

After Cyan: Potential Trends In Section 11 Litigation

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The U.S. Supreme Court last week 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, the authors explore the court's unanimous ruling in Cyan Inc. v. Beaver County Employees Retirement Fund, and what's next for plaintiffs and defendants.

The U.S. Supreme Court on March 20, 2018, issued a unanimous opinion in Cyan Inc. v. Beaver County Employees Retirement Fund. The court preserved plaintiffs' ability to pursue class action securities claims under the Securities Act of 1933 in state court as well as in a federal forum. Cyan Inc., like many other companies in recent years, was named a defendant in a securities fraud class action filed in California state court alleging violations of Section 11 of the '33 Act.

This article summarizes recent trends in the filing of these class actions in federal and state court, and thereby serves as a starting point for future analysis of whether the Supreme Court's Cyan decision will spur additional state court filings. Indeed, because it is now clear that plaintiffs can assert federal Section 11 claims in state court without having those claims removed to federal court, a reasonable hypothesis is that the incidence of Section 11 filings in state court will increase nationwide, and not just in California.

Our baseline data consist of class actions with Section 11 claims but no Rule 10b-5 claims filed in the federal and California state courts.[1] As noted elsewhere, the California courts have been the most active jurisdiction for these lawsuits, in part because California courts have historically rejected efforts to remove claims filed in state court to federal court.[2]

As shown in figure 1, the number of Section 11-only class actions filed in California state court grew dramatically from only three in 2011 to 18 in 2016. By 2015, the number of Section 11-only class actions filed in California state court exceeded the number filed in the entire federal court system. That pattern was also apparent in 2016. In 2017, however, the number of Section 11-only California



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class actions declined 61 percent from 18 in 2016 to seven, and the number of Section 11-only federal class action filings exceeded those in California. This decline coincided with the U.S. Supreme Court's decision to grant Cyan's petition for certiorari in June 2017.[3]

FIGURE 1: NUMBER OF FILINGS WITH SECTION 11-ONLY CLAIMS
IN FEDERAL AND CALIFORNIA STATE COURTS
2011–2017



Source: Cornerstone Research; Stanford Securities Class Action Clearinghouse

Note:

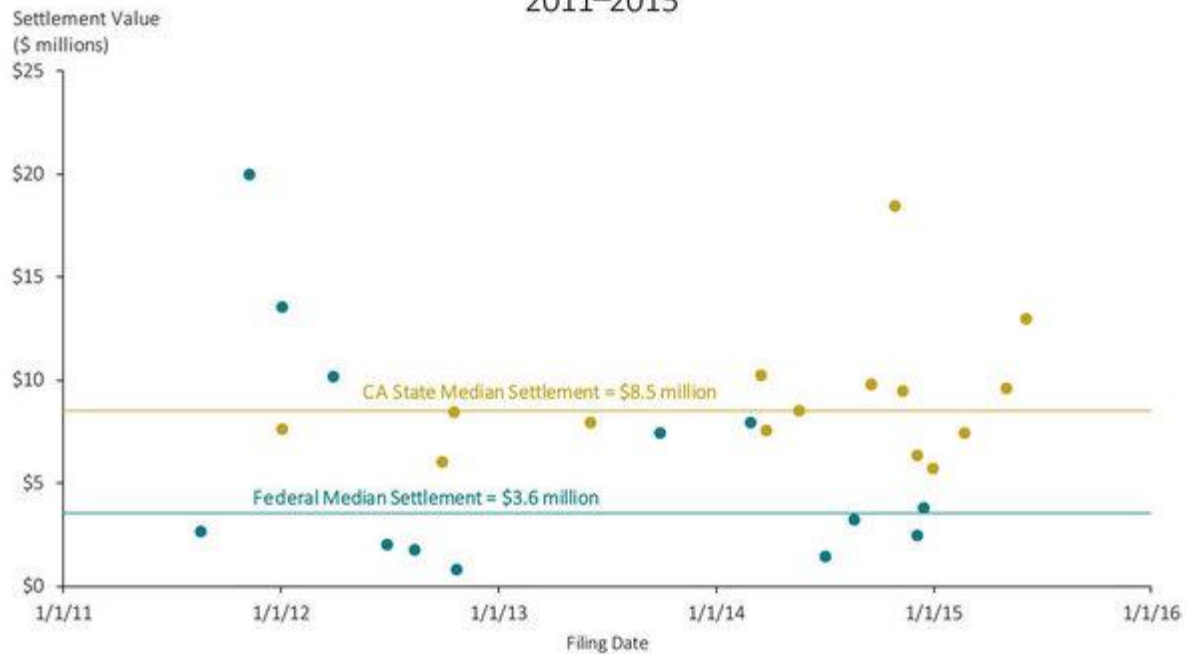
[1] Only filings identified as having Section 11, but no Rule 10b-5, claims in the first identified complaint are presented. Claims other than these may or may not be present.

