

Supreme Court upholds state court jurisdiction over '33 Act class actions

(March 22, 2018) - A unanimous U.S. Supreme Court has ruled that state courts have concurrent jurisdiction with federal courts over class-action lawsuits that only allege violations of the Securities Act of 1933.

Cyan Inc. et al. v. Beaver County Employees Retirement Fund et al., No. 15-1439, 2018 WL 1384564 (U.S. Mar. 20, 2018).

In an opinion written by Justice Elena Kagan, the high court said the Securities Litigation Uniform Standards Act of 1998, [15 U.S.C.A. § 77v\(a\)](#), stripped state courts of their jurisdiction over class actions filed under the Securities Exchange Act of 1934, [15 U.S.C.A. § 78a](#), but not class actions alleging only 1933 Act violations.

The top court agreed to review the issue after three California state courts refused to dismiss a Cyan Inc. shareholder's class-action lawsuit accusing the telecommunications systems supplier of misrepresenting its sales figures before an initial public offering.

The complaint, filed by the Beaver County Employees Retirement Fund in a California state court, alleged violations of Sections 11, 12(a)(2) and 15 of the 1933 Act, [15 U.S.C.A. §§ 77k](#), [77l\(a\)\(2\)](#) and [77o](#). The suit did not include any other federal or state law claims.

An increase in state filings

"The outcome in *Cyan* will likely result in a tactical move by the plaintiffs' bar to pursue more state court venues when litigating 1933 Act class actions, as you only need 50 or more plaintiffs to meet the numerosity requirement," according to Ivan Dolowich of Kaufman Dolowich & Voluck, who is not involved in the case.

"As more cases get filed in state court, it will be more difficult ... to get cases dismissed with prejudice, resulting in more significant defense costs and greater overall losses," he added.

Jason de Bretteville of Stradling Yocca Carlson & Rauth agreed that the ruling will result in a larger number of securities class actions in state court.

"The decision is a substantial win for the plaintiff's bar, who now may evade federal procedural protections, including certain provisions of the Private Securities Litigation Reform Act, merely by filing 1933 Act claims in state court," said de Bretteville, who was not involved in the case.

"Justice Kagan's decision, which resolves a long-standing split among the courts by means of a remarkably thorough statutory exegesis, clearly will result in a surge in state court filings," he noted. "That surge will substantially increase the cost of litigating and settling 1933 Act cases."

Cyan's IPO

California-based Cyan filed a registration statement with the Securities and Exchange Commission for its IPO in 2013 that described the company's financial condition in positive terms.

The registration statement emphasized growing revenues and strong demand for Cyan's products. It also said sales were on track despite a decreased in business from Windstream Corp., a cloud computing company that had been Cyan's largest customer.

Cyan sold its stock at \$11 per share and raised almost \$98 million in the IPO on May 8, 2013, the suit said.

But the company experienced less growth than anticipated in its registration statement after Windstream substantially cut its orders and Cyan could not replace the sales, according to the complaint.

Analysts downgraded Cyan's stock, and it fell about 60 percent over the next several months, the suit said. The stock was trading at \$4.30 per share when Beaver County filed its suit April 1, 2014, in the San Francisco County Superior Court.

In addition to Cyan, the suit named as defendants Chairman and CEO Mark Floyd, ex-Chief Financial Officer Michael Zellner and six other directors. Floyd left the company in August 2015.

It also named IPO underwriters Goldman Sachs & Co., J.P. Morgan Securities LLC, Jefferies LLC and Pacific Crest Securities LLC.

Judgment on the pleadings denied

Cyan moved for judgment on the pleadings, arguing the state court lacked jurisdiction over the Securities Act claims. The Superior Court denied the request in an unreported August 2015 decision, according to the company's petition to the U.S. Supreme Court.

Both California's 1st District Court of Appeal and the state high court subsequently rejected Cyan's appeals without opinion, the petition said.

Cyan appealed to the U.S. Supreme Court.

Concurrent jurisdiction

Cyan had argued that the California courts should have tossed the suit because it is barred by the Securities Litigation Uniform Standards Act.

Under Section 77v(a) of the Securities Act, federal district courts have jurisdiction "concurrent with state and territorial courts, except as provided in Section 77p ... with respect to covered class actions, of all suits in equity and actions at law brought to enforce any liability or duty created by the [Securities Act]."

Section 77p defines covered a class action as a single lawsuit where damages are sought on behalf of more than 50 people. It bars securities class actions alleging state law claims from state court and mandates removal of covered class actions to federal court.

According to Cyan, the "except as provided" language in [Section 77v\(a\)](#), along with the bar on state law claims language, precludes state court jurisdiction over 1933 Act claims even when a state law claim is not alleged.

The top court disagreed.

"SLUSA's text, read most straightforwardly, leaves in place state courts' jurisdiction over 1933 Act claims, including when brought in class actions," Justice Kagan wrote.

"If Congress had wanted to deprive state courts of jurisdiction over 1933 Act class actions, it had an easy way to do so: just insert into Section 77p an exclusive federal jurisdiction provision," she added.

Additionally, Justice Kagan noted that SLUSA's purpose is to preclude state court jurisdiction over "certain vexing state law class actions," which does not necessitate barring all federal securities law class actions from state courts.

By Peter H. Hamner, Esq.

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