpretation, the United States claimed that SLUSA permitted state courts to retain jurisdiction over suits alleging only Securities Act claims, but that SLUSA also allowed for the removal of those claims to federal court.

The Supreme Court's Initial Response

On November 28, 2017, the Supreme Court heard oral argument in *Cyan*, in which counsel for Petitioners, Respondents, and the United States participated.

Justices Sotomayor and Kagan led the questioning of Petitioners. Justice Sotomayor attempted to make sense of the statutory language by proposing that the purpose of SLUSA may have been to simply ensure that claims covered by the Securities Act were adjudicated under uniform federal law (as opposed to similar state laws), without regard to the venue.[29] Justices Sotomayor and Kagan further questioned Petitioners' claim that the language in Section 77v(a) of the Securities Act only referred to the definition of

"covered class actions" in Section 77p of the Securities Act, rather than the entirety of Section 77p.[30] Justice Kagan also noted that most securities actions were filed under the Securities Exchange Act of 1934, rather than the Securities Act, and Congress did expressly provide exclusive jurisdiction to federal courts in that context.[31] In response to questioning from Justice Ginsburg, Petitioners' counsel agreed that the statutory language was an "obtuse" way of signaling exclusive federal jurisdiction of Securities Act claims.[32]

Other justices questioned whether any sense could be made of the statutory language at all. Both Justices Alito and Gorsuch pressed Respondents regarding the text of SLUSA, asking whether Congress' adopted language was simply "gibberish."[33] Justice Alito expressly noted that he thought "all the readings that everybody has given to all of these provisions are a stretch."[34] In response to these questions, Respondents expressed their belief that this interpretation was consistent with Congress' intent.[35] Chief Justice Roberts and Justice Thomas did not ask any questions during the oral argument.

Justices Breyer, Ginsburg, and Kennedy appeared intrigued by the government's interpretation that SLUSA permitted state courts to retain jurisdiction over suits alleging only Securities Act claims, while also allowing for removal of those claims to federal court. The justices, however, noted concern that the present action did not involve or directly present the removal issue.[36] Justice Kennedy directly asked Respondents' counsel whether the Court might decide the jurisdictional issue while "reserv[ing]" the removal question for resolution in the future. In response, Respondents' counsel responded that "I have learned that the answer to the question can the Supreme Court do X is always yes."[37]

The Court is poised to soon decide the best of these options (or possibly craft one of its own), which will undoubtedly have strategic implications for companies defending against securities class actions.

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Endnotes

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

[2] *Id.* at 82.

[3] *See* 144 Cong. Rec. H11019-01, H11020 (1998) ("The premise of this legislation is simple: lawsuits alleging violations that involve securities that are offered nationally belong to Federal court."); H.R. Rep. No. 105-803 ("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. Rep. No. 105-640 (1998) ("Under the legislation, 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).").

[4] 15 U.S.C. § 77p(f)(2).

[5] 15 U.S.C. § 77p(b)-(c).

[6] Petition for Writ of Cert. at 2.

[7] *Id.* at 14.

[8] Petition for Writ of Cert., *Countrywide Financial Corp. v. Luther*, 2011 WL 7039415 (U.S.).

[9] *Id*.

[10] *Id*. at 2.

[11] *Id*. at 21.

[12] Petition for Writ of Cert. at 10.

[13] Brief for the United States as *Amicus Curiae* in Support of Granting Writ of Cert. at 6.

[14] Brief for Petitioners at 9.

[15] 15 U.S.C. § 77v(a).

[16] Brief for Petitioners at 11.

[17] *Id*. at 17.

[18] *Id*. at 17-18.

[19] *Id*.

[20] *Id*. at 20.

[21] Brief for Respondents at 7.

[22] *Id*.

[23] *Id*. at 6.

[24] *Id*.

[25] *Id*. at 25.

[26] *Id*. at 28.

[27] Brief for the United States as *Amicus Curiae* at 6.

[28] *Id*. at 9.

[29] Transcript of Oral Hearing at 5.

[30] *Id*. at 14.

[31] *Id*. at 18.

[32] *Id*. at 5.

[33] *Id*. at 11, 47.

[34] *Id*. at 41.

[35] *Id*. at 59.

[36] *Id*. at 45.

[37] *Id*.