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CYAN AND THE FUTURE OF SECURITIES CLASS ACTIONS IN STATE COURT

The Supreme Court in the Cyan *case has before it the question whether a 1998 amendment to the Securities Act of 1993 divests state courts of concurrent jurisdiction over "covered class actions" asserting 1933 Act claims. The authors discuss the legislative history of the amendment, the split decisions of the lower courts, the positions of the parties in the Supreme Court, and the comments of the justices at the oral argument. The case is pending.*

By Maeve L. O'Connor and Elliot Greenfield *

On November 28, 2017, the Supreme Court heard oral argument in *Cyan, Inc. v. Beaver County Employees Retirement Fund* ("*Cyan*"), which squarely addresses an issue that has divided federal district courts for decades: whether the Securities Litigation Uniform Standards Act of 1998 ("SLUSA") deprives states courts of concurrent jurisdiction over class actions asserting claims under the Securities Act of 1933. Since the enactment of SLUSA nearly twenty 20 years ago, district courts have struggled to interpret the changes that the statute made to the jurisdictional and removal provisions of the 1933 Act. District courts in several states – most notably, California – have concluded that state courts retain jurisdiction over 1933 Act class actions and that such actions filed in state court may not be removed to federal court. As a result, there has been a surge in filings of 1933 Act class actions in those jurisdictions over the past several years, in an apparent effort to avoid the procedural protections provided by the Private Securities Litigation Reform Act of 1995 ("PSLRA"). Questions and commentary at oral argument in *Cyan* suggest that, like the lower courts, the Supreme Court may struggle to interpret SLUSA's amendments to the 1933 Act – statutory language that Justice Alito referred to as "gibberish." For the reasons set forth below, the Supreme Court should hold that, after SLUSA, state courts no longer have jurisdiction over most 1933 Act class actions.

I. SLUSA's AMENDMENT TO THE 1933 ACT's JURISDICTIONAL PROVISION

As originally enacted, the 1933 Act provided for concurrent federal and state court jurisdiction, and barred the removal of actions filed in state court. In 1995, Congress enacted the PSLRA to curb "perceived abuses of the class action vehicle in litigation involving nationally traded securities" and to address concerns that securities class actions were "being used to injure the entire U.S. economy" by means of "nuisance filings, targeting of deep-pocket defendants, vexatious discovery requests, and manipulation by class action lawyers of the

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clients whom they purportedly represent."[1] The PSLRA includes a number of procedural protections, including requirements that (i) plaintiffs publish nationwide notice of a pending action, alerting members of the purported class that they can seek to be appointed lead plaintiff and (ii) the court thereafter appoint lead plaintiff based on the rebuttable presumption that the plaintiff with the largest alleged loss is the "most adequate plaintiff."[2] The PSLRA automatically stays discovery during the pendency of any motion to dismiss and, in fraud cases, imposes a heightened pleading standard for the element of scienter.[3] The PSLRA also places important limitations on any award of damages to the named plaintiff and on the payment of attorneys' fees and expenses.[4] These provisions had a powerful impact in federal court, but the PSLRA "had an unintended consequence: It prompted at least some members of the plaintiffs' bar to avoid the federal forum altogether."[5]

Congress passed SLUSA in 1998 with the express purpose of closing this loophole. Congress stated that, since the enactment of the PSLRA, "considerable evidence has been presented to Congress that a number of securities class action lawsuits have shifted from Federal to State courts," and that "this shift has prevented [the PSLRA] from fully achieving its objectives."[6] The Conference Report for SLUSA provides in its opening statement that SLUSA "makes Federal court the exclusive venue for most securities class action lawsuits."[7]

The goal of SLUSA, therefore, is to require that securities class actions be subject to the PSLRA. There is no dispute that SLUSA accomplishes this goal – in part – by precluding class actions asserting certain claims under state law that mirror the elements of a 1933 Act claim.[8] Whether and how SLUSA affects state court jurisdiction over 1933 Act class actions, on the other hand, has been hotly debated for decades. For the reasons discussed below, SLUSA is best understood as divesting state courts of concurrent jurisdiction over "covered class actions" asserting 1933 Act claims.[9] As a result, such actions filed in state court (i) must be dismissed by state courts for lack of jurisdiction and (ii) are no longer subject to the 1933 Act's bar on removal, which is expressly limited to actions "brought in any State court of competent jurisdiction."[10]

As amended by SLUSA, the 1933 Act's jurisdictional provision states:

> The district courts of the United States and the United States courts of any Territory shall have jurisdiction . . . 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 this subchapter.[11]

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

[2] 15 U.S.C. § 77z-1(a); § 78u-4.

