The Supreme Court's *Cyan* Decision and What Happens Next

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On March 20, 2018, the Supreme Court decided *Cyan, Inc. v. Beaver County Employees Retirement Fund*[1] ("*Cyan*"), ruling unanimously that, under the Securities Litigation Uniform Standards Act ("SLUSA"), class actions under the Securities Act of 1933 ("'33 Act") (1) may be brought in state court, and (2) are not removable to federal court. The decision swings the doors of state courts wide open to actions asserting '33 Act claims against issuers, officers, directors, underwriters, and others involved in the securities offering process. There is much debate about whether the Supreme Court's construction of the relevant provisions of SLUSA, which Justice Alito at oral argument referred to as "gibberish," make sense. Regardless of one's views on that score, it is difficult to contest that the result of *Cyan* is, to pick a word, odd: putative class-action plaintiffs can now avoid federal court by asserting solely federal claims under the '33 Act. Whether state courts generally or particular state courts will become, to borrow a term utilized by the Supreme Court in another leading securities law ruling, the "Shangri-La of class-action litigation for lawyers representing those allegedly" misled in the context of a securities offering remains to be seen.[2] In any event, *Cyan* undoubtedly will be a catalyst for class-action-litigation lawyers to search for the most-plaintiff-friendly jurisdiction and thus introduce all the well-recognized perils associated with forum-shopping and inconsistent, unpredictable standards across multiple jurisdictions.

Securities Litigation Reform Legislation and the District Court Split

In 1995, Congress passed the Private Securities Litigation Reform Act ("PSLRA") to curb "abuses of the class-action vehicle in litigation involving nationally traded securities."[3] To this end, the PSLRA codified a number of procedural and substantive safeguards aimed at reducing abusive filings and protecting class members and defendants from the harmful effects of the existing securities-class-action environment. However, plaintiffs' attorneys quickly realized that they could avoid the PSLRA's protections by filing securities class actions in state court.

In response, Congress passed SLUSA in 1998, with the express purpose of "prevent[ing] plaintiffs from seeking to evade the protections that Federal law provides against abusive litigation" by filing in state court.[4] SLUSA intended to accomplish that goal by making "Federal court the exclusive venue for most securities fraud class action litigation involving nationally traded securities."[5]

[1] 583 U.S. __ (2018).

[2] *Morrison v. National Australia Bank Ltd.*, 561 U.S. 247, 270 (2010).

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

[4] H.R. Conf. Rep. No. 105-803, at 13 (1998).

[5] *Id.* at 15.

SLUSA amended the provisions of the ’33 Act governing jurisdiction and removal.[6] First, SLUSA created an exception to the clause granting state and federal courts concurrent jurisdiction over ’33 Act claims, by stating that concurrent jurisdiction existed “except as provided in section 77p of this title with respect to covered class actions.” Second, SLUSA amended the clause stating that no case may be removed from state court, by adding “[e]xcept as provided in section 77p(c) of this title.” Additionally, SLUSA provided for the eventual dismissal of certain state securities class actions described in section 77p.

The amendments led to a split in the federal district courts over whether SLUSA stripped state courts of jurisdiction over ’33 Act class actions, and whether those federal claims would be removable to federal court. Some courts—including, most notably, in California—denied removal and granted remand because 77p mentions only state-law claims. Other courts—following the Southern District of New York’s holding in *Knox v. Agria Corp.*[7]—reasoned that SLUSA’s first amendment strips state courts of jurisdiction over ’33 Act claims and thus requires them to be removed. Most of these decisions evaded review in federal Courts of Appeals because remand orders are generally not reviewable under 28 U.S.C. § 1447(d), but, eventually, *Cyan* found its way through a unique procedural channel to the Supreme Court, which granted certiorari.

The *Cyan* Decision

In a unanimous opinion by Justice Kagan, the Supreme Court held that “SLUSA’s text, read most straightforwardly, leaves in place state courts’ jurisdiction over 1933 Act claims, including when brought in class actions.” The Court observed that SLUSA stripped state courts of jurisdiction only over ’33 Act claims “as provided in section 77p” and section 77p specifically references only class actions brought under state law. In so holding, the Court denied that its reading renders the statutory language granting state courts jurisdiction over ‘33 Act claims “except as provided in section 77p” meaningless because the jurisdictional provision relates to ’33 Act claims and section 77p references only state-law claims. The Court theorized that Congress “could well have added the [provision] in a more general excess of caution.” The Court rejected the argument that SLUSA allows for the removal of certain ‘33 Act class actions on a similar basis.

