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Supreme Court holds that the Securities Litigation Uniform Standards Act does not bar state courts from hearing 1933 Act class actions

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On March 20, 2018, the Supreme Court issued a unanimous opinion, authored by Justice Elena Kagan, clarifying that the Securities Litigation Uniform Standards Act of 1998 ("SLUSA"), 112 Stat. 3227, does not bar state courts from hearing class actions brought under the Securities Act of 1933 (the "Securities Act"), 48 Stat. 74, as amended, 15 U.S. C. § 77a *et seq*. *Cyan, Inc. v. Beaver County Employees Retirement Fund*, 583 U.S. __, 2018 WL 1384564 (March 20, 2018). As originally enacted, the Securities Act expressly provided for concurrent jurisdiction of the state and federal courts over private suits, and barred removal to federal court. In *Cyan*, the Court addressed whether SLUSA's amendments to the Securities Act changed that law. Resolving a longstanding split among the state and federal courts, the Court held that they did not. While the legislative history of SLUSA indicated that the law was intended to limit securities suits in state court, that could not overcome what the justices concluded was clear statutory language.

Background

The case was brought as a class action in California state court alleging misrepresentations in an initial public offering by Cyan, a former telecommunications company, and asserting only federal claims under the Securities Act. The trial court denied defendants' motion to dismiss on jurisdictional grounds under SLUSA and the state appellate courts declined to review that decision. The United States Supreme Court granted certiorari to review and decide whether cases alleging only Securities Act claims can be litigated in state court, an issue of technical statutory interpretation that has bedeviled courts since SLUSA became law.

The Securities Act addresses the initial offerings of securities, while the Securities Exchange Act of 1934 (the "Exchange Act"), 48 Stat. 881, as amended, 15 U.S.C. § 78a et seq., governs post-offering trading in securities and is the source of the much-litigated Rule 10b-5. The Private Securities Reform Act of 1995 (the "PSLRA"), 109 Stat. 737, imposed numerous substantive reforms on securities class actions brought in both state and federal courts, as well as procedural reforms applicable to cases in federal court, to address "perceived abuses of the class-action vehicle in litigation involving nationally traded securities." *Merrill Lynch, Pierce, Fenner & Smith, Inc. v. Dabit*, 547 U.S. 71, 81 (2006). To avoid the requirements imposed on plaintiffs by the PSLRA, plaintiffs' lawyers fled to state court, bringing securities claims under state law. The avowed intent of SLUSA was to terminate that trend.

SLUSA expressly eliminated a broad swath of securities class actions brought under state laws, plainly stating that "covered class actions" (i.e., class actions involving more than 50 plaintiffs) concerning a "covered security" (i.e., traded on a national exchange) may not be brought in either state or federal court if the case is "*based upon the statutory or common law of any state*." (Securities Act 15 U.S.C. § 77p(b).) Any such action filed in state court "shall be removed to federal court," where it will be dismissed. (*Id.* § 77p(c).)

SLUSA was not as clear about the future of securities class actions brought in *state* court based on *federal* law and specifically the Securities Act. While the Exchange Act had always provided for exclusive federal jurisdiction, for sixty-five years Securities Act claims could be brought in state or federal court. Did SLUSA change that?

The key SLUSA provision modified section 22 of the Securities Act containing the reference to concurrent jurisdiction. (15 U.S.C. § 77v). In a "conforming amendment," Congress amended that jurisdictional language to state that federal courts shall have jurisdiction "concurrent with State and Territorial courts *except as provided in section 77p* of this title."

That language has been a source of considerable debate since 1998, and appeared to also challenge the justices of the top court at oral argument, where Justice Alito described the text as "gibberish." In their unanimous decision, however, the Court pursued a technical and focused analysis of that italicized language, which the Court labeled as the "except clause" and several interlocking and cross-referencing provisions, to hold that the language of the provision was clear, and had not altered the concurrent jurisdiction provided in section 22 of the Securities Act. In reaching that conclusion, the Court refused to adopt Cyan's argument premised on the statutory definition of "covered class action," referred to in a portion of 77p. Section 77p(f)(2), which defines a covered class action to be any class action with more than 50 defendants. Thus, Cyan argued that the except clause must be read to provide for concurrent jurisdiction except for any such class action. The Court was not persuaded. First, the except clause cross references the *entire* text of 77p, and not just the definition of "covered class action" in 77p(f)(2). Second, the Court could find no other examples in the U.S. Code where Congress had used an except clause to cross-reference a definition. The uniform practice, according to the Court, is that language in a statute such as "except as provided in ___" should only be read to cross reference to other substantive provisions. Slip Op. at 9-10.

Pointedly, the Court rejected the idea that Congress intended to make a significant substantive change to a long-standing jurisdictional provision by a cross-reference. To the contrary, as the Court so succinctly put it, "Congress does not 'hide elephants in mouseholes.'" *Id.* at 12, quoting *Whitman v. American Trucking Ass'n, Inc.*, 531 U.S. 457, 468 (2001).

The Court was also skeptical of arguments based on legislative history, rejecting the premise that Congress had intended in SLUSA to preclude all efforts to evade the PSLRA by bringing securities class actions in state courts. Whatever the reasons Congress had for drafting the except clause as it did were beside the point, even as the Court acknowledged that there might be some questions about the except clause's "precise purpose." The Court would not give the except clause a "broader reading than its language can bear" nor "devise a statute (and at that, a transformative one) of [its] own." Slip op. at 18.

In a final point, the Court addressed the position of the United States, as amicus, that Congress intended in SLUSA to retain state court jurisdiction of Securities Act cases, but permit removal of those cases to federal court, where the procedural protections of the PSLRA apply. Comparing these arguments to Cyan's advocacy, the Court again declined to interpret "clear language" based on "an intuition that Congress must have intended something broader." Slip op. at 24, quoting *Michigan v. Bay Mills Indian Community*, 572 U.S. at __ (2014).

Analysis

The *Cyan* case is yet another example of the Court's refusal to accord great weight to legislative history in the face of what it concludes is clear statutory language, even where that language appears to be at odds with articulated legislative purposes. As the Court stated, "we do not generally expect statutes to fulfill 100% of all their goals." (Slip. op. at 14.) In the Court's view, SLUSA did achieve the primary goal of eliminating efforts by plaintiffs to evade the PSLRA by bringing securities class actions based on state law theories. In the end, the Court was unwilling to upend sixty-five years of concurrent jurisdiction over Securities Act claims by giving an expansive reading to such patchwork language.

The plaintiffs' bar is hailing the decision as a victory for investors. Undeniably, defendants in securities class actions based on an initial offering of securities, including both issuers and underwriters, will face an increased risk of litigating in state court, where the PSLRA procedural protections do not apply.

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