[2] There were 15 filings from 2011 to 2017 with parallel actions in both state and federal court. These filings are included in the counts for both federal and state courts.

In addition to becoming more numerous than federal filings in 2015 and 2016, the maximum dollar loss, or MDL, of the California state Section 11-only filings were larger in the aggregate than the comparable MDLs of federal filings for 2014 through 2016 before reversing in 2017. MDL measures the dollar value change in the defendant firm's market capitalization from the trading day with the highest market capitalization during the class period to the trading day immediately following the end of the class period. MDL is thus associated with the maximum claim that a plaintiff might be able to assert in class action securities fraud litigation.[4] In 2015 and 2016, when the number of California state Section 11-only filings exceeded federal filings by 38 percent (33 versus 24, respectively), MDL for the California state filings was \$65.2 billion, 390 percent greater than the \$13.3 billion MDL for federal filings.

An amicus brief filed on behalf of Cyan noted that California state Section 11-only filings were less likely than their federal counterparts to be dismissed.[5] Consequently, a larger percentage of Section 11-only claims filed in California state court were resolved by settlement. Figure 2 shows settlement amounts, when available, for federal and California state filings in years 2011 through 2015. We focus on these years for comparison purposes because a majority of the more recently filed class actions remain unresolved.

FIGURE 2: SETTLEMENT AMOUNTS OF FEDERAL AND CALIFORNIA STATE SECTION 11-ONLY CLASS ACTIONS 2011–2015



Source: Cornerstone Research; Stanford Securities Class Action Clearinghouse

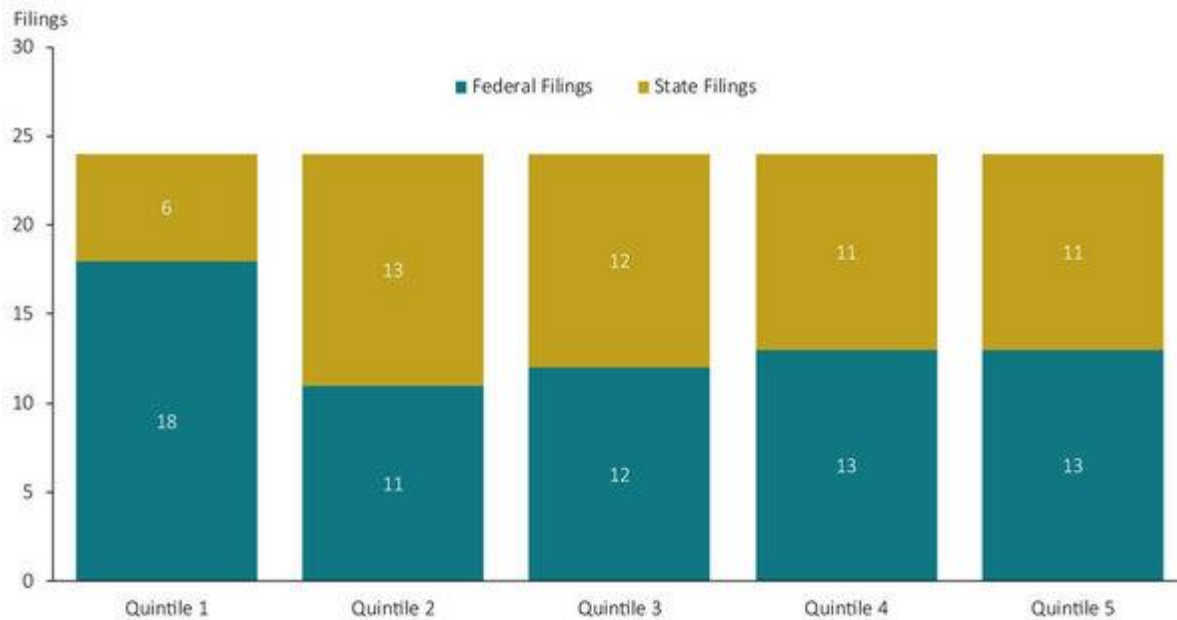
Note: One settlement of a federal class action filed in October 2011 for \$215 million is not presented in the graph, but is reflected in the reported median value of federal settlements.