[3] 15 U.S.C. § 77z-1(b); § 78u-4(b).

[4] 15 U.S.C. § 77z-1(a); § 78u-4(a).

[5] *Dabit*, 547 U.S. at 82.

[6] Pub. Law No. 105-353, 112 Stat. 3227.

[7] H.R. Conf. Rep. No. 105-803, 1998 WL 703964, at 13 (1998).

[8] Section 77p(b) states: "No covered class action based upon the statutory or common law of any State or subdivision thereof may be maintained in any State or Federal court by any private party alleging – (1) an untrue statement or omission of a material fact in connection with the purchase or sale of a covered security or (2) that the defendant used or employed any manipulative or deceptive device or contrivance in connection with the purchase or sale of a covered security." 15 U.S.C. § 77p(b).

Section 77p(c) allows claims precluded by Section 77p(b) to be removed to federal court: "Any covered class action brought in any State court involving a covered security, as set forth in subsection (b), shall be removable to the Federal district court for the district in which the action is pending, and shall be subject to subsection (b)." 15 U.S.C. § 77p(c).

[9] 15 U.S.C. § 77v(a).

[10] *Id.*

[11] 15 U.S.C. § 77v(a) (emphasis added to language added by SLUSA).

The meaning of the italicized clause above (the "Except Clause"), which creates a carve-out from concurrent state court jurisdiction over actions asserting 1933 Act claims, is the key question before the Supreme Court in *Cyan*. The debate arises because the Except Clause says that concurrent state court jurisdiction over actions asserting 1933 Act claims exists "except as provided in section 77p of this title with respect to covered class actions," but it does not indicate which subsection of 77p is being referenced.

The most straightforward interpretation of the Except Clause – and ultimately, the *only* reasonable interpretation – is that state courts no longer have jurisdiction over "covered class actions" asserting 1933 Act claims. In other words, when Congress added language providing that concurrent jurisdiction exists over 1933 Act claims "except as provided in section 77p of this title with respect to covered class actions," Congress was referring to Section 77p(f), which sets forth the definition of "covered class actions."[12] Under this interpretation, state courts continue to have jurisdiction over individual actions, as well as any other actions that do not meet the statutory definition of a "covered class action." Interpreting the jurisdictional provision as referring to the definition of "covered class action" in Section 77p(f) makes sense because "covered class action" is "a term of art with no meaning absent a reference to some definition."[13] Moreover, the other subsections of Section 77p that mention "covered class actions" all "deal exclusively with state law claims, and do not touch on jurisdiction over 'suits in equity or actions at law brought to enforce any liability or duty created by the [the 1933 Act].'"[14]

Some courts nonetheless have interpreted the Except Clause's reference to "Section 77p" not to refer to the definition of "covered class action" under Section 77p(f), but instead to Sections 77p(b) and 77p(c), which address precluded state law claims.[15] That interpretation is problematic because the 1933 Act's jurisdictional provision relates only to actions asserting claims under the 1933 Act, not under state law.[16] The Except Clause, therefore, must limit state courts' jurisdiction over actions asserting *1933 Act claims*, which would not be accomplished by eliminating jurisdiction over actions asserting precluded *state law claims*. In other words, SLUSA's amendment to the jurisdictional provision would be mere surplusage because state courts would still have concurrent jurisdiction over *all* actions asserting 1933 Act claims.

Seeking to avoid this problem, some courts have held that SLUSA divests state courts jurisdiction only over class actions that assert both 1933 Act claims *and* precluded state law claims.[17] That interpretation, however, leads to a fundamental inconsistency: state courts would have jurisdiction over actions asserting *only* precluded state law claims or *only* 1933 Act claims, but not over actions asserting *both* precluded state law claims and 1933 Act claims. It would be irrational for a court to have jurisdiction over claims if they are asserted in separate actions but not if they are asserted in the same action. Nor is there any reason to think that Congress intended such a result.

A central flaw in these attempts to link the Except Clause to Sections 77p(b) and 77p(c) is the conflation of two distinct legal concepts: jurisdiction and preclusion. Jurisdiction governs the actions that a court may hear; preclusion limits the actions that a party may bring.[18] Accordingly, Sections 77p(b) and 77p(c), which involve preclusion, do not provide any limitation on state court jurisdiction. Although Section 77p(b) precludes certain state law actions, both federal and state courts have jurisdiction to hear those precluded actions and the proper course is to dismiss them. As Judge Richard Posner explained, when the SLUSA precludes a state

[12] A "covered class action" includes any action in which a plaintiff asserts claims "on a representative basis on behalf of themselves and other unnamed parties similarly situated, and questions of law or fact common to those persons or members of the prospective class predominate . . . over any questions affecting only individual persons or members." 15 U.S.C. § 77p(f)(2)(A)(i)(II).

