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SUPREME COURT URGED TO REVIEW CALIFORNIA SECURITIES DECISION

(Diamond Multimedia Systems, Inc. v. Superior Court of Santa Clara County)

The Washington Legal Foundation (WLF) last week urged the U.S. Supreme Court to review a decision by the California Supreme Court that California law regulates the securities market for the entire nation.

In a brief filed with the Court, WLF argued that the California Supreme Court's decision deserves to be reviewed because it contradicts the well-established principle that state statutes violate the Commerce Clause when they directly regulate interstate commerce. That decision lets California courts use California law to decide cases based on securities transactions that occur entirely out-of-state. What's more, the lower court has unfairly used California law to decide a case where many unnamed class members have little if any connection with California.

The California Supreme Court had decided that attorneys may bring a nationwide securities class action lawsuit in California courts, although the same lawsuit could not have been brought in federal court. In doing so, the court allowed a lawsuit against Diamond Multimedia Systems to go forward despite the fact that many plaintiffs had never bought or sold stock in California.

In a brief filed with the California Supreme Court, WLF asserted that the lawsuit, which was purportedly brought on behalf of a nationwide class of investors, should not have been brought in state court under California state law. WLF argued that the federal courts are the appropriate forum for allegations of interstate securities fraud and that the federal securities laws provide adequate protection for investors.

WLF's brief also argued that many plaintiffs' lawyers filed class-action securities lawsuits in state courts to avoid the procedural and substantive reforms imposed on such suits in federal court by Congress. In 1995, Congress enacted the Private Securities Litigation Reform Act of 1995, which was designed to address litigation

abuses in securities law cases. Among other things, that law limited the liability of securities issuers for making forward-looking statements; enacted procedural reforms of class-action suits so that investors, and not their lawyers, would direct the course of litigation; tightened the pleading standards for securities fraud suits and increased the use of sanctions for frivolous claims; and prohibited the use of RICO for securities fraud cases.

WLF's brief further argued that the plain language of the California securities law at issue limited the law's reach to securities transactions "in this state," but that the plaintiffs in the case were non-residents who purchased their stock outside of California. WLF noted that the expansive interpretation of California law advocated by the plaintiffs could result in the application of California law simply because a defendant briefly appeared in California and made a statement later alleged to have been misleading, even though the corporation whose stock was sold, and the seller, purchaser, and broker, were all from states other than California.

WLF further argued that the application of state law to such interstate securities transactions would exceed the permissible scope of state regulation of interstate commerce under the Commerce Clause.

"No state has the constitutional authority to directly regulate the securities market for the other 49 states," said WLF Senior Counsel for Litigation Affairs Shawn Gunnarson. "That authority belongs with Congress alone."

WLF filed its brief on behalf of itself and the Allied Educational Foundation.

The Washington Legal Foundation is a nonprofit public interest law and policy center with supporters nationwide. It devotes a significant portion of its resources to defending and promoting the principles of free enterprise and individual rights.

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