Figure 2 shows that the median settlement for a Section 11-only filing in California state court has been more than twice the comparable median in federal court. Additionally, California state filings have exhibited less variance in their settlement amounts.

One explanation for the larger median settlement in Section 11-only claims filed in California state court is that these filings tend to be of larger “size.” Figure 3 compares the market capitalization of issuers subject to Section 11-only litigation in California state court with the capitalization of issuers facing Section 11-only claims in federal court. The figure groups into five quintiles all federal and California state class actions based on the maximum market capitalization of the issuer during the class period, sorted from smallest to largest. Thus, the smallest 20 percent of filings, regardless of the jurisdiction in which the litigation was filed, are in the first quintile, the next largest 20 percent are in the second, etc.

The chart shows that 75 percent of the class actions in the lowest quintile were filed in federal courts. In contrast, the mix of California state and federal filings is roughly equal in the larger quintiles. A qualitatively similar picture emerges if MDL is used instead of issuer size, or if the analysis is limited to only the subset of settled class actions reflected in figure 2. For reasons that are unclear, many of the “smaller” Section 11-only claims have been pursued in federal courts as opposed to California state courts.

FIGURE 3: "SIZE" OF FEDERAL AND CALIFORNIA STATE SECTION 11-ONLY CLASS ACTIONS
 DISTRIBUTION OF MAXIMUM MARKET CAPITALIZATION BY QUINTILE
 2011-2017



Source: Cornerstone Research; Stanford Securities Class Action Clearinghouse

Note:

[1] There were 15 filings from 2011 to 2017 with parallel actions in both state and federal court. These filings are included in the counts for both federal and state courts.

[2] There were 12 filings from 2011 to 2017 for which max market cap was not calculable. These filings are not considered when determining the quintiles.

This state of affairs, whatever brought it about, has come to an end. Cyan's clear signal that Section 11 claims filed in state court can remain in state court causes the litigation chess game to evolve to a new phase. Some corporations have adopted federal-state forum selection provisions requiring that all Section 11 claims be adjudicated in federal court. Plaintiffs have, however, challenged the validity of these provisions under Delaware law.[6] If those federal-state forum selection provisions are held to be valid, then we might observe wide-scale adoption of those provisions, both by companies engaged in initial public offerings as well as by publicly traded issuers engaged in other registered offerings. The consequence of this evolution would be a return of Section 11 litigation to federal court, where it has long resided. Legislation amending the securities laws to provide for exclusive federal jurisdiction of '33 Act claims would have an equivalent effect. But, if forum selection provisions are held to be ineffective, and if there is no responsive legislation, it would not be surprising to observe a more aggressive shift of Section 11 claims from the federal to the state forum in coming years.

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DISCLOSURE: Grundfest was one of the law professor signatories to an amicus brief filed in support of Cyan in Cyan Inc. et al. v. Beaver County Employees Retirement Fund et al. Cornerstone Research, Joseph Schertler and Sasha Aganin provided data and research support to Cooley LLP, counsel of record for the law professor amici curiae.

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[1] To the extent that multiple similar lawsuits were filed against a defendant company, the figures in this article track the first identified complaint, which is the first complaint filed of one or more securities class action complaints with the same underlying allegations filed against the same defendant or set of defendants. To the extent that multiple class actions were consolidated, the consolidated litigation was followed.

[2] "High Court Faces Tricky Knot On State Securities Suits," Carmen Germaine, Law360, June 29, 2017.

[3] While not presented in this article, federal class actions may have both Section 11 and Rule 10b-5 allegations. Both 2015 and 2016 were unusually active years of filing activity in the California state courts under Section 11, however in the federal courts the filing activity in those years for class actions with Section 11 allegations, regardless of any additional claims, was not as pronounced relative to other recent years. See, Cornerstone Research, Securities Class Action Filings, 2017, Year In Review, p. 21.

[4] MDL is not an indicator of liability or measure of potential damages. Instead, it estimates the impact of all information revealed during or at the end of the class period, including information unrelated to the litigation. Moreover, it is based on all shares outstanding rather than only shares traceable to the offering.

[5] Cyan Inc. et al. (Petitioner) v. Beaver County Employees Retirement Fund et al. (Respondents), No. 15-1439, Brief of Amici Curiae Law Professors in Support of Petitioner.

[6] Sciabacucchi et al. v. Blue Apron Holdings Inc., Stitch Fix Inc. and Roku Inc., In the Court of Chancery of the State of Delaware, Case No. 2018-0931. See also, "After Cyan: Some Prognostications," Boris Feldman and Ignacio Salceda, Law360, March 23, 2018.