What To Look For In Cyan V. Beaver County Oral Arguments

By **William O'Brien**

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On June 28, 2017, the U.S. Supreme Court granted certiorari in Cyan Inc. v. Beaver County Employees Retirement Fund, No. 15-1439. At issue is whether state courts have subject matter jurisdiction over class actions alleging only federal claims under the Securities Act of 1933.[1] This question should have been laid to rest in 1998, when Congress passed certain amendments to the 33 Act through the Securities Litigation Uniform Standards Act, otherwise known as SLUSA.[2]

Lower courts, however, have sharply divided over the answer. While some jurisdictions have held that SLUSA stripped state courts of jurisdiction over all 33 Act claims involving "covered class actions" (i.e., actions involving 50 or more people), others have ruled that this authority was left intact. This split, in turn, has spawned a chaotic patchwork of inconsistent rulings that has undermined SLUSA's core purpose — to "make Federal court the exclusive venue for most securities class action lawsuits."[3]

Imposing order on this chaos has now fallen to the Supreme Court. And the stakes are high. The plaintiff and defense bars have fought for decades over where securities class actions may be litigated. And with good reason: Because some states have been more receptive to securities suits, the location of a 33 Act claim — whether it proceeds in state or federal court — can be the difference between plaintiffs extracting a costly settlement or having their claims thrown out at the pleadings stage. Take for instance California: Only 6 percent (three out of 50) of 33 Act class action complaints have been involuntarily dismissed since 2011, when the California Court of Appeals held, in Luther v. Countrywide Financial Corp.,[4] that SLUSA had not disturbed the power of state courts to hear 33 Act claims.[5] By contrast, approximately 32 percent of all securities class actions are typically rejected at the pleadings stage by federal courts.[6]

The question now is where the Supreme Court will come down on this issue. Although it is too early to say, we may be able to glean some clues from the justices when they take the bench for oral argument this Tuesday, Nov. 28. One possible sign may be if the justices are drawn to the views expressed by the Office of the Solicitor General ("OSG"), which filed an amicus brief earlier this year at the court's request. As discussed below, if OSG's overall position gains traction, it could be an ominous sign for Beaver County Employees Retirement Fund and its fellow plaintiffs-respondents. For although the OSG rejects the interpretations of SLUSA offered by both parties, its alternative framework would largely curtail recent efforts by plaintiffs to flood state courts with 33 Act claims.

The Jurisdictional Dispute Explained

The dispute in Cyan can be traced back to the 1990s, when plaintiffs started filing securities class actions in state court to evade reforms that Congress had enacted through the Private Securities Litigation Reform Act of 1995, or "PLSRA."[7] The PSLRA had sought to curb a proliferation of abusive litigation tactics by, among other things, placing limitations on plaintiffs' attorneys fees, adopting selection criteria for lead plaintiffs, and requiring courts to stay discovery during the pendency of motions to dismiss.

Plaintiffs were able to file 33 Act claims in state court (and thereby escape the heightened scrutiny mandated by the PSLRA) because at the time, Section 22 of the 33 Act not only granted concurrent subject matter jurisdiction to state and federal courts over all "violations [of] this subchapter," but also barred defendants from removing such suits to federal court.[8]

In 1998, Congress tried to close this loophole by amending Section 22(a). This provision, as modified, currently provides that

> The district courts of the United States and the United States courts of any Territory shall have jurisdiction of offenses and violations under this subchapter ... and, concurrent with State and Territorial courts, *except as provided in section [Section 16] 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.[9]

The purpose of this amended language, denoted in italics, was to carve out an exception to the grant of concurrent jurisdiction over "offenses and violations of this subchapter" (i.e., of the 33 Act) — hence, Congress's use of the phrase "except as provided."

Defining the parameters of the "except" clause, however, has led to conflict among the lower courts, which have divided into two main camps. For instance, the majority of federal district courts in five circuits (the Second, Third, Fourth, Fifth and Tenth) have endorsed a broad, defendant-friendly interpretation that eliminates state court jurisdiction over essentially all 33 Act claims styled as covered class actions. The majority of federal district courts in four other circuits (the First, Seventh, Ninth and Eleventh), by contrast, have taken the opposite position — that SLUSA preserved state court jurisdiction over 33 Act claims.

