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Supreme Court Upholds State Court Jurisdiction Over Securities Act Claims

In a unanimous decision, the U.S. Supreme Court has held that U.S. state courts have jurisdiction over securities class action lawsuits alleging only claims under the Securities Act of 1933 (the “Securities Act”), leaving open at least one way for plaintiffs to obtain what is often perceived as a more favourable state court forum.

The question of whether a lawsuit belongs in federal or state court has been one of the key issues in the securities class action world since enactment of the Private Securities Litigation Reform Act of 1995 (the “PSLRA”). In an attempt to curb frivolous securities class action litigation, the PSLRA put in place a number of procedural hurdles, such as heightened pleading standards for certain elements of a claim, that have made it easier to dismiss such lawsuits at an early stage, as well as a stay of all discovery while a motion to dismiss is pending. Since the procedural rules are only applicable to federal courts, many plaintiffs opted to file securities class actions in state court. In reaction to the increase in state court filings, Congress then adopted the Securities Litigation Uniform Standards Act of 1998 (“SLUSA”), which prohibited any “covered class action”¹ based on state law that alleges dishonest practices in connection with the purchase or sale of a “covered security.”²

In *Cyan, Inc v. Beaver County Employees Retirement Fund*, 583 U.S. ____ (March 20, 2018), the respondents had purchased Cyan stock in an initial public offering. After the stock declined in value, the investors brought a class action against Cyan in a California state court, alleging only Securities Act violations based on alleged material misstatements in Cyan’s initial public offering documents. Cyan moved to dismiss the case, arguing that SLUSA had stripped state courts of the authority to hear Securities Act class action claims. The California courts, however, rejected Cyan’s argument, holding that the state courts still have jurisdiction over all suits alleging only Securities Act claims.

Both the Securities Act and the Securities Exchange Act of 1934 (the “Exchange Act”) create private rights of actions allowing investor lawsuits in connection with securities offerings. The Securities Act, which regulates the original issuance of securities, authorizes both federal and state courts to exercise jurisdiction over such private lawsuits and bars the removal of such suits from state to federal

¹ A “covered class action” is one in which damages are sought on behalf of more than 50 people.

² A “covered security” is a security listed on a U.S. national stock exchange.

court. By contrast, all suits brought under the Exchange Act, which regulates the subsequent trading of securities, fall within the exclusive jurisdiction of the federal courts. Many plaintiffs have traditionally favoured state courts as being more sympathetic to cases against large companies, particularly overseas defendants. The key procedural protections of the PSLRA are a requirement to plead with particularity certain elements of claims that sound in fraud, in particular falsity and the requisite state of mind (known as scienter). Exchange Act claims require both of these elements while Securities Act claims require a plaintiff to establish falsity but not scienter. In addition, discovery is stayed in federal court for claims under both statutes while a motion to dismiss is pending unless the court orders otherwise, which rarely occurs.

Looking in detail at the language of SLUSA, the Court held that SLUSA did not strip state courts of their longstanding jurisdiction to adjudicate class actions brought under the Securities Act. SLUSA's bar on class actions, the Court concluded, only applied to those based on state law claims and did not affect the Securities Act's grant of jurisdiction to state courts. While the Court acknowledged imprecision in certain provisions of the statute relied upon by Cyan, it declined to "devise a statute (and at that, a transformative one) of our own" and noted that "[i]f further steps are needed, they are up to Congress."

The Court also addressed a related question raised by the Federal Government as amicus curiae: whether SLUSA enabled defendants to remove Securities Act class actions from state to federal court for adjudication. Again, the Court found that SLUSA's target was class actions based on state law claims; thus, a class actions based only on Securities Act claims would still be subject to the Securities Act's bar on the removal of lawsuits from state to federal court.

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We will continue to monitor developments in this area and welcome any queries you may have. If you have any questions, please contact the people on the right or your usual Linklaters contact.

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