ROPES & GRAY ALERT

Corporate & Shareholder Litigation

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Supreme Court Holds State Courts May Continue to Hear Certain Federal Securities Claims

Attorneys
John D. Donovan
Daniel V. Ward
Kristi Jobson

On March 20, 2018, the Supreme Court held that shareholders may pursue securities class actions alleging false or misleading prospectuses in either state or federal court. In *Cyan, Inc. v. Beaver County Employees Retirement Fund*, the Court held that state and federal courts have concurrent jurisdiction over claims for misrepresentations in connection with securities offerings, and that defendants may not remove those cases to federal court. The practical impact of *Cyan* is likely to be that plaintiffs will sue in state courts to avoid the procedural obstacles that so-called "reform" legislation has imposed on federal securities class actions.

In 1995, Congress enacted the Private Securities Litigation Reform Act (PSLRA), which was intended to curb abuses of the securities laws by enterprising plaintiffs and their counsel. To escape the reform provisions, nimble plaintiffs opted to file securities class actions in state court under state law. Congress responded by passing the Securities Litigation Uniform Standards Act of 1998 (SLUSA), amending both the 1933 and 1934 Acts to prohibit securities class actions based on state law if they involve a class of 50 or more class members.

Since SLUSA, however, courts have split on the question of whether SLUSA extinguished concurrent state and federal court jurisdiction over 1933 Act claims arising from securities offerings. Defendants argued that creating ostensibly "uniform" federal standards for securities class actions would make no sense if plaintiffs could avoid them by pursuing a limited class of cases in state court. But the language of SLUSA was ambiguous. In *Cyan*, the Supreme Court resolved the ambiguity, and held that state courts retain jurisdiction over 1933 Act claims, and defendants sued in state court cannot remove cases to federal court. On behalf of a unanimous court, Justice Kagan rejected Cyan's textual argument and its contention about SLUSA's purpose, concluding that "SLUSA's purposes and legislative history fail to overcome [SLUSA's] clear statutory language."

Cyan's interpretation of SLUSA leads to a paradoxical result: SLUSA eliminated state court jurisdiction for state law claims, but retained state court jurisdiction over a federal law claim while limiting the federal courts' ability to hear federal claims by forbidding removal. Justice Kagan acknowledged that the statutory framework sets up an "indubitable puzzle," but punted to the legislature to clean up its drafting: "If further steps are needed, they are up to Congress."

The *Cyan* decision will be touted as a victory for shareholders, who will inevitably claim that the ability to sue in state court preserves more plaintiff-friendly forums. But the consequence of a dual system for 1933 Act claims is troubling. In state court, plaintiffs will not be subject to the procedural safeguards provided by the PSLRA—including the PSLRA's stay on discovery until resolution of any motion to dismiss. Furthermore, without the PSLRA, shareholders and their lawyers will not need to compete for the job of lead plaintiff and counsel, incentivizing a "race to the courthouse" rewarding counsel in the first-filed case. And while federal courts review hundreds of cases brought under the federal securities laws each year, a state court judge may be less likely to possess intimate familiarity with the 1933 Act. Following *Cyan*, companies should expect shareholders to file claims arising out of securities offerings in state court.

If you have questions about this alert, please contact Gregg Weiner, David Hennes, or Peter Welsh.