



Clarifying “Gibberish”: Supreme Court Holds That State Courts Can Hear Securities Act Lawsuits

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On March 20, in a case [watched closely by the securities bar](#), the Supreme Court addressed the implications of the [Securities Litigation Uniform Standards Act of 1998 \(SLUSA\)](#)—a statute that Justices Alito and Gorsuch described during oral argument as “gibberish.” In [Cyan, Inc. v. Beaver County Employees Retirement Fund](#), the Court unanimously held in a decision by Justice Kagan that SLUSA does *not* (1) strip state courts of jurisdiction over class actions alleging violations of only the Securities Act of 1933 (the 1933 Act), or (2) allow defendants to remove such actions from state court to federal court. This Sidebar discusses the case’s background, the Court’s decision, and the decision’s implications for securities litigation.

Background

The details of [Cyan](#) and the circuit split that preceded the Court’s decision are discussed in a prior [Sidebar](#). In short, the 1933 Act—which principally regulates initial offerings of securities—[provides](#) a cause of action against an issuer of securities and certain other persons if certain documents associated with a securities offering contain untrue or misleading statements or omissions of material fact. As originally enacted, the 1933 Act provided that (1) state courts had concurrent jurisdiction with federal courts to hear lawsuits to enforce the Act’s provisions, and (2) if such lawsuits were brought in state court, defendants could not remove them to federal court.

In 1995, Congress passed the Private Securities Litigation Reform Act (PSLRA) “to [combat](#) perceived abuses in securities litigation.” Among other things, the PSLRA [provided](#) certain defendant friendly requirements for large securities class actions involving claims under the 1933 Act. Some of these provisions made substantive changes to the 1933 Act, which apply in both state and federal court. However, other PSLRA provisions made procedural changes to securities class actions, which apply only in federal court. After the PSLRA’s enactment, securities plaintiffs “began [bringing](#) class actions under state [securities] law, often in state court” to avoid the PSLRA’s defendant friendly requirements.

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Three years later, in order to combat this “shift from Federal to State courts” and “prevent certain State private securities class action[s] . . . from being used to frustrate the objectives” of the PSLRA, Congress enacted SLUSA. As relevant in *Cyan*, SLUSA contained the following three provisions amending the 1933 Act:

1. a [preclusion provision](#) providing that “covered class actions” (class actions involving more than 50 plaintiffs) alleging conduct that is prohibited by the 1933 Act may not be brought under *state* law in either state or federal court;
2. a [removal provision](#) allowing defendants to remove such state-law actions from state court to federal court for adjudication of a motion to dismiss; and
3. a [jurisdictional provision](#) amending the 1933 Act’s general jurisdictional provision, which originally provided state courts with concurrent jurisdiction over 1933 Act claims.

With respect to the latter item, SLUSA amended that provision to provide for concurrent jurisdiction over 1933 Act claims “except as provided in section [16] . . . with respect to covered class actions.” Among other things, [Section 16](#) of SLUSA includes a definition of the term “covered class action” (defined to mean class actions in which damages are sought on behalf of more than 50 persons, among other requirements). However, Section 16 contains no explicit limitations on the jurisdiction of state courts. Prior to *Cyan*, federal courts were [divided](#) as to whether SLUSA’s jurisdictional provision stripped state courts of jurisdiction over 1933 Act claims in “covered class actions.”

The petitioners in *Cyan*, a hardware and software supplier and associated individuals defending a “covered class action” brought under the 1933 Act in California state court, [argued](#) that SLUSA stripped state courts of jurisdiction over such actions. By contrast, the [respondents](#) (plaintiffs in the California state court litigation) and the [U.S. Office of the Solicitor General](#) (OSG) as amicus argued that because Section 16 of SLUSA—the provision referenced by SLUSA’s jurisdictional amendment as “provid[ing] . . . except[ions]” to the 1933 Act’s general rule of concurrent jurisdiction—contains no explicit limitations on state court jurisdiction over 1933 Act claims, SLUSA did not strip state courts of jurisdiction over such claims.

Moreover, although the defendants did not seek removal of the *Cyan* litigation to federal court, the OSG [asked](#) the Court to “provide helpful guidance to lower courts” concerning defendants’ ability to remove 1933 Act claims in “covered class actions” from state court to federal court. The OSG [read](#) SLUSA’s removal provision—which [provides](#) for the removal of actions described in SLUSA’s preclusion provision—as allowing defendants to remove (1) state-law claims alleging conduct that is also prohibited by the 1933 Act, and (2) 1933 Act claims. By contrast, the plaintiffs [argued](#) that SLUSA allows for the removal of only the former category of claims.

The Court’s Decision

In *Cyan*, the Court sided with the plaintiffs on both the jurisdictional and removal issues, [holding](#) that SLUSA does not (1) strip state courts of jurisdiction over “covered class actions” alleging violations of only the 1933 Act, or (2) allow defendants to remove such actions from state court to federal court.

