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Supreme Court Reaffirms that 1933 Act Class Claims Brought in State Court Can Remain in State Court

by John J. Murphy III and David C. Franceski Jr.

On March 20, the United States Supreme Court in *Cyan, Inc. v. Beaver County Employees Retirement Fund*, reaffirmed that because federal and state courts share concurrent jurisdiction over class actions alleging violations of the Securities Act of 1933 (1933 Act), such actions can remain in state court. The Court rejected arguments that recent amendments to the 1933 Act allow defendants to remove such actions from state courts. The decision ensures class actions alleging 1933 Act violations will continue to be litigated in state court absent future action by Congress to limit jurisdiction to the federal district courts.

The underlying litigation in *Cyan* was initiated by three pension funds and an individual who had purchased shares of Cyan through an initial public offering. After the stock declined in value, the purchasers brought a class action for damages alleging Cyan's offering documents contained material misstatements in violation of the 1933 Act. Plaintiffs did not allege any state law claims. Cyan moved to dismiss the claims for lack of subject matter jurisdiction, arguing that provisions of the Securities Litigation Uniform Standards Act of 1998 (SLUSA) stripped state courts of the power to adjudicate 1933 Act claims. The trial court denied the motion and the California appellate courts declined to review the ruling. The United States Supreme Court granted Cyan's petition for certiorari to resolve a split among state and federal courts on the jurisdictional issue.

Congress authorized both federal and state courts to exercise jurisdiction over private suits when it enacted the 1933 Act. However, when Congress drafted the Securities Exchange Act of 1934 one year later, it granted federal district courts exclusive jurisdiction over private suits alleging violations of the 1934 Act involving secondary trading on national exchanges.

Prompted by growing concerns about perceived abuses in class actions involving nationally traded securities, Congress passed the Private Securities Litigation Reform Act (Reform Act) in 1995, which added both substantive and procedural amendments to the 1933 and 1934 Acts. The substantive reforms included a "safe harbor" from federal liability for certain "forward-looking statements" made by company officials. Unexpectedly, however, the Reform Act led to a proliferation of securities class actions under state law, which effectively thwarted the Reform Act's provisions.

Congress adopted SLUSA several years later to address these developments. Section 77p(b) of the Act expressly prohibits securities class actions alleging violations of state statutory or common law. The Act further provided for the removal of such class action claims from state court so that these class actions based upon alleged violations of state law can be dismissed in the federal district court, but did not explicitly address federal claims filed in state court based on federal concurrent jurisdiction statutes like the 1933 Act.

The SLUSA provision primarily at issue on appeal was Section 77v of the Act, which provided for concurrent jurisdiction over 1933 Act claims "except as provided in section 77p of this title with respect to covered class actions." Cyan argued that the "except clause" evidenced an intention on the part of Congress to vest federal district courts with exclusive jurisdiction over class actions alleging violations of the 1933 Act.

The Supreme Court disagreed, finding nothing in the text or legislative history to support Cyan's argument. While the Court agreed that SLUSA stripped state courts of jurisdiction to entertain securities class action suits alleging violations of state law, it could find no corresponding intent on the part of Congress to deprive state courts of jurisdiction to adjudicate class action claims based solely upon violations of the 1933 Act. To the contrary, the Court noted, Congress was well aware at the time it enacted SLUSA that state courts had been adjudicating all manner of 1933 Act claims, including class actions, for more than 65 years. The Court observed that the preamble of SLUSA highlights its limited scope, namely, "to limit the conduct of securities class actions under State law."

Although the Court acknowledged considerable uncertainty concerning the actual intent of Congress in drafting the "except clause," it concluded actual intent was irrelevant because the text of the clause did not support the far broader reading of the clause suggested by Cyan. During oral argument, Justice Alito was far less charitable in his assessment of the drafting skills of Congress, stating, "[W]e have very smart lawyers here who have come up with creative interpretations, but this is gibberish. It's … just gibberish." Given its reading of the statute, the Court also rejected an argument by the federal government which acknowledged concurrent jurisdiction over 1933 Act class actions claims but interpreted SLUSA as allowing for the removal of such claims to federal court.

Unless and until Congress takes further action, 1933 Act class action claims can continue to be heard in state courts. This will allow class action plaintiffs and their counsel to file claims in those state courts they deem most sympathetic to their claims. Although the substantive provisions of the Reform Act, including its safe harbor provision, will continue to apply in state court actions, the procedural provisions of the Reform Act will not. For example, the Reform Act requires a lead plaintiff in an action pending in federal court to file a sworn certification stating that he has not purchased the relevant security "at the direction of plaintiff's counsel" and that he will receive no additional compensation or benefits for serving as a class representative beyond his pro rata share of any recovery. However, these provisions do not apply to class actions filed in state court.

We expect 1933 Act class action filings in state court to proliferate unless and until Congress enacts a legislative patch to SLUSA. Though filing in state court may pose other jurisdictional and service hurdles not found in federal court for class plaintiffs, those hurdles may be substantially outweighed by the attraction of proceeding before state court judges and juries. And though state courts have been involved in the development of 1933 Act law before, the prospect of 50 different jurisdictions now doing so in the class action context subject to 50 different sets of procedural rules could mean many sleepless nights for the securities and financial services industries and their counsel.

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