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# After Cyan: Some Prognostications

By **Boris Feldman and Ignacio Salceda** (March 23, 2018, 4:51 PM EDT)

*In a win for the plaintiffs bar, the U.S. Supreme Court on March 20, 2018, held that the Securities Litigation Uniform Standards Act did not strip state courts of jurisdiction to hear class actions alleging only Securities Act of 1933 violations. In this Expert Analysis series, attorneys explore the court's unanimous ruling in Cyan Inc. v. Beaver County Employees Retirement Fund, and what's next for plaintiffs and defendants.*


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The years-long battle over the Cyan issue has ended. Unambiguously, with one voice, the U.S. Supreme Court has held that claims under the Securities Act of 1933 may be brought in federal or state court. The ruling resolves the split in the courts on the issue, undoing many decisions mainly on the East Coast, while upholding many others (mainly) on the West Coast.

What are the coming attractions for the world of shareholder litigation? Herewith, our personal prognostications. As our clients say, actual results may differ materially.

**1. Many Additional Lawsuits**

Plaintiff securities lawyers in recent years have filed many suits under Section 11 of the '33 Act in state court, especially in California, primarily challenging initial public offerings. Once the Supreme Court granted certiorari in Cyan, the filings appeared to slow. Now that the plaintiffs bar has won, they will probably file many additional suits. Why? Because they like state court. As a generality, it is more difficult to get shareholder suits dismissed in state court than in federal. Strong Section 11 claims may well continue to be brought in federal court — particularly when coupled with claims under U.S. Securities and Exchange Commission Rule 10b-5 and Section 10(b) of the Securities Exchange of 1934. But weaker claims, which may well not have been brought in federal court, often are more viable in state.

Who is at risk? Plaintiffs have plenty of time to bring a Section 11 claim: three years from the date the IPO went effective, and one year from inquiry notice of a claim. The trigger for a suit in state court has often been the mere fact that the stock price has fallen below the price in the offering. So any public company that has gone public in the last few years and "broken issue" should be on the lookout for a process server.

Where these suits will be filed is an open question. Because the law in the New York federal district courts had been clear that state-filed Section 11 suits were removable, plaintiffs avoided suing New York-based companies there. Such restraint ends today. One of the certain outcomes of Cyan is a proliferation of Section 11 suits in the New York trial courts.

The impact in California may be mixed. On the one hand, suits that had been filed against non-California companies, but in California state courts (because of the favorable precedents), may now revert to their home-state courts. On the other hand, the plaintiffs bar tends to feel very comfortable in California superior courts, especially in certain counties viewed as hospitable to such lawsuits.

Moreover, so many of the companies that go public are based in California that it is always a fertile terrain for plaintiff securities lawyers. Net net, California state Section 11 filings probably will increase in number.

**2. Intramural Squabbling Among Plaintiffs Firms**

Now that it is clear that Section 11 suits may continue to be filed in state as well as federal court, expect interforum tugs of war. A plaintiff that sues in federal court — say, on a Rule 10b-5 claim (which, like all claims under the '34 Act, can only be brought in federal court) — may also include a Section 11 claim in order to remain in control of the litigation. Such a plaintiff could seek to shut down redundant state Section 11 suits.

Similarly, a defendant already sued in federal court may use the existence of the federal suit as a basis for staying or dismissing a duplicative state suit. One might also expect some horse trading among plaintiffs firms: "We'll pursue only the '34 Act claim in federal court, if you agree not to challenge us for the lead, and you get to litigate in state court on the '33 Act claim." In such situations, the judicial system as a whole may suffer because of having to adjudicate two separate suits instead of one. Although outcomes may vary, the likelihood is that a combined federal suit — Section 11 claim plus 10b-5 claim — will lead to freezing of the '33 Act-only state suit.

**3. Adoption of the Grundfest Clause**

A number of public companies have adopted a provision in their articles of incorporation or bylaws proposed by Stanford professor (and former SEC commissioner) Joseph Grundfest. The clause provides that any shareholder may bring a Section 11 claim against the company or its officers and directors only in federal court. Typical language is as follows:

> Unless the Corporation consents in writing to the selection of an alternative forum, the federal district courts of the United States shall be the exclusive forum for the resolution of any complaint asserting a cause of action arising under the Securities Act of 1933. Any person or entity purchasing or otherwise acquiring any interest in any security of the Corporation shall be deemed to have notice of and consented to this provision.

Many companies that went public during the pendency of Cyan did not adopt such clauses, perhaps because they expected that the Supreme Court would rule that Section 11 claims could not be brought in state court. Now that Cyan has green-lighted such suits, one can expect that many companies will adopt the Grundfest clause prior to going public.

