PRODUCTS LIABILITY LITIGATION

Home > ABA Groups > Section of Litigation > Committees > Products Liability Litigation > Practice Points > 2018 > Supreme Court Clarifies Two-Decade Circuit Split Involving Class Actions

Supreme Court Clarifies Two-Decade Circuit Split Involving Class Actions

Christopher K. Friedman – May 8, 2018

The U.S. Supreme Court recently resolved a circuit split involving certain types of securities-fraud claims allowed in state court. *See Cyan, Inc. et al. v. Beaver County Employees Retirement Fund, et al.*, Slip. Op. 15-1439 (U.S. Mar. 20, 2018). This decision will certainly lead to the increase of class-action securities litigation in state court. Moreover, this decision clarifies the steps that defense counsel should take when handling securities-fraud claims in both state and federal court, and make clear an area of law that, for the past 20 years, has been extremely opaque.

Following the Great Depression, Congress passed several laws designed to protect investors, including the Securities Act of 1933 (193 Act), which addressed fraud in the initial offering of securities. Among other things, the 1933 Act provided a cause of action for fraud in the offering of securities, and gave state and federal courts concurrent jurisdiction over such claims. However, the 1933 Act prohibited the removal of claims filed in state court. *See* 15 U.S.C. § 77v(a).

Six decades later, to cure perceived abuses committed by plaintiffs bringing securities-fraud cases, Congress passed the Private Securities Litigation Reform Act (PSLRA). Although the PSLRA created several procedural protections for defendants, it only applied to cases filed in federal court. Unsurprisingly, plaintiffs began avoiding federal court by filing securities-fraud cases in state court and invoking state law. Congress responded by passing a second reform act: the Securities Litigation Uniform Standards Act (SLUSA), which prohibited both state and federal courts from adjudicating state-law securities-fraud cases brought by more than 50 individuals ("covered class actions"). 15 U.S.C. § 77p(b). Moreover, SLUSA explicitly allowed these suits to be removed to federal court. 15 U.S.C. § 77p(c).

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In *Cyan*, a group of investors, invoking the 1933 Act, brought a damages class action in California Superior Court, alleging that Cyan, Inc.—a telecommunications company—made material misstatements in their offering documents. Cyan moved to dismiss the claims, arguing that SLUSA stripped state courts of their jurisdiction over *all* 1933 Act claims brought by covered classes, and not just those that invoked state law. The trial court denied Cyan's motion to dismiss. After the California appellate courts affirmed the trial court's decision, the U.S. Supreme Court granted certiorari.

Specifically, Cyan contended that SLUSA's amendment to the 1933 Act's jurisdictional provision stripped state courts of jurisdiction over 1933 Act claims. Under SLUSA, state and federal courts have concurrent jurisdiction over 1933 Act claims "except as provided in section 77p . . . with respect to covered class actions." 15 U.S.C. § 77v(a). Because SLUSA defined "covered class action" as "*any* single lawsuit in which . . .damages are sought on behalf of more than 50 persons or prospective class members . . . ," Cyan argued that SLUSA prohibited state courts from adjudicating *any* 1933 Act-covered class action. 15 U.S.C. § 77p(f)(2) (emphasis added).

The Court disagreed, holding that although SLUSA strips both state and federal courts of jurisdiction to hear covered class actions alleging state-law securities fraud, it "says nothing, and so does nothing to deprive state courts of jurisdiction over class actions based on *federal* law[,]" and that Congress would not have radically upended a long-standing statutory scheme through a technical-exception clause. *Cyan*, Slip Op. 15-1439 at 8, 12 (U.S. Mar. 20, 2018) ("Congress does not 'hide elephants in mouseholes.'" (quoting *Whitman v. American Trucking Assns., Inc.*, 531 U.S. 457, 468 (2001)). The Court also addressed a proposal by the U.S. solicitor general acting as amicus curiae. Specifically, the solicitor general suggested that under SLUSA, state courts maintained concurrent jurisdiction over 1933 Act claims, but that that the exception clause gave defendants the ability to remove the 1933 Act claims to federal court. The Court rejected this approach as well.

In sum, the Court clarified long-standing confusion over how state and federal courts should handle class-action lawsuits alleging fraud in the offering of securities. Under the Court's formulation, "all covered securities class actions *must* proceed under federal law [and] some (*i.e.*, those alleging 1933 Act claims) *may* proceed in state court." *Cyan*, Slip Op. 15-1439 at 15 (U.S. Mar. 20, 2018) (emphasis added).

Bottom Line for Practitioners

- When dealing with covered class action lawsuits (in state or federal court) alleging fraud in the offering of securities, practitioners must pay special attention to the particular source of law

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underlying the claims. All securities-fraud claims brought by covered classes under state law are prohibited by SLUSA, and defendants should move to dismiss these claims.

- Defendants have two options when facing a covered class action, brought in state court, alleging fraud in the offering of securities based solely on state law. They can either (a) move the state court to dismiss the claims or (b) remove the case to federal court and then move the federal court to dismiss the claims.
- When facing "mixed claims" (i.e., covered class-action claims alleging both 1933 Act violations and state law violations), SLUSA directs state courts to dismiss the state law claims for lack of subject-matter jurisdiction. However, the *Cyan* Court, in dicta, suggests that parties can also remove state-law securities-fraud claims to federal court for purposes of their dismissal.

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