These divisions only grew deeper in 2011 with the decision in Countrywide. By reaffirming the right of state courts to hear 33 Act class action, the California Court of Appeals transformed the Golden State into a virtual safe haven for plaintiffs looking to escape the heightened pleading and other requirements of the federal court system. Indeed, the trend line is unmistakable: Since Countrywide was decided, 50 class action lawsuits have been filed in California state courts alleging 33 Act claims.[10] This compares to the six such actions that were brought in California between 1998, when SLUSA was enacted, and 2011.[11]

Petitioners' Argument

Cyan and its co-petitioners, not surprisingly, have lined up behind the broad approach to

interpreting the "except" clause. They posit that this clause, by invoking Section 16, was cross-referencing the statutory definition of "covered class action" in Section 16(f) so as to emphasize that the exception was eliminating state court jurisdiction over all 33 Act claims brought as covered class actions. Or stated differently, by coupling the phrase "covered class actions" with a reference to Section 16, the "except" clause was defining — by way of Section 16(f) — the universe of 33 Act claims that could no longer be prosecuted in state court.

Courts backing the restrictive approach reject this view, arguing that Congress's focus was not Section 16(f), but rather Section 16 as a whole. Viewing the inquiry through this widened lens, they reason, compels the conclusion that SLUSA preserved state court jurisdiction over all 33 Act claims. Why? Because according to these courts (and the plaintiff's bar), there is no subpart within Section 16 that purports to divest state courts of jurisdiction over federal claims. In the judgment of these courts, as well as the respondents, it is implausible that Congress would have sought to accomplish such a sea change in the law through an implied reference to a definitional provision.

There is considerable support for Cyan's interpretation, however. As one court has noted, "[t]he statutory language [of the "except" clause] is amenable to [the pro-defendant] reading," in part because "the phrase 'covered class action' is a term of art with no meaning absent a reference to some definition."[12] It therefore makes sense that Congress would have wanted to cross-reference the definition of this term in Section 16(f). Moreover, the three other subparts within Section 16 that mention covered class actions deal exclusively with state law claims and say nothing about the sole focus of the "except" clause — "offenses and violations under ... this chapter [the 33 Act]."[13] This has led several courts to conclude that "the definitional provision of Section 16 [is] the only subsection that can breathe meaning into the SLUSA jurisdictional exception,"[14] making defendants' (and Cyan's) reliance on it the "better reading of the text."[15]

Respondents' Argument

The respondents' interpretation relies on a different provision within Section 16, subpart (b). By its terms, Section 16(b) bars both state and federal courts from hearing any *state law* claim if it (i) meets the definition of a covered class action, (ii) involves securities regulated on a national exchange, and (iii) alleges misrepresentations and omissions of fact or manipulation and deceit. Congress, the respondents argue, had this preclusion provision in mind when it sought to define the reach of the "except" clause. Consequently, while state courts are prohibited from adjudicating the state law class actions narrowly defined in Section 16(b), they retain full authority over 33 Act claims, which are nowhere mentioned.

The problem with this interpretation, though, is that it collides with the statutory text. The "except" clause, as even the OSG explains, "is most naturally read as a limitation on the preceding phrase [in Section 22(a)] dealing with the concurrent jurisdiction of state courts."[16] That phrase, as previously noted, specifies that state and federal courts "shall have [concurrent] jurisdiction ... of all suits in equity and actions at law brought to enforce" obligations created by the 33 Act — that is, exclusively *federal* claims.[17] Because Section 22(a) is only concerned with subject matter jurisdiction over 33 Act claims, it makes no sense to contend, as the respondents do, that the "except" clause constrains the power of state courts to hear state law claims. This position, as one court explained, just cannot be squared with the statutory text: "[S]tate claims ... are not a subset of federal claims, excisable through an exception."[18]

The Solicitor General's Argument

The OSG rejects the positions offered by both sides, opting instead for a third approach that sidesteps the question of how to interpret the "except" clause. The OSG agrees that

"SLUSA cannot achieve its purpose of preventing circumvention of the PSLRA's substantive and procedural requirements" unless the statute grants defendants access to a federal forum. It does not believe, however, "that the 'except' clause provides the only statutory mechanism for ensuring such access in 1933 Act suits requirements."[19] To the OSG, the answer lies not in defining the "except" clause but in exploring the interplay between the 33 Act's two removal provisions — set forth in Sections 22(a) and 16(c), respectively.

