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Cover Page Footnote

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PUTTING THE “UNIFORM” BACK IN THE SECURITIES LITIGATION UNIFORM STANDARDS ACT OF 1998: THE CASE FOR EMPLOYING A REASONABLE RELATIONSHIP APPROACH

Christopher R. Bellacicco⁺

America’s securities laws are “derive[d] from a simple and straightforward concept: all investors, whether large institutions or private individuals, should have access to certain basic facts about an investment prior to buying it, and so long as they hold it.”¹ These laws inform and protect individuals, encouraging investment and capital exchanges.² Currently, fifty-two percent of Americans have money in the stock market.³ When deciding upon funds or companies in which to invest, average Americans, like other investors, are influenced by the condition of a company and the statements the company has released regarding its financial situation.⁴ However, companies may disenfranchise investors by providing misleading information or failing to disclose important information, eventually causing the company’s value to drop.⁵ Incensed investors may attempt to sue the company as a class to recover damages to offset the decrease in value of their stock, even though their losses are not always caused by fraud.⁶

⁺ J.D. and Securities Law Program Certificate Candidate, May 2014, The Catholic University of America, Columbus School of Law; B.A., 2011, The Catholic University of America. The author would like to thank Professor David A. Lipton for his advice in selecting this topic and suggestions throughout the writing process. He would also like to thank the members of the Catholic University Law Review for their help with this Comment. Finally, the author wishes to thank his Aunt Maureen, whose life exemplified the meaning of hard work and perseverance.

1. *The Investor’s Advocate: How the SEC Protects Investors, Maintains Market Integrity, and Facilitates Capital Formation*, U.S. SEC. & EXCH. COMM’N, (June 10, 2013), <http://www.sec.gov/about/whatwedo.shtml>.

2. H.R. REP. NO. 104-369, at 31 (1995) (Conf. Rep.).

3. Lydia Saad, *U.S. Stock Ownership Stays at Record Low*, GALLUP, (May 8, 2013), <http://www.gallup.com/poll/162353/stock-ownership-stays-record-low.aspx>. This number reflects persons who own individual stock, stock mutual funds, or retirement accounts such as a 401(k) or IRA. *Id.*

4. JOHN C. COFFEE, JR. & HILLARY A. SALE, *SECURITIES REGULATION: CASES AND MATERIALS* 5 (12th ed. 2012) (explaining that investors want extensive and accurate information about a company’s finances). For this reason, disclosure becomes essential. *Id.* at 2 (stating that “[a] distinctive feature of American securities regulation is that it . . . establishes a detailed and mandatory system of continuing, periodic disclosure with which ‘public’ companies must comply.”).

5. *See Basic Inc. v. Levinson*, 485 U.S. 224, 241–42 (1988) (quoting *Peil v. Speiser*, 806 F.2d 1154, 1160–61 (3d Cir. 1986)) (explaining that because the price of a company’s stock traded on an open market is dictated by information about the company’s condition, any misrepresentations will have a detrimental effect on its stock, and adversely affect shareholders).

6. *See* H.R. REP. NO. 104-369, at 31 (1995) (Conf. Rep.) (stating that “[p]rivate securities litigation is an indispensable tool with which defrauded investors can recover their losses without

To combat these frivolous suits, Congress has enacted legislation such as the Securities Litigation Uniform Standards Act (SLUSA) of 1998,⁷ which precludes certain class action lawsuits.⁸ Although recent scholarship has focused on securities legislation such as the Sarbanes-Oxley Act,⁹ the Dodd-Frank Wall Street Reform and Consumer Protection Act,¹⁰ and the Jumpstart Our Business Startups (JOBS) Act,¹¹ public companies and investors still feel the effects of certain controversial 1990s-era statutes.¹²

In response to the tremendous amount of securities litigation in the early 1990s,¹³ Congress passed the Private Securities Litigation Reform Act (PSLRA)

having to rely upon government action.”); S. REP. NO. 104-98, at 4 (1995) (finding that frivolous securities class action lawsuits may be based on a company’s negative announcement rather than fraud); *id.* at 8 (noting that frivolous securities class action lawsuits may be filed in reaction to a decrease in “stock price, a failed product development project, or even unpredictable adverse market conditions.”). The government feared that these frivolous suits could adversely affect the economy. *See* H.R. REP. NO. 104-369, at 31 (remarking that meritless securities class action suits may undermine the American capital markets).