[13] *Hung v. iDreamSky Tech. Ltd.*, 2016 WL 299034, at *2 (S.D.N.Y. Jan. 25, 2016).

[14] *Knox v. Agria Corp.*, 613 F. Supp. 2d 419, 423-24 (S.D.N.Y. 2009).

[15] *See*, *e.g.*, *Desmarais v. Johnson*, No. C 13-03666, 2013 WL 5735154, at *3 (N.D. Cal. Oct. 22, 2013).

[16] The reference to "this subchapter" means the 1933 Act. *See* 15 U.S.C. § 77a ("This subchapter may be cited as the "Securities Act of 1933".).

[17] *See*, *e.g.*, *Rajasekaran v. CytRx Corp.*, No. CV 14-3406, 2014 WL 4330787, at *6 (C.D. Cal. Aug. 21, 2014) (citing *In re Tyco International Ltd. Multidistrict Litig.*, 322 F. Supp. 2d 116, 120 n.7 (D.N.H. 2004)).

[18] *See Exxon Mobil Corp. v. Saudi Basic Indus. Corp.*, 544 US 280, 293 (2005) ("Preclusion, of course, is not a jurisdictional matter.").

law action, preclusion "operates as an affirmative defense . . . not a jurisdictional defense."[19]

In the end, if one accepts that SLUSA divested state courts of jurisdiction over *some* category of 1933 Act cases, then the only reasonable conclusion is that state courts lack jurisdiction over "covered class actions" – as defined in Section 77p – asserting 1933 Act claims. The only other conclusion is that Congress chose to amend the 1933 Act jurisdictional provision by adding language that has no effect whatsoever, a conclusion that would violate the "cardinal principle of statutory construction that [courts] must give effect, if possible, to every clause and word of a statute."[20] That principle presumably is even stronger where, as here, the clause at issue was specifically added in an amendment to an existing statute.

II. SPLIT AMONG THE DISTRICT COURTS

Federal district courts, which address the issue of state court jurisdiction in the context of motions to remand, are split on whether state courts retain subject matter jurisdiction over 1933 Act class actions. The bulk of the decisions holding in favor of state court jurisdiction come from district courts in California, and the overall tally of decisions therefore reflects the choice of plaintiffs to file in jurisdictions that do not allow removal. For example, although the Southern District of New York hears by far the most securities class actions every year, federal courts in that district deny remand motions, and consequently only a handful of 1933 Act class actions have been filed in New York state courts in the nearly 20 years since the passage of SLUSA.

The primary reason that plaintiffs have successfully avoided removal in California is the Ninth Circuit's 2008 opinion in *Luther v. Countrywide Home Loans Servicing LP*.[21] The defendants in *Luther* removed the case under the Class Action Fairness Act, not SLUSA, but the Ninth Circuit stated broadly that the 1933 Act "strictly forbids the removal of cases brought in state court and asserting claims under the Act."[22] Although the *Luther* court did not address SLUSA's amendment to the 1933 Act's jurisdictional provision, California district courts have consistently relied on *Luther* in granting remand and rejecting the argument that state courts lack subject matter jurisdiction.

Courts in California and elsewhere have also incorrectly relied on dicta from the Supreme Court's opinion in *Kircher v. Putnam Funds Trust*.[23] *Kircher* involved only state law claims and the Supreme Court addressed the scope of removal under 15 U.S.C. § 77p(c).[24] The Court stated that Section 77p(b) governed the scope of state law claims that are precluded by SLUSA and that Section 77p(c) allowed removal only of those state claims precluded under Section 77p(b).[25] To the extent that state courts could not be trusted to dismiss precluded state law claims, Section 77p(c) permits a defendant to remove the case to federal court for dismissal of those claims. No 1933 Act claims were at issue and the Court made clear that it was not considering removal under 28 U.S.C. § 1441(a).[26]

III. OPPORTUNITIES FOR APPELLATE REVIEW

The split among courts regarding state court jurisdiction over 1933 Act class actions has persisted for decades because there is no federal appellate authority on the matter. Although a securities plaintiff could seek interlocutory review of a district court order denying remand, not one has ever chosen to do so.