Despite the fact that it could not identify the meaning of the first “except as provided” clause under its reading, the Court nevertheless concluded that the legislative purpose and history of SLUSA did not “create doubts about SLUSA’s meaning.” The Court explained that SLUSA’s key objective of “‘prevent[ing] plaintiffs from seeking to evade the protections that Federal law provides against abusive litigation by filing suit in State, rather than in Federal, court’” was achieved for the ‘33 Act by barring state-law class actions and simultaneously including certain “substantive sections protecting defendants (like a safe harbor for forward-looking statements) in suits brought under the federal securities laws.” The opinion did not grapple with the fact that plaintiffs may evade SLUSA’s procedural protections by filing in state court. Instead, the Court tacitly dismissed this concern by noting that the bulk of securities class actions are brought pursuant to the 1934 Securities Exchange Act (“’34 Act”) and so will proceed in federal court anyway. For the Court, this meant that SLUSA still “largely”—though not “entirely”—“accomplished the purpose articulated in its Conference Report: moving securities class actions to federal court.”

[6] 15 U.S.C. § 77v(a).

[7] 613 F. Supp. 2d 419 (S.D.N.Y. 2009).

The Future

The Court's decision may well accelerate the exodus of '33 Act class actions from federal to state court that began in earnest in the early 2010s. Many state courts have far fewer—and less predictable—procedural protections than federal court, in large part because state courts have not uniformly adopted the procedural protections contained in the PSLRA. For example, as compared to federal courts, many state courts do not have uniform procedures for consolidating parallel cases, there may be limited ability to immediately appeal a class certification order, pleading standards may be lower, and discovery is often more expansive in scope and duration and—in some instances—is not limited by the PSLRA's discovery stay.

While in the preceding decade plaintiffs' lawyers have primarily filed '33 Act class actions in California-state courts given California-federal courts' propensity to remand such cases, the Court's decision effectively opens the doors to all state courts across the country and allows plaintiffs to more freely engage in forum-shopping. It may be that plaintiffs will continue to view California as the most favorable jurisdiction for '33 Act cases, but it is also possible that plaintiffs will identify another jurisdiction that is more plaintiff-friendly. This could lead to a concentration of filings in that jurisdiction, and force issuers to defend suits in many different locales. Over time, an increase in the number of state courts and judges having to handle '33 Act cases is apt to lead to the inconsistent interpretation of the substantive provisions of the '33 Act, further encouraging forum-shopping.

In addition, the dynamic of competition between plaintiffs' counsel is likely to result in the type of "race to the courthouse" that the PSLRA was designed to eliminate via the appointment of lead plaintiffs, and lead to parallel litigations in federal court and one or more state courts. Such parallel litigations are inefficient and could significantly increase legal costs. Ironically, they are also bad for class members themselves. Given the *res judicata* effects of settlement in some instances, parallel litigation can encourage plaintiffs' counsel to settle earlier than they otherwise would to avoid being bound by a settlement in a competing case and losing out on contingency fees.

Whether Congress will step in and explicitly eliminate state court jurisdiction over '33 Act claims will depend, in large measure, on whether state courts become a Shangri-La for class action litigation under the '33 Act. It is certainly ironic, as many have pointed out, that the very statute construed in *Cyan*—SLUSA—is itself an emphatic reflection of congressional desire to avoid having state courts become the primary venue for securities-class-action litigation, at least as it relates Section 10(b) of the '34 Act and equivalent state and common law claims involving the purchase and sale of securities. It took Congress three years after the passage of the PSLRA to take steps to shift securities-class-action litigation back to federal court. Now that the quest for the most plaintiff-friendly venues is certain to begin again in earnest post-*Cyan*, the calls for congressional action will undoubtedly grow.

Another possibility is that issuers and potential issuers may attempt to respond to the Court's decision by updating their articles of incorporation with a clause stipulating that federal court will be the exclusive venue for all '33 Act class actions. Those sorts of corporate governance solutions are as of yet untested in the courts, but another by-product of *Cyan* may well be litigation on that front.

While congressional or corporate governance work-arounds of *Cyan* remain a possibility, in the near term issuers and those involved in securities offerings must gear up for the possibility that they could become subject to class-action litigation in many different state courts in situations where the market price of the securities has dropped from the offering price. Issuers facing '33 Act claims in state court will want to address the following issues promptly to manage the litigation successfully:

1. Quickly understand the procedural rules of the state in which the litigation is filed, including the pleading standards, transfer and consolidation provisions, the state's approach to forum non conveniens motions, the standards for class certification, the appealability of class certification and other orders on an interlocutory basis, the availability of discovery stays pending dispositive

threshold motions, any compulsory disclosures required by state law, the willingness of the state court to sequence personal jurisdictional discovery and class discovery ahead of merits discovery, and the applicable service rules.

2. Take steps to manage parallel litigations in federal and state courts by coordinating responses in each litigation, including ensuring that any resolution will bind all pending actions or meaningfully reduce exposure in other actions. Finding national counsel with expertise in the underlying substantive federal law at issue—the ’33 Act—will also be worthwhile, even if the litigation is filed in a location in which that counsel is not located, especially in light of the potential for competing class actions in federal and one or more state courts.

3. Locate skillful local counsel in the state or states in which the litigation is filed in order to successfully manage the litigation in each state.

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