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Supreme Court Confirms State Courts Can Hear Certain Claims Based on Securities Offerings

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On March 20, 2018, the Supreme Court held in *Cyan, Inc. v. Beaver County Employees Retirement Fund* (15-1439) that state courts retain their jurisdiction to adjudicate class action lawsuits brought under the federal Securities Act of 1933 (the “1933 Act”) and that defendants are not entitled to remove such 1933 Act class actions from the state courts to the federal courts for adjudication.

The Cyan decision resolves a split among federal and state courts over whether a series of 1990s Congressional reforms prevented state courts from hearing class action cases involving claims of violations in securities offerings under the 1933 Act.

The 1933 Act was enacted to create a private right of action to enforce certain obligations pertaining to securities offerings. A plaintiff could historically bring an action based on the 1933 Act in both federal and state courts. On the contrary, the Securities Exchange Act of 1934 (the “1934 Act”), which regulates not the original offering of securities but their subsequent trading, provides that any lawsuit brought under the 1934 Act must be brought in the federal courts.

In response to “perceived abuses of the class-action vehicle in litigation involving nationally traded securities”, Congress enacted the Private Securities Litigation Reform Act (the “Reform Act”) in 1995, which amended both the 1933 Act and 1934 Act. The practical effect was that plaintiffs began filing securities class action lawsuits under state law rather than federal law (i.e., 1933 Act and 1934 Act) to avoid the new hurdles imposed by the Reform Act on such federal lawsuits. Sensing an end run around by plaintiffs, Congress enacted the Securities Litigation Uniform Standards Act of 1998 (the “Standards Act”), which prohibits securities class action lawsuits (in federal or state court) based on state law claims involving fraud in connection with the offering of securities if such lawsuits involve a plaintiff class of more than 50 members.

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Since the enactment of the Standards Act, courts have been split on the question of whether the Standards Act also prohibits state courts from hearing class action lawsuits based on federal law claims in connection with the offering of securities (i.e., the 1933 Act).

The Cyan case is based on claims brought by investors against Cyan, Inc. in connection with their investment in Cyan, Inc.'s initial public offering. After the stock declined in value following the IPO, the investors filed suit against Cyan, Inc. in California state court alleging that Cyan, Inc.'s offering documents contained material misstatements in violation of the 1933 Act. The investors did not make any state law securities claims and Cyan, Inc. moved to dismiss alleging that the state court lacked jurisdiction based on the Standards Act.

Justice Kagan, writing the unanimous opinion for the Court, found that state courts retain their longstanding jurisdiction over securities class action lawsuits alleging violations of the 1933 Act. Further, in answering a question posed by the federal government in an amicus brief, the Court held that defendants are not permitted to remove such lawsuits from state court to federal court. The result is that a class action lawsuit brought in state court under state law may be removed to federal court but an action under federal law may not be removed to federal court. Justice Kagan noted this inconsistency but left it to Congress to address.

The practical result of Cyan is likely to be continued, and possibly increased, securities class action cases brought in state court alleging violations of the 1933 Act that cannot then be removed to federal court. If the case is not in federal court, it may arguably not be subject to the Reform Act's intended procedural safeguards, such as stays on discovery until resolution of motions to dismiss. A further practical effect is that state court judges, not typically experts on federal securities litigation, may issue rulings that are out of sync with those issued by federal courts, creating further uncertainty in such securities litigation.

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