Whether a defendant may appeal an order granting remand is less straightforward. A federal statute, 28 U.S.C. § 1447(d), states that "[a]n order remanding a case to the State court from which it was removed is not reviewable on appeal or otherwise." Despite that broad language, the Supreme Court has repeatedly held that Section 1447(d) "preclude[s] review only of remands for lack of subject matter jurisdiction and for defects in removal procedure."[27] Accordingly, the Supreme Court has held that an appellate court may review a remand order issued on other grounds, such as abstention or a

[19] *Brown v. Calamos*, 664 F.3d 123, 127-28 (7th Cir. 2011).

[20] *Williams v. Taylor*, 529 U.S. 362, 404 (2000) (internal quotations omitted).

[21] 533 F.3d 1031 (9th Cir. 2008).

[22] *Id.* at 1033.

[23] 547 U.S. 633 (2006).

[24] *Id.* at 637, 641-644.

[25] *Id.* at 643 ("[W]e read authorization for the removal in subsection (c) . . . as confined to cases "set forth in subsection (b) . . . .").

[26] *Id.* at 641-42 (reviewing the record and stating that "there was no indication that removal jurisdiction might exist on some ground other than § 77p(c) (complete diversity, for example).").

[27] *Powerex Corp. v. Reliant Energy Servs, Inc.*, 551 U.S. 224, 229-30 (2007); *see also Thermtron Prods, Inc. v. Hermansdorfer*, 423 U.S. 336 (1976).

refusal to exercise supplemental jurisdiction.[28] Because district courts indisputably have subject matter jurisdiction over 1933 Act class actions, an order remanding such an action cannot be based on a lack of subject matter jurisdiction. In what appears to be the sole federal appellate decision addressing this issue, however, the Eleventh Circuit concluded that it lacked jurisdiction to hear an appeal of an order remanding a 1933 Act class action on the basis that it lacked "removal jurisdiction."[29] The conclusion that a purported lack of "removal jurisdiction" equates to a lack of subject matter jurisdiction in these circumstances is questionable, as district courts have original jurisdiction over 1933 Act claims.[30]

The *Cyan* case demonstrates a separate avenue for federal appellate review. *Cyan* is a putative class action brought in California state court asserting only claims under the 1933 Act. The defendants filed a motion for judgment on the pleadings for lack of subject matter jurisdiction in the Superior Court of California. That motion was denied, and both the California Court of Appeal and the California Supreme Court denied the defendants' petitions for appellate review. The defendants then filed a petition for a writ of certiorari with the United States Supreme Court, presenting the question: "Whether state courts lack subject matter jurisdiction over covered class actions that allege only [1933 Act] claims."[31] Although the plaintiff initially filed a waiver of its right to respond to the petition, the Supreme Court requested that it file a response and also invited the Acting Solicitor General to file a brief expressing the views of the United States. The Supreme Court subsequently granted the *Cyan* petition and now appears likely to resolve the dispute among the district courts regarding state court jurisdiction.

IV. THE *CYAN* APPEAL

In their merits briefs, Petitioners and Respondents took positions that largely mirror the arguments discussed above. Petitioners argued that the plain text of the Except Clause divests state courts of jurisdiction over 1933 Act claims in covered class actions, a reading also supported by SLUSA's overall structure and its purpose.[32] Respondents disagreed, noting that the Except Clause uses the word "provided" and refers to Section 77p broadly; had Congress intended Petitioners' reading, "it would have used a common and clear formulation, such as: 'except with respect to covered class actions as defined in section 77p(f)(2).'"[33]

Instead, Respondents argue, the Except Clause divests state courts of jurisdiction only over so-called "mixed" cases – *i.e.*, cases asserting both 1933 claims and precluded state law claims.[34] As Petitioners pointed out, however, Respondents' argument – that Sections 77v(a) and 77p "would have been at war with each other" if a plaintiff filed a "mixed" case – incorrectly conflates jurisdiction and preclusion, which are entirely distinct concepts.[35]

The Solicitor General agreed with Respondents that SLUSA did not divest states courts of jurisdiction over 1933 Act class actions, but agreed with Petitioners that SLUSA's purpose – preventing circumvention of the PSLRA – "depends on defendants' access to a federal forum."[36] To reconcile those views, the Solicitor General revived an argument that was made by defendants in a number of early SLUSA cases but was largely abandoned after the Supreme Court's decision in *Kircher* – namely, that removal under Section 77p(c) is *not* limited to precluded state law claims and instead encompasses both state and federal claims that allege the type of misconduct described in Section 77p(b).[37]

The oral argument before the Supreme Court provides little guidance as to how the Court is likely to rule. The

[28] *Carlsbad Tech., Inc. v. HIF Bio, Inc.*, 556 U.S. 635, 641 (2009) (appellate court could review remand order based on decline of supplemental jurisdiction); *Quackenbush v. Allstate Ins. Co.*, 517 U.S. 706, 711-12 (1996) (appellate court could review remand order based on abstention).

