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The Post-Cyan Spike In State Securities Act Filings

By **James Goldfarb and Gaurav Talwar** (March 19, 2019, 1:54 PM EDT)

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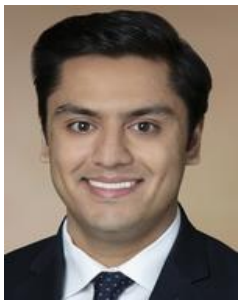

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One year ago, the U.S. Supreme Court held that the Securities Litigation Uniform Standards Act of 1998 neither ended concurrent jurisdiction over class actions alleging only Securities Act claims, nor authorized removing those actions to federal court. The unanimous opinion in Cyan Inc. v. Beaver County Employees Retirement Fund[1] resolved a split among state and federal courts over SLUSA's effect.

Among the (unsuccessful) arguments favoring reversal was a prediction that plaintiffs would inundate state courts with Securities Act class actions if concurrent jurisdiction continued. According to the argument, that result would frustrate Congress' intent that securities class actions be treated uniformly. The respondents dismissed the argument. The court gave it short shrift.

But time might bear out the argument. Recently compiled data demonstrates a post-Cyan spike in Securities Act class actions filed in state courts. This article summarizes the data, then discusses the implications of continued state court jurisdiction for Securities Act class actions, as well as some potential solutions to problems that Cyan seems to have exacerbated.

SLUSA and Cyan

Congress passed SLUSA to staunch an unintended consequence of the Private Securities Litigation Reform Act of 1995. That legislation instituted protections to curb abusive practices in federal securities class actions. The protections included a lead plaintiff selection process, an automatic stay of discovery pending resolution of motions to dismiss, and a safe harbor provision for forward-looking statements. To skirt those protections, plaintiffs lawyers started filing lawsuits in state courts.

SLUSA aimed to counteract that shift by "completely disallow[ing] (in both state and federal courts) sizable class actions that are founded on state law and allege dishonest practices respecting a nationally traded security's purchase or sale."[2] SLUSA also provided for the removal to federal court, and subsequent dismissal, of class actions filed in state courts.

In Cyan, the parties squared off over whether SLUSA's prohibitions applied to state court class actions alleging only Securities Act violations. Much of the Cyan briefing centered on statutory interpretation. But petitioners and several amici also pointed out that "[p]ermitting class action plaintiffs' lawyers to

target California and other states as safe havens for vexatious federal securities litigation undermines the strong federal interest … in maintaining uniformity and integrity in the interpretation and application of the federal securities laws."[3]

They also warned of a continued "flood of Securities Act class actions" in state courts.[4] But the warnings did not sway the court. Focusing on the statute's plain language, the court held that SLUSA barred from state courts class actions alleging state securities claims, not class actions alleging only Securities Act claims.[5]

State and Parallel Filings Spike

One year on, the flood warnings appear to have been prescient. According to data compiled by Cornerstone Research, plaintiffs filed 17 Securities Act class actions in state courts in 2018, more than four times the average annual filing rate in the previous eight years. Those figures exclude parallel proceedings in state and federal courts. Plaintiffs filed 13 of those in 2018, more than double the annual average filing rate over the same eight-year period.[6]

Dismissal rates underscore the concerns raised by petitioners and its amici. For Section 11 cases filed in state courts between 2010 and 2017, the dismissal rate was 33 percent. The rate for similar cases filed in federal court was 48 percent.[7] The settlement rates for the two sets of cases are almost the same (44 versus 43 percent),[8] which suggests that Section 11 cases filed in state courts take longer to resolve than those filed in federal court.

More data is needed before calling this a trend.[9] But the rise in state court filings and parallel proceedings suggests an unsurprising strategy shift by plaintiffs that threatens to increase defendants' legal risk.

Cyan's Implications

If Cyan is driving more Securities Act class actions to state courts and more parallel state and federal court filings, defendants could face increasingly complex and expensive litigation. Federal courts have tools to streamline pretrial proceedings in related lawsuits filed in one or more districts. But no similar mechanism exists for related cases filed in multiple state courts.

To manage such complexity at the state level, a defendant might consider the particular state's procedural rules for staying cases, transferring venue intrastate or dismissing cases on forum non conveniens grounds, among other options. In parallel proceedings, defendants procedural toolkit might be more limited.

The All-Writs Act, which provides federal courts limited authority to enjoin state court actions, probably is unavailable in most instances, both because Congress expressly granted jurisdiction to state courts to hear Securities Act claims and because of competing federalism considerations.[10] Still, the Reform Act authorizes federal courts to stay discovery in "any private action in State court,"[11] and courts have done so when discovery in a state court action threatens to circumvent the stay in a Securities Act class action pending in federal court.[12]

Additionally, applying issue or claim preclusion principles, a defendant could try to leverage in one venue or forum a favorable decision attained in another. Of course, plaintiffs may do the same, which underscores the risk posed by more state court actions and parallel proceedings.

Complexity and expense aside, more state court class actions and parallel proceedings increases the risk of inconsistent rulings, whether by state court judges unfamiliar with the Securities Act's terrain, or in cases involving unsettled or tricky issues. Conflicting and erroneous merits rulings are one concern. How a state court judge treats the Reform Act's protections is another.