The OSG's theory proceeds in two main steps, beginning with language that SLUSA added to the 33 Act's removal bar. As noted earlier, the pre-SLUSA iteration of Section 22(a) not only gave state courts the power to hear 33 Act claims, but barred defendants from removing them. As the OSG notes, SLUSA weakened (i.e., carved out an exception to) this anti-removal provision by adding the phrase, "[e]xcept [when] ... provided in Section [16(c)] of this title."[20]

Step two, in turn, directs parties to Section 16(c), which specifies that "[a]ny covered class action brought in any State court involving a covered security, as set forth in [Section 16(b)], shall be removable to the Federal District court for the district in which the action is pending, and shall be subject to [Section 16(b)]."[21] The OSG opines that this language "is best understood" as permitting defendants to remove any covered class action involving a covered security so long as it alleges the type of misconduct described in Section 16(b) (i.e., misstatements and omissions of material fact or manipulative and deceptive practices).[22] But this argument, when raised in the past by private litigants, has met with some resistance. Indeed, because Section 16(b) only precludes certain *state law* class actions, some courts reason that SLUSA's amendment to the anti-removal clause, on its face, cannot be used to remove federal claims.[23]

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It is impossible to know whether the justices will accept any of these three positions. But again, there may be clues to look out for when the court hears argument. There is evidence to suggest, for instance, that when the OSG is asked to express the views of the United States as a nonparty observer, as in this case, its recommendations are given substantial weight.[24] So it may be instructive to listen for cues that the justices are sympathetic to the OSG's approach.

If they are, this could signal an end to what has become an epidemic of state court forum shopping in 33 Act class actions. Although the OSG posits that the respondents "have the better of the interpretive dispute" vis-à-vis the petitioners,[25] the overall thrust of the OSG's position tilts decisively toward Cyan and corporate defendants more generally. While the petitioners and the OSG part ways on how to construe the "except" clause, their positions share the same remedial objective — granting defendants meaningful access to a federal forum so that plaintiffs cannot circumvent the procedural and other protections enshrined in the PSLRA.

And crucially, that unity of purpose is reflected in the OSG test, which would allow defendants to remove any 33 Act claim that (i) qualifies as a covered class action; (ii) involves a security traded on a national exchange; and (iii) alleges the substantive misconduct proscribed by Section 16(b) (i.e., misstatements and omissions of fact and/or manipulation and deceit). Yes, Cyan's interpretation of SLUSA would cast a wider net. Not only would it divest state courts of jurisdiction over 33 Act suits involving noncovered securities (like the mortgage-backed certificates in Countrywide), it would reach all covered class actions under the 33 Act regardless of the misconduct alleged. Still, a "win" by the OSG would represent a major, albeit incomplete, victory for corporate defendants, since it would curb the explosion of state court forum shopping that was ushered in by Countrywide.

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[1] 15 U.S.C. § 77a et seq.

[2] Pub. L. 105-353, 112 Stat. 3227.

[3] H.R. Conf. Rep. No. 105-803, at 13 (1998) (emphasis added); see also Merrill Lynch, Pierce, Fenner & Smith Inc. v. Dabit, 547 U.S. 71, 82 (2006) (observing that SLUSA was intended to prevent "state-court litigation of class actions involving nationally traded securities").

[4] Luther v. Countrywide Fin. Corp., 195 Cal. App. 4th 789 (2011).

[5] Brief of the Securities Industry and Financial Markets Association, et al., as Amicus Curaie in Support of Petitioners (Sept. 5, 2017), at 9 (citation omitted) ("SIFMA Br.").

[6] Id.

[7] Pub. L. 104-67, 109 Stat. 737.

[8] 15 U.S.C. § 77v(a).

[9] Id. (emphasis added).

[10] SIFMA Br. at 9.

[11] Petition at 8 n.11; see also id. at App. I (listing 33 Act class actions filed in California state court before and after Countrywide was decided).

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

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

[14] Id.

[15] Hung, 2016 WL 299034, at *2.

[16] Brief for the United States as Amicus Curaie (May 23, 2017) ("US Br."), at 7.

[17] 15 U.S.C. § 77v(a).

[18] Hung, 2016 WL 299034, at *2.

[19] Id. at 13.

[20] Id. at 14.

[21] 15 U.S.C. § 77p(c).

[22] Id. at 14.

[23] Schwartz v. Concordia Int'l Corp., No. 16-CV-6576 (CLP), 2017 WL 2559777, at *5 (E.D.N.Y. June 12, 2017) ("Because the instant case involves only federal claims asserted under the Securities Act, this case does not fall under the Anti-Removal Provision's exception for state-law class actions, per the cross-reference to section [16(c)].").

[24] See Matt Sundquist, Analysis: Former Solicitors General and the Supreme Court Bar (Mar. 4, 2011) (over a four-term period, the Court "agreed with the [OSG]'s overall recommendations eighty-six percent of the time."), available at http://www.scotusblog.com/2011/03/analysis-former-solicitors-general-and-the-supreme-court-bar/.

[25] US Br. at 11.