[29] *Williams v. AFC Enters. Inc.*, 389 F.3d 1185, 1191 (11th Cir. 2004).

[30] "Removal jurisdiction" typically refers to situations in which a federal court has jurisdiction only upon removal. For example, a federal court has jurisdiction over an action asserting state law claims precluded by SLUSA only if the action is filed in state court and subsequently removed. *See Kircher v. Putnam Funds Trust*, 547 U.S. 633, 642 (2006).

[31] Petition for Writ of Certiorari, *Cyan, Inc. v. Beaver Cty. Emps.' Ret. Fund*, No. 15-1439 (filed May 24, 2017), at i.

[32] Brief for Petitioners ("Pet. Br."), *Cyan, Inc. v. Beaver Cty. Emps.' Ret. Fund*, No. 15-1439 (filed Aug. 28, 2017), at 14-22.

[33] Brief for Respondents ("Resp. Br."), *Cyan, Inc. v. Beaver Cty. Emps.' Ret. Fund*, No. 15-1439 (filed Oct. 13, 2017), at 15-16.

[34] Resp. Br. at 10.

[35] Pet. Br. at 32.

[36] SG Br. at 23.

[37] SG Br. at 24-25; *but see Kircher*, 547 U.S. at 643 ("[W]e see no reason to reject the straightforward reading: removal and jurisdiction to deal with removed cases is limited to those precluded by the terms of subsection (b).").

justices expressed a great deal of frustration with the lack of clarity of the relevant statutory provisions and they appeared to agree that none of the interpretations put forward by the parties or the Solicitor General were completely natural. As Justice Alito commented, "all the readings that everybody has given to all of these provisions are a stretch."[38] On one hand, as several justices noted, if Congress wanted to divest state courts of concurrent jurisdiction over all 1933 Act covered class actions, it could have used clearer language.[39] On the other hand, the interpretation of the Except Clause offered by Respondents is, as Justice Ginsberg characterized it, a "road to nowhere."[40]

Justice Alito appeared to be particularly frustrated, repeatedly referring to the statutory language as "gibberish" and later asking, "Is there a certain point at which time we say this means nothing, we can't figure out what it means, and, therefore, it has no effect, it means nothing?"[41] Justice Gorsuch responded to that question, pointing out that the Except Clause is superfluous under Respondents' interpretation of the clause and emphasizing that "nobody likes gibberish, but it is our job to try and give effect whenever possible to Congress's language."[42] Counsel for Respondents argued that the Except Clause could "mean something" even if it "may not accomplish anything."[43]

With respect to SLUSA's purpose, Justices Ginsberg and Alito both expressed doubt that Congress intended 1933 Act claims to be heard in state court, where many of the PSLRA's procedural protections do not apply.[44] Justice Sotomayor differed somewhat on this point, suggesting that the main purpose of SLUSA was to ensure that claims were brought under federal law, not state law.[45] The bulk of the argument focused on the text itself, however, rather than issues of legislative history or intent.

The Court also lacked any apparent consensus regarding the Solicitor General's interpretation of the scope of removal under Section 77p(c), with Justice Breyer appearing somewhat receptive, but Justice Sotomayor calling it "a bit of a stretch," and Justice Alito declaring that "it's so far from reality that it really strains credulity."[46] Justices Ginsberg and Kennedy both questioned whether the removal issue was properly before the Court, given that Cyan had not removed the instant case.[47]

V. CONCLUSION

In deciding *Cyan*, the Supreme Court has an opportunity to bring clarity to a statutory scheme that has divided district courts for decades and to give effect to SLUSA's purpose of preventing plaintiffs from evading the protections of the PSLRA by ensuring that securities class actions are litigated under federal law and in federal court. ■

[38] Transcript of oral argument ("Tr."), *Cyan, Inc. v. Beaver Cty. Emps.' Ret. Fund*, No. 15-1439, dated November 28, 2017, *available at* https://www.supremecourt.gov/oral_arguments/argument_transcripts/2017/15-1439_linq.pdf, at 41.

[39] Tr. at 4, 11, 15.

[40] Tr. at 57-58.

[41] Tr. at 11, 41.

[42] Tr. at 47-48.

[43] Tr. at 44.

[44] Tr. at 59, 66.

[45] Tr. at 5.

[46] Tr. at 40, 41.

[47] Tr. at 37, 45.