7. Securities Litigation Uniform Standards Act of 1998, Pub. L. No. 105-353, 112 Stat. 3227 (codified as amended in scattered sections of 15 U.S.C.) [hereinafter SLUSA].

8. 15 U.S.C. § 77p(f)(2)(A)(i)(I) (2006) (preventing securities class actions with a class of more than fifty persons from being filed); *see also infra* Part I.B.

9. Sarbanes-Oxley Act of 2002, Pub. L. No. 107-204, 116 Stat. 745 (codified as amended in scattered sections of the U.S.C.). Although Sarbanes-Oxley is traditionally associated with corporate governance reform, it also contains provisions requiring disclosure to the Securities and Exchange Commission (“SEC”). *See, e.g.*, 15 U.S.C. § 78p(a)(1) (2006 & Supp. 2012) (requiring anyone owning more than ten percent of an equity security to file with the SEC).

10. Dodd-Frank Wall Street Reform and Consumer Protection Act, Pub. L. No. 111-203, 124 Stat. 1376 (2010) (codified in scattered sections of the U.S.C.). Dodd-Frank includes, *inter alia*, numerous measures aimed at increasing investor protection. *See, e.g.*, 15 U.S.C. § 78d(g)(4)(C) (Supp. 2012) (establishing the Office of the Investor Advocate, which was created to help investors identify problems with financial services).

11. Jumpstart Our Business Startups Act, Pub. L. No. 112-106, sec. 102(b)(1), 126 Stat. 306, 309 (2012) (codified in scattered sections of the U.S.C.) (loosening the disclosure requirements for emerging growth companies when filing registration statements).

12. Lois Yurow, Letter From the Editor, 8 No. 9 WALLSTREETLAWYER.COM: SEC. ELEC. AGE 2 (2005). In fact, the Supreme Court has granted certiorari for a series of SLUSA cases stemming from a Ponzi scheme perpetrated by R. Allen Stanford. *See* Roland v. Green, 675 F.3d 503, 506 (5th Cir. 2012), *cert. granted in part sub nom. Chadbourne & Parke LLP v. Troice*, 133 S. Ct. 977. The Supreme Court will interpret the “in connection with” requirement to determine when covered securities are sufficiently related to non-covered securities to trigger SLUSA preclusion. *Chadbourne & Parke LLP v. Troice*, 81 U.S.L.W. 3405 (U.S. Jan. 18, 2012) (explaining that the grant of certiorari is limited to Question 1 of the petition for certiorari). However, the Court’s decision will not likely address the type of misrepresentation allegations contained in a complaint, nor will it discuss what sort of test should be used to determine whether the allegation is so interrelated to the claim as to bring it within the ambit of SLUSA. *See id.*

13. *Securities Litigation*, INST. FOR LEGAL REFORM, <http://www.instituteforlegalreform.com/issues/securities-litigation-0> (last visited July 29, 2013) (observing that abusive securities litigation was rampant during the early 1990s).

of 1995,¹⁴ which imposed heightened pleading standards to prevent securities class actions alleging misrepresentation or omission from being brought in federal courts.¹⁵ Yet, plaintiffs sought to avoid PSLRA requirements by filing suit in state courts, or, in the case of diversity suits, by filing state law claims in federal court.¹⁶

Congress passed SLUSA in 1998 to prevent the circumvention of class actions in state courts if the action alleges “an untrue statement or omission of a material fact in connection with the purchase or sale of a covered security.”¹⁷ If a claim containing these allegations is filed in state court, the case is removed to federal court where it may be dismissed under PSLRA.¹⁸ If a state law claim containing such allegations is filed in federal court, the action should be dismissed under SLUSA.¹⁹ However, SLUSA preclusion depends on the federal court’s interpretation of whether allegations of material misrepresentation must be explicit in complaints for a suit to be barred by SLUSA.²⁰

Some courts, such as the Sixth Circuit, look beyond the words of the complaint itself in determining whether there is an allegation of misrepresentation in connection with securities.²¹ Other courts, such as the Ninth Circuit, grant leave to amend and allow those individual claims not precluded by SLUSA to move forward.²² Still other courts, such as the Third Circuit, require that claims operate as “factual predicate[s]” to allegations of misrepresentation in order to be barred by SLUSA, and also allow those

14. Private Securities Litigation Reform Act of 1995, Pub. L. No. 104-67, 109 Stat. 737 (codified as amended in scattered sections of 15 U.S.C.) [hereinafter PSLRA].