The next battle in the forum war, post-Cyan, will be the validity of such clauses. Suits are pending in the Delaware Court of Chancery and the Los Angeles County Superior Court in which plaintiffs claim that such clauses are improper under Delaware corporate law. We believe that the courts ultimately will uphold such clauses under Delaware law, especially based on the Court of Chancery decision in the Chevron case.[1] Chevron held that forum clauses with respect to breach-of-fiduciary-duty claims are valid and enforceable. But we are hardly objective on the issue, since our firm litigated the Chevron case and is defending the pending suits in Delaware and Los Angeles. In all likelihood, definitive resolution of these issues will take a few years. During that time, many state Section 11 suits are likely to face motions to dismiss based on the Grundfest clause.

**4. Congress to the Rescue?**

With the ink on the Cyan decision barely dry, the plaintiffs bar is comfortably in the Section 11 saddle. They won. But history suggests that this may be victory of a battle, not the war.

In 1995, Congress adopted the Private Securities Litigation Reform Act. The Reform Act established a variety of protections for defendants in shareholder suits. The initial reaction of the plaintiffs bar was to move to state court. Particularly in California — an innovator's paradise in litigation as well as technology — plaintiffs firms starting bringing shareholder class actions under the California Corporations Code, in California state court. This was one way around the new federal strictures.

The defense bar responded by seeking rapid, definitive adjudication of the contours of California law, via multiple mandamus petitions to the California courts of appeal and Supreme Court. The strategy

worked, in part. After defendants lost a series of decisions in the lower state courts, the California Supreme Court in 1999 did indeed resolve the interpretative issues in two key decisions.[2] Unfortunately, they did so with an expansive reading in plaintiffs' favor on all fronts. That sounds a little like the recent Cyan decision, doesn't it?

But now, the rest of the story. All of the filings in California state court, along with the broad reading of California law by those courts, enabled the business community to go back to Congress for help. In late 1998, Congress responded by preempting whole-hog the state securities laws for class actions, when it adopted SLUSA.[3] This statutory move shut down plaintiffs' state-court gambit.

Might history repeat itself? Cyan is a statutory interpretation decision. The Supreme Court has ruled that Congress did not intend, in SLUSA, to eliminate state court jurisdiction for '33 Act claims. Cyan leaves Congress free to amend the statute in order to make the elimination of such jurisdiction clear. It could easily do so by giving federal courts exclusive jurisdiction over such suits (and thus mirroring the '34 Act). Alternatively, if Congress chose to leave individual actions in state court but allow for removal of class actions to federal court, Congress could do so in as little as seven words — adding "and with respect to covered class actions" to the carveout of the anti-removal provision of Section 22(a) of the '33 Act.[4]

If private-ordering — in the form of adoption of Grundfest clauses — does not solve the problem, the business community might indeed return to Congress for help. A simple rider on an appropriations bill could add the seven little words that statutorily override Cyan.

Will that happen? Who knows? It might depend in part on the restraint vel non that plaintiffs show in bringing nonmeritorious Section 11 suits in state court — and on the willingness of state court judges to toss such suits. If history is a guide, Cyan could turn out to be a judicial way station on the road to a definitive legislative solution.

In the meantime, defendants should not just stand by, hoping that Congress will ride to the rescue. Nonmeritorious Section 11 suits in state courts can be fought and won.

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***DISCLOSURE: The authors are counsel to the company and the individual defendants in the Cyan litigation, as well as to the defendants in some of the other cases mentioned in this article.***



[1] Boilermakers Local 154 Retirement Fund v. Chevron Corp., 73 A.3d 934 (Del. Ch. 2013).

[2] Stormedia Inc. v. Superior Court, 20 Cal.4th 449, 976 P.2d 214, 84 Cal.Rptr.2d 843 (1999); Diamond Multimedia Systems Inc. v Superior Court, 19 Cal.4th 1036, 80 Cal.Rptr.2d 828, 968 P.2d 539 (1999).

[3] Securities Litigation Uniform Standards Act of 1998, Pub. L. 105-353, 112 Stat. 3227.

[4] The provision currently reads: "Except as provided in section 77p(c) of this title, no case arising under this subchapter and brought in any State court of competent jurisdiction shall be removed to any court of the United States." 15 U.S.C. §77v(a). To make class actions removable, the revised language would read: "Except as provided insection 77p(c) and with respect to covered class actions

under this title, no case arising under this subchapter and brought in any State court of competent jurisdiction shall be removed to any court of the United States."