To cite one example, state court judges might not feel constrained by the Reform Act's certification and lead-plaintiff appointment requirements or its limitations on damages and attorneys' fees.[13] Those protections apply in Securities Act class actions brought "pursuant to the Federal Rules of Civil Procedure,"[14] which Securities Act class actions filed in state courts are not.

Other Reform Act protections plainly apply in state court cases. For example, the automatic stay of discovery applies in "any private action" under the Securities Act. That would include state court actions, class or otherwise, alleging Securities Act violations, regardless of the existence of parallel federal court proceedings.[15] The protections for forward-looking statements, set forth in a forum-agnostic section of the Reform Act, also apply in state court Securities Act class actions.[16] The Supreme Court confirmed as much when it held in Cyan that the statutory safe harbor applied "even when a [Securities] Act suit was brought in state court."[17]

Help on the Way?

The Supreme Court in Cyan was unconvinced that preserving concurrent jurisdiction counters Congress' goal of ensuring the uniform treatment of securities class actions.[18] Since Cyan, some have suggested that Congress clarify the matter by mandating exclusive federal court jurisdiction over Securities Act class actions. But that has yet to happen. Bills that would have accomplished that were introduced last year in the House of Representatives (H.R. 5037) and the Senate (S. 3421). But they died in committee and have not been reintroduced in the new Congress.

Efforts to address the issue through the levers of corporate law have faltered too. In December, the Delaware Chancery Court invalidated provisions in the charters of three corporations that would have required shareholders to file securities class actions in federal court.[19] Whether embedding a jurisdictional provision in the terms of a security itself could work remains to be seen.[20]

Barring congressional action or developments in corporate law, defendants appear to be entering a period of rising securities litigation risk. The number of Securities Act class actions filed in state court, and parallel proceedings in state and federal court, appears to be rising, which in turn threatens to increase litigation complexity and costs.

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[1] Cyan Inc. v. Beaver County Employees Retirement Fund, 138 S. Ct. 1061 (2018).

[2] Cyan, 138 S. Ct. at 1067.

[3] Br. of Sec. Indus. and Fin. Markets Ass'n, Chamber of Comm., and Nat'l Venture Capital Ass'n as Amici Curiae in Support of the Pet. for Writ of Cert., 2016 WL 3538389, at *8 (June 27, 2016); accord Pet. Reply Br., 2017 WL 5433199, at *18-23; Br. of Wash. Legal Found. as Amicus Curiae in Support of Pet., 2017 WL 3913760, at *6 (Sept. 5, 2017); Br. for Bus. Roundtable and Soc. for Corp. Governance as Amici Curiae Supporting Pet., 2017 WL 3948180, at *31 (Sept. 5, 2017); Br. of Amici Curiae Law Profs. in Support of Pet., 2017 WL 4082013, at *19 (Sept. 5, 2017) ("Law Profs. Br.").

[4] Law Profs. Br., 2017 WL 4082013, at *19.

[5] 138 S. Ct. at 1069.

[6] Cornerstone Research, Securities Class Action Filings — 2018 Year in Review, at 4.

[7] Id. at 23.

[8] Id.

[9] Id. at 21 ("The uptick in state actions following the Cyan decision indicates a change in approach by plaintiffs, but more data are needed to evaluate the potential trend").

[10] However, courts have applied the All Writs Act to enjoin parallel state court actions that threaten to upend an impending settlement of a complex, multijurisdictional federal securities class action. See, e.g., In re Baldwin-United Corp., 770 F.2d 328 (2d Cir. 1985).

[11] 15 U.S.C. § 77z-1(b)(4) (providing for the court to enter the stay "upon a proper showing" and "as necessary in aid of its jurisdiction, or to protect or effectuate its judgments").

[12] Salameh v. Tarsadia Hotels, No. 09-cv-2739, 2012 WL 12941995, at *2 (S.D. Cal. July 2, 2012).

[13] 15 U.S.C. §§ 77z-1(a)(2), (3), (4), (5).

[14] 15 U.S.C. § 77z-1(a)(1).

[15] 15 U.S.C. § 77z-1(b)(1).

[16] 15 U.S.C. § 77z-2.

[17] Id. at 1066. Curiously, Cyan categorized the Reform Act's protections as either procedural or substantive and suggested that only the latter applied in state court actions. Id. at 1066-67, 1072-73. The automatic stay of discovery arguably is procedural but, as noted, applies in "any private action" under the Securities Act, including state court actions. Perhaps the court was ambivalent about the distinction it was drawing, which might explain why it gave only one example of a procedural protection (lead plaintiff certification (id. at 1067, 1072)), and never referenced the automatic discovery stay.

[18] Id. at 1072-73.

[19] Sciabacucchi v. Salzberg, No. 2017-0931, 2018 WL 6719718 (Del. Ch. Dec. 19, 2018).

[20] Section 14 of the Securities Act prohibits agreements that waive compliance with the federal

securities laws. 15 U.S.C. § 77n. But the purpose of that provision is to ensure that investors can avail themselves of the securities laws' substantive, not procedural, protections. See Rodriguez de Quijas v. Shearson/Am. Exp. Inc., 490 U.S. 477 (1989) (arbitration agreement not void under Section 14). A forum selection agreement requiring a securityholder to litigate Securities Act claims in federal court — a forum Congress expressly designated for such claims — does not deprive the securityholder of the law's substantive protections.