15. See 15 U.S.C. § 78u-4(b) (2006 & Supp. 2012) (imposing heightened pleading standards for securities class action litigation such as proving defendant’s state of mind).

16. H.R. REP. NO. 105-803, at 1 (1998) (Conf. Rep.) (finding evidence that more securities class action lawsuits are now being filed in state courts).

17. 15 U.S.C. § 77p(b)(1) (2006). SLUSA’s purpose of preventing class action suits from being brought in state court to avoid PSLRA is discussed *infra* at note 40.

18. See 15 U.S.C. § 77p(c) (allowing for removal of “[a]ny covered class action brought in any State court involving a covered security.”); 15 U.S.C. § 77p(b) (preventing class actions alleging state law claims of misrepresentation connected to covered securities from proceeding in state or federal courts).

19. See *Davis v. John Hancock Viable Life Ins. Co.*, 295 F. App’x 245, 246 (9th Cir. 2008) (noting that SLUSA precludes state law securities class action claims regardless of where the claim was filed).

20. See *Brown v. Calamos*, 664 F.3d 123, 127 (7th Cir. 2011) (describing the approaches taken by different circuits in interpreting the SLUSA requirements), *cert. denied*, 132 S. Ct. 2774 (2012); see also Thomas O. Gorman, *SLUSA Bars Breach of Duty Claim That’s Tangled With Misrepresentation*, 9 No. 1 SEC. LITIG. REP. 9 (2011) (explaining the different approaches taken in applying SLUSA); Robert L. Shapiro & Janet S. McCloud, *Hurdles in Private Securities Fraud Litigation: An Overview*, 8 No. 9 SEC. LITIG. REP. 1, 7 (2011) (observing the different approaches circuit courts have taken in interpreting the reach of SLUSA’s preemption).

21. See *infra* Part I.C.1 (discussing the Sixth Circuit’s broad approach to determine whether a complaint alleges misrepresentation or omission).

22. See *infra* Part I.C.2. (discussing the Ninth Circuit’s approach, which is similar to the Sixth Circuit’s but allows plaintiffs to amend their complaints).

individual claims not precluded to move forward.²³ The recent Seventh Circuit case, *Brown v. Calamos*, refused to resolve this split.²⁴ Without a Supreme Court pronouncement on the issue, these circuits will continue to use their respective approaches.²⁵ This variation in approaches leads to uncertainty and promotes forum shopping.²⁶ Furthermore, such uncertainty frustrates SLUSA's goals of preventing frivolous litigation and promoting uniformity.²⁷

This Comment discusses the approaches taken by various circuits to determine when SLUSA precludes a securities class action lawsuit that alleges misrepresentation or omission. Part I begins by describing the history of, and events leading up to, the passage of SLUSA. It then traces the development of case law, highlighting the approaches and rationales used by the Sixth, Ninth, Third, and Seventh Circuits. Part II discusses the shortcomings of these various approaches and explains why they do not adequately address SLUSA's goals. Finally, Part III proposes that courts should adopt a reasonable relationship test to determine whether an allegation is sufficiently related to a claim to trigger SLUSA preclusion. This reasonable relationship approach best achieves the goals of SLUSA—preventing securities class action litigation alleging misrepresentation.

I. A SPLIT OVER SLUSA: DIVISION OVER PROPER INTERPRETATION OF THE LAW

A. Pre-SLUSA: PSLRA

During the 1980s and early 1990s, securities class action lawsuits increased significantly.²⁸ Many of these suits were prompted by decreases in stock prices

23. See *Rowinski v. Salomon Smith Barney Inc.*, 398 F.3d 294, 300 (3d Cir. 2005); *LaSala v. Bordier et Cie*, 519 F.3d 121, 141 (3d Cir. 2008) (citing *Rowinski*, 398 F.3d at 300); see also *infra* Part I.C.3. (discussing the Third Circuit's narrower approach to determining whether a complaint alleges misrepresentation or omission).