The Jurisdictional Question

With respect to the first holding, the Court concluded that Section 16 of SLUSA “[says nothing, and so does nothing, to deprive state courts of jurisdiction over class actions based on federal law.](#)” The Court [rejected](#) the defendants’ alternative reading of SLUSA’s jurisdictional provision, according to which

Section 16’s definition of the term “covered class action” “provided” the relevant “except[ion]” to concurrent jurisdiction over 1933 Act claims. In rejecting this argument, the Court [reasoned](#) that SLUSA’s jurisdictional provision referred to Section 16 “as a whole,” and that the defendants accordingly erred by cherry-picking its definition of “covered class action.” Moreover, the Court [explained](#) that Section 16’s definition of “covered class action” “cannot be read to ‘provide[]’ an ‘except[ion]’ to the rule of concurrent jurisdiction” because “[a] definition does not provide an exception, but instead gives meaning to a term.” “Congress,” the Court reasoned, “well knows the difference between these two functions.”

The Court also reasoned that the defendants’ proposed interpretation of SLUSA’s jurisdictional provision was inconsistent with the remainder of the relevant statutory scheme. The Court noted that SLUSA’s preclusion and removal provisions [apply](#) only to class actions involving “covered securities,” a term [defined](#) to mean securities traded on a national securities exchange. However, the Court [reasoned](#) that the defendants’ interpretation of SLUSA’s jurisdictional provision—according to which Section 16’s definition of “covered class action” divested state courts of jurisdiction over 1933 Act claims—would divest state courts of jurisdiction over 1933 claims that do not involve “covered securities.” According to the Court, that conclusion would follow from the defendants’ interpretation because, unlike SLUSA’s preclusion and removal provisions, Section 16’s definition of “covered class action” does not explicitly exclude actions that do not involve “covered securities.” Reading SLUSA as divesting state courts of jurisdiction over 1933 Act claims that do not involve “covered securities,” the Court [explained](#), would be “out of line with SLUSA’s overall scope.”

Finally, the Court [explained](#) that the defendants’ interpretation of SLUSA’s jurisdictional provision was untenable because it “read[] too much into a mere ‘conforming amendment.’” In the Court’s view, had Congress intended to change the 65-year tradition of concurrent jurisdiction over 1933 Act claims, it would have done so using more “direct” means.

After its analysis of SLUSA’s text and structure, the Court proceeded to reject the defendants’ appeals to SLUSA’s [purpose](#) to “make good on the promise of the [PSLRA]” to combat perceived abuses in securities litigation. In rejecting this argument, the Court [explained](#) that its reading of SLUSA was consistent with the statute’s purpose, because the PSLRA’s substantive protections still apply to 1933 Act claims brought in state court, and SLUSA’s preclusion provision still prevents plaintiffs from refashioning 1933 Act claims under state law in order to avoid those protections. In rejecting the defendants’ related argument that the Court’s interpretation rendered SLUSA’s jurisdictional provision purposeless, the Court identified a number of plausible functions that the provision served other than divesting state courts of jurisdiction over 1933 Act claims. However, the Court [noted](#) that irrespective of any “uncertainty surrounding Congress’s reasons for drafting [SLUSA’s jurisdictional provision] . . . we have no sound basis for giving [it] a broader reading than its language can bear.”

The Removal Question

The Court also held that SLUSA’s removal provision does not allow defendants to remove 1933 Act claims from state court to federal court. In arriving at this conclusion, the Court [reasoned](#) that because SLUSA’s removal provision allows for the removal of actions “as set forth in” SLUSA’s preclusion provision, and SLUSA’s preclusion provision applies only to state-law claims, 1933 Act claims cannot be removed. After a detailed textual analysis of the relevant provisions, the Court [rejected](#) an alternative interpretation proffered by the OSG, according to which SLUSA’s removal provision allows for the removal of actions involving *the types of misconduct described by SLUSA’s preclusion provision* (a category that would include 1933 Act claims). The Court [explained](#) that the OSG’s interpretation was

inconsistent with its prior case law interpreting SLUSA’s preclusion and removal provisions and “disregard[ed the] clear language” of the statute.

Cyan’s Implications

The Court’s decision in *Cyan* may be a boon to plaintiffs suing under the 1933 Act. *Cyan* makes clear that plaintiffs can bring 1933 Act claims in state court, and that defendants cannot remove such claims to federal court. Some commentators have contended that companies defending securities fraud lawsuits [generally prefer](#) to [litigate](#) in a federal forum, where they enjoy the procedural protections of the PSLRA. A study submitted to the Court via an amicus brief found that [25 percent](#) of class actions based on Section 11 of the 1933 Act brought in federal court between 2011 and 2016 were involuntarily dismissed, while [six percent](#) of 1933 Act suits brought in California courts (where the *Cyan* litigation was brought) during that period were involuntarily dismissed. Moreover, the median settlement value in securities class actions was [92 percent higher](#) in California courts than federal courts during that period. Accordingly, *Cyan*’s preservation of state-court jurisdiction over 1933 Act claims, and its rejection of the proposition that defendants can remove such claims to federal court, sustains the availability of what many plaintiffs regard as favorable forums to bring securities law actions. While there is at least one [legislative proposal](#) to provide for exclusive federal jurisdiction over 1933 Act claims and thereby reverse the effect of *Cyan*, it remains to be seen whether Congress will seek to amend the 1933 Act along those lines.

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