Securities Regulation Daily Wrap Up, TOP STORY—U.S.: Justices seek to grasp (a), (b), (c)'s of SLUSA amid 'gibberish', (Nov. 28, 2017)

Securities Regulation Daily Wrap Up

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By Mark S. Nelson, J.D.

The Supreme Court heard oral argument in a case that asks the justices to clarify the scope of concurrent jurisdiction between federal and state courts in state cases that raise only Securities Act claims in light of the Securities Litigation Uniform Standards Act (SLUSA). At heart, this is a case of statutory interpretation in which Cyan, Inc. wants the Court to lean in favor of the broader policy goals of the Private Securities Litigation Reform Act (PSLRA) for which SLUSA was supposed to have filled gaps. Beaver County Employees' Retirement Fund, however, would have the Court uphold long-standing concurrent jurisdiction for Securities Act claims brought in state courts. On the eve of oral argument, the case devolved into a flurry of sharply-worded filings in which Cyan asserted that Beaver County's recent supplemental brief was "misleading or false." Oral argument often centered on Congressional "gibberish" (*Cyan, Inc. v. Beaver County Employees' Retirement Fund*, November 28, 2017).

Pre-argument drama. The Cyan case has roots in the Securities Act and in a California intermediate appellate court decision about an investor lawsuit over securities issued by Countrywide Financial Corporation. The California Court of Appeal, in *Luther v. Countrywide*, held that SLUSA did not bar a covered class action (not involving a covered security) and alleging only Securities Act claims. As a result, the case was not precluded by, and was not removeable to, federal court under SLUSA. The California court had reasoned that Securities Act Section 22's "except" clause referred to the entirety of Section 16 and not, as Countrywide had argued, to Section 16(f)(2), the definition of "covered class action."

Beaver County sued Cyan over alleged violations of Securities Act Sections 11, 12(a)(2), and 15 regarding Cyan's initial public offering. The case proceeded and California's appellate courts denied Cyan's appeals without opinion. The trail court's denial of Cyan's motion for judgment on the pleadings cited *Luther* as the basis for its decision. In *Cyan*, like *Luther*, the case involves a "covered class action," or in the statutory parlance, among other things, a suit for damages on behalf of more than 50 persons. At the cert stage, there appears to have been some dispute over whether the case involved a "covered security," with Cyan's petition asserting that Beaver County Employees' did not dispute that Cyan's stock was listed on a national exchange, the statutory hallmark of a covered security.

Nearly a week before oral argument, Beaver County submitted a supplemental brief disputing key points made by Cyan. Specifically, citing Cornerstone Research's mid-year report on securities class actions, Beaver County asserted that there was no "dramatic increase" in Securities Act cases heard in California courts, as Cyan had claimed. Beaver County also disputed that state cases based on the Securities Act had increased only after the PSLRA; Beaver County said there were more state-law securities claims, but not more Securities Act claims in state courts. Beaver county further said that Cyan's worries about court sanctions if it sought removal to federal court were unfounded.

Cyan countered on the eve of oral argument that eleven Securities Act class actions had been filed in California state courts during the period after SLUSA but before *Luther*; after *Luther*, Cyan said 53 such cases were filed in California state courts. Cyan repeated its claim that these cases did not exist before the PSLRA and noted that Beaver County had relied on "*mixed cases*" for its conclusion that state class actions of the type were more prevalent before the PSLRA while not citing any state cases based solely on the Securities Act. Lastly, Cyan disputed Beaver County's assertion that the case could have been removed; Cyan said it was hesitant to challenge warnings from judges about the unlawfulness of removal requests. Cyan separately submitted a letter

to the Court asking that Beaver County's supplemental brief be stricken because it violated one of the Supreme Court's rules.

Gibberish and its cure. Justice Ginsburg opened and closed the questioning of Cyan's counsel, Neal Katyal, by noting that Cyan's theory was a "rather obtuse" way of ousting state courts to which Katyal agreed. Following up on questions posed by Justice Kagan, Justice Alito then interjected that the statute was "gibberish" (he later said "obtuse" would be "flattering'). He also said he had checked former Justice Scalia's book on statutory interpretation regarding the question of "what we are supposed to do when Congress writes gibberish." Katyal denied that the statute is entirely gibberish, but also noted that even Justice Scalia, a textualist, would have looked to the statutory findings, as Cyan does, for answers about what Congress intended.

