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# Supreme Court Clarifies Jurisdiction Under Securities Exchange Act

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The U.S. Supreme Court ruled today that the provision of the Securities Exchange Act of 1934 granting federal district courts exclusive jurisdiction over suits brought to enforce the Exchange Act is subject to the same jurisdictional test established by the general federal-question jurisdictional statute. The Court held in *Merrill Lynch v. Manning* that, under both statutes, the question is whether the case "arises under a federal law." The Court thus rejected the defendants' effort to remove a case from state court by asserting a broader theory of federal jurisdiction under the Exchange Act.

## Factual Background

The *Manning* case was filed in New Jersey state court by shareholders of a company whose stock had been shorted by the defendant financial institutions. The shareholders contended that the defendants had engaged in "naked" short-selling of the company's stock, thereby allegedly diluting the shareholders' voting rights and causing the stock's value to decline. The plaintiffs pled only state-law claims, but their complaint also repeatedly mentioned the Securities and Exchange Commission's Regulation SHO – the anti-fraud rule governing "naked" short-selling – and asserted expressly and by implication that the defendants had violated the federal securities laws.

The defendants removed the case to federal court, contending that federal jurisdiction existed under (*i*) the general "federal question" statute (28 U.S.C. § 1331) because the plaintiffs' state-law claims involved questions of federal law and (*ii*) § 27 of the Exchange Act, which gives federal district courts exclusive jurisdiction over suits "to enforce any liability or duty created by" the Exchange Act or SEC rules promulgated under it. The District Court upheld the removal, believing that the case was premised on – and that its resolution depended upon – the alleged violation of Regulation SHO. But the Court of Appeals for the Third Circuit reversed.

The Third Circuit first concluded that the case was not removable under the general federal-question statute because, even though the complaint had alleged violations of federal law, resolution of the federal issue was not "necessary" to the outcome of the case. A state court could adjudicate the plaintiffs' claims solely under state law, without reference to federal law. The Third Circuit also rejected the Exchange Act's exclusive-jurisdiction provision as a separate basis for removal, holding that exclusive-jurisdiction provisions such as § 27 do not expand the scope of federal jurisdiction under the general federal-question statute; they serve only to divest state courts of jurisdiction over the specified matters.

In so ruling, the Third Circuit agreed with precedent from the Second Circuit on the exclusive-jurisdiction issue, but disagreed with Ninth and Fifth Circuit cases holding that exclusive-jurisdiction provisions such as § 27 can establish jurisdiction even when the federal-question jurisdiction provision does not do so. The Supreme Court granted certiorari to resolve the Circuit split, and it affirmed the Third Circuit's ruling.

**Supreme Court's Decision**

The Supreme Court agreed with the Third Circuit that the jurisdictional test in § 27 of the Exchange Act "matches the one we have formulated for § 1331 [*i.e.*, the general federal-question statute], as applied to cases involving the Exchange Act. If (but only if) such a case meets the 'arising under' standard, § 27 commands that it go to federal court."

The Court reviewed its jurisprudence under the federal-question statute and reiterated that a case can "arise under" federal law in two ways. "Most directly, and most often, federal jurisdiction attaches when federal law creates the cause of action asserted" – in other words, when the complaint pleads a claim denominated as a federal cause of action. But a case can also "arise under" federal law if a state-law claim "necessarily raise[s] a stated federal issue, actually disputed and substantial, which a federal forum may entertain without disturbing any congressionally approved balance of federal and state power."

The Court rejected the defendants' contention that Exchange Act § 27's jurisdictional grant for suits "brought to enforce any liability or duty created by [the Exchange Act]" was somehow broader than the federal-question statute's jurisdictional scope under the "arising under" standard.

Six of the eight Justices joined the majority opinion by Justice Kagan. Justice Thomas, with Justice Sotomayor, concurred in the judgment. The concurrence would have rested the judgment on the "brought to enforce" language of § 27 itself, which (according to Justice Thomas) would not have supported federal jurisdiction in this case because the complaint did not allege a federal claim. Justices Thomas and Sotomayor therefore disagreed with the majority's conclusion that the federal-question statute's "arising under" phrase is the same as the Exchange Act's "brought to enforce" phrase.

**Implications**

The Court's decision clarifies that the jurisdictional tests under § 27 of the Exchange Act and under the general federal-question statute are the same – and that both are subject to familiar "arising under" principles. The decision also leaves certain issues for potential future consideration.

First, the Court did not retreat from its standards for determining whether a question "arises under" federal law. The decision confirms that a plaintiff cannot avoid federal jurisdiction by pleading a state-law claim if that claim depends on a resolution of a disputed and substantial question of federal law.

Second, the Court and the concurrence did not consider the Third Circuit's conclusion that the plaintiff's claims did not necessarily raise a federal issue, because the defendants had not challenged that portion of the ruling. The decision therefore does not add to the meaning of "arising under" jurisprudence – and it does not address whether the Third Circuit correctly concluded that issues concerning SEC Regulation SHO were not necessary to disposition of the case.

Third, the Court chose not to construe § 27's grant of exclusive federal jurisdiction for "violations of the [Exchange Act] or the rules and regulations thereunder." The plaintiff had argued that the "violations" language applies only to criminal proceedings and SEC enforcement actions, not private actions. The defendants had contended that the "violations" clause was irrelevant because, "in private suits for damages, it goes no further than the 'brought to enforce' language." The Court concluded that, because "both parties have thus taken the 'violations' language off the table, we do not address its meaning." Whether the "violations" language expands the statute's jurisdictional scope even though the "brought to enforce" language does not do so is therefore perhaps an open question for another day.