To Justice Kagan's question about the Exchange Act begetting the most securities cases, Katyal cited Alibaba's amicus brief for the notion that half of the cases involving initial public offerings have federal and state litigation components. Justice Sotomayor then posed a hypothetical: What happens if a plaintiff brings a Securities Act claim and a non-Securities Act state claim? Justice Sotomayor eventually got Katyal to agree that Cyan's theory was ouster despite the presence of non-Securities Act state claims; the justice said that was a "fairly extreme result" that inverts the presumption of concurrent jurisdiction.

Justice Ginsburg then closed Cyan's argument in chief by telling Katyal that the "cure is in your own hands," namely, removal, but that Cyan had not sought removal. Katyal ended by saying that the government's removal theory could assuage some of Cyan's policy worries, but he insisted that Cyan's statutory interpretation was better.

The question only the government asked. The government had concluded in an amicus brief that the California state court in *Luther* had correctly held that concurrent jurisdiction persists regarding state cases that allege only Securities Act claims. But the government went on to urge the justices to allow removal of these cases, although the removal question was not directly before the Court because Cyan never sought removal and the state court's decision was limited to the question of jurisdiction.

Assistant to the Solicitor General Allon Kedem told the justices that the removal issue depends on which sub-clause of Securities Act Section 16(c) that the limiting language "as set forth in subsection (b)" refers to. The limiting provision could attach to either "any covered class action" (not the best choice said Kedem), or it could attach to "involving a covered class action" (the government's view); according to Kedem, this phrase is the last antecedent, that is, give meaning to the words immediately preceding the limiting language where there is no contrary interpretation.

At various times, Justice Ginsburg had questioned if the Court should take a pass on the case because Cyan never tried to remove it to federal court. Justice Sotomayor had called the government's argument a "stretch." Then Justice Alito returned to his "gibberish" line of questioning.

Justice Alito asked if the drafters of the removal provision had thought about statutory interpretation. Kedem said he doubted they had thought of the rule of the last antecedent. Justice Alito interjected that the government's view was "so far from reality that it really strains credulity." Kedem replied that both the government's view and any contrary view are a stretch. Justice Alito reiterated that all of the readings are a stretch (the transcript indicated "laughter" in the courtroom). Then Justice Alito concluded his line of questioning: "I'm serious. Is there a certain point at which we say this means nothing, we can't figure out what it means, and, therefore, it has no effect, it means nothing?" Kedem responded that the court should avoid saying the removal provision means nothing.

Part of the government's argument had come under heavy questioning from Justice Breyer about how Section 16(c) intertwines with Section 16(b), that is, how the removal text works in conjunction with the types of class actions described. At the end of Kedem's time, Justice Breyer asked if there was a Congressional report on what "involving" means, as in "involving a covered security." Kedem conceded that the government had not found one.

Superfluity. Beaver County's argument, presented by Tom Goldstein, began with a recitation about how the Securities Act has a long history of concurrent jurisdiction that is absent from other securities laws. Goldstein

said that Congress would have been explicit if it intended to eliminate concurrent jurisdiction. Justice Kennedy was the first to beak in; he asked if the Court can decide the case but reserve the removal question. Goldstein quipped that the answer is always "Yes" (transcript indicates "laughter" in the courtroom). Goldstein went on to say that the justices could conclude that the statutory language is unclear and reserve the removal question. But Goldstein said he believed it would be hard for the Court to conclude that removal is proper.

Justice Gorsuch, who asked few questions of Katyal or Kedem, engaged in what appeared from the printed transcript to be a rapid-fire exchange with Goldstein about whether various pieces of the Securities Act's text were superfluous. Justice Gorsuch had opened his line of questions thus: "[A]ren't we stuck with gibberish your way too." At the end of the exchange, Goldstein summed up that while the statute lacks "incredible precision" the Court's *Kircher* opinion explained that one part of Section 16 says which types of cases are banned, another part deals with "recalcitrant state courts," and together the cases in the first part are removable under the second part. Goldstein also chided the government's last antecedent theory for, among other things, referencing the wrong last antecedent.

Justice Alito asked Goldstein if it made any sense to let state courts have concurrent jurisdiction to the extent a plaintiff's attorney does not include a state law claim. Goldstein said it would at least settle some ambiguities. Justice Ginsburg referred to the relevant text of Section 22(a), which contains two "except" clauses, as "the road to nowhere."

Justice Breyer elicited the "choice" from Goldstein in an extended dialog. Goldstein agreed that the choice between interpretations is between mixed cases and state cases with only Securities Act claims. Goldstein emphasized that Exchange Act cases were the true target of the PSLRA, not Securities Act cases. In reply to Justice Alito, Goldstein said the statute has meaning even if it points to a "null set" (Goldstein disagreed it was a null set), but that other interpretations do not flow easily from the words Congress used.

Katyal returned for four minutes of rebuttal in which he spoke uninterrupted about specific points raised by Justices Gorsuch, Breyer, Kennedy, Alito, and Ginsburg. Katyal concluded that Cyan's interpretation of the relevant statutes made the most sense.

Preclusion, safe havens and blunt instruments. Cyan, Inc. and its amici want the justices to close what they see as a state-court loophole for Securities Act claims that was seldom used until the PSLRA made it more difficult for investors to sue companies in federal court. They urge the justices to take a broad view of Securities Act Sections 16 and 22 to close that loophole and deny plaintiffs state court discovery that would be off limits in other types of securities cases that must be brought in federal court.

Two amici cited *King v. Burwell*, a Supreme Court decision that could also impact the Dodd-Frank Act whistleblower case (*Digital Realty Trust v. Somers*) heard the same day as *Cyan*, for the proposition that the SLUSA amendments to the Securities Act should be interpreted to give effect to the congressional goal of precluding state courts from hearing Securities Act claims. (Katyal made the only passing reference to *King v. Burwell* at oral argument). The briefs were submitted by a group of law professors, including former SEC Commissioner Joseph Grundfest, and by the Business Round Table and the Society for Corporate Governance, on Cyan's behalf. Amici quoted from the last substantive paragraph of the Court's majority opinion in *King v. Burwell*:

> Congress passed the Affordable Care Act to improve health insurance markets, not to destroy them. If at all possible, we must interpret the Act in a way that is consistent with the former, and avoids the latter. Section 36B can fairly be read consistent with what we see as Congress's plan, and that is the reading we adopt.

In the whistleblower context, the dissenting judge in the Ninth Circuit's *Somers* decision urged limiting *King v. Burwell* to its unique facts.

Amici Washington Legal Foundation worried that allowing state courts to hear such suits could expand the private right of action under the Exchange Act by letting Rule 10b-5 suits (which must be filed in federal court) proceed simultaneously with Securities Act claims in state court. The Securities Industry and Financial Markets Association said the Court should close California's "safe haven" for Securities Act suits.

By contrast, Beaver County Employees' and their institutional investor amici noted that federal and state courts had concurrent jurisdiction over Securities Act suits for decades and that the 105th Congress considered, but never enacted, legislation to close the Securities Act suit loophole (*See*, H.R. 1653). A different group of law professors backing Beaver County observed that judicial federalism "decouples the law upon which a claim is based from the court that may hear that claim." The law professors also urged the Court to reject broad policy arguments as too blunt an instrument in favor of a more precise approach.

Moreover, amici Public Citizen, Inc. cautioned the justices against taking up the government's removal argument because it is unnecessary to decide the case and, in any event, would conflict with the Court's *Kircher* opinion, which limited removal authority to cases described in Securities Act Section 16(b). The government had concluded in its amicus brief that the California courts properly interpreted SLUSA, but that Securities Act cases might still be removed to federal court. The Los Angeles County Employees Retirement Association posited that while state courts may adjudicate securities cases faster than federal courts, state courts still abide by procedures akin to those in federal courts (their amicus brief compares federal and California procedures) such that state courts are not the "plaintiff-friendly free-for-all" Cyan fears.

The case is No. 15-1439.

Attorneys: Thomas C. Goldstein (Goldstein & Russell, PC) for Beaver County Employees Retirement Fund. Neal Kumar Katyal (Hogan Lovells US LLP) for Cyan, Inc.; Allon Kedem, Assistant to the Solicitor General, for the U.S., as amicus curiae.

Companies: Cyan, Inc.; Beaver County Employees Retirement Fund; Washington Legal Foundation; Public Citizen, Inc.; Los Angeles County Employees Retirement Association

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