24. 664 F.3d 123, 130 (7th Cir. 2011), *cert. denied*, 132 S. Ct. 2774 (2012) (refusing to adopt a particular approach and holding instead that "the suit is . . . barred by SLUSA under any reasonable standard").

25. *Id.* at 127 (discussing the different circuit court approaches).

26. See John M. Wunderlich, "Uniform" Standards for Securities Class Actions, 80 TENN. L. REV. 167, 184 (2012) (observing that the standard used to determine whether litigation is precluded by SLUSA depends on the forum); see also Matthew O'Brien, *Choice of Forum In Securities Class Actions: Confronting "Reform" of the Securities Act of 1933*, 28 REV. LITIG. 845, 847 (2009) (noting the inconsistent outcomes which may result from different circuit court approaches).

27. SLUSA, Pub. L. No. 105-353, sec. 2(5), 112 Stat. 3227, 3227 (1998) (indicating that SLUSA was enacted to prevent frivolous litigation); see also Wunderlich, *supra* note 26, at 184 (arguing that having different standards governing securities class action litigation is "contrary to SLUSA's goal of uniformity").

28. S. REP. NO. 104-98, at 8 (1995). The report refers to a study that found that, "in the early 1980's, every company in one business sector that suffered a market loss of \$20 million or more in its capitalization was sued." *Id.* (citing Janet Cooper Alexander, *Do the Merits Matter? A Study of Settlements in Securities Class Actions*, 43 STAN. L. REV. 497, 511-13 (1991)). The Senate Report

often caused not by fraudulent actions, but by an array of other factors such as a decrease in profits or other negative news affecting a company or investment fund.²⁹ Faced with a class action lawsuit and the potential liability for millions of dollars in damages, defendants often tried to settle out of court.³⁰ As a result, settlement of these suits was no longer based on the merits of the case, but on the depth of the defendant's pockets.³¹

Given the substantial financial impact of these suits on the market, Congress sought to intervene.³² Congress found that the ease with which plaintiffs could file these actions contributed to the increasing number of such suits.³³ Congress sought to curb these abusive litigation practices by passing the Private Securities

further notes that one of every six companies under the age of ten years old and backed by venture capital was sued at least once. S. REP. NO. 104-98, at 8 (citing *Securities Litigation Reform Proposals S. 240, S. 667, and H.R. 1058: Hearings on the Impact of Shareholder Lawsuits on Publicly-Held Companies and to Discourage the Filing of Nuisance or "Strike" Suits By Entrepreneurial Lawyers Creating a Lucrative Industry from the Filings of Meritless Litigation and the Extraction of Settlements Before the Subcomm. on Securities of the S. Comm. on Banking, Housing, and Urban Affairs*, 104th Cong. 61 (1995) (Testimony of James F. Morgan, President-Elect, National Venture Capital Association).

29. See S. REP. NO. 105-182, at 23 (1998) (explaining that class action suits were being filed after a decrease in a company's stock price with no evidence of fraud); see also *supra* note 6 (noting that class action lawsuits may be prompted by events such as negative announcements by a company).

30. See S. REP. NO. 104-98, at 4 (finding that lawyers would file "frivolous 'strike' suits alleging violations of the Federal securities laws in the hope that defendants will quickly settle to avoid the expense of litigation."); see also Alexander, *Do the Merits Matter?* *supra* note 28, at 532 (noting that many companies are inclined to settle in securities class actions because the potential costs are so high that a loss could result in insolvency); Janet Cooper Alexander, *Rethinking Damages in Securities Class Action*, 48 STAN. L. REV. 1487, 1488 (1996) (recognizing public companies may be forced to pay hundreds of millions of dollars in securities class action suits); Jennifer O'Hare, *Preemption Under the Securities Litigation Uniform Standards Act: If It Looks Like a Securities Fraud Claim And Acts Like a Securities Fraud Claim, Is It a Securities Fraud Claim?*, 56 ALA. L. REV. 325, 335 (2004) (indicating defendants would settle a case regardless of the merits because it was cheaper to settle than to pay for the litigation-related costs).

31. S. REP. NO. 104-98, at 9; see also Summary of Testimony of the United States Securities and Exchange Commission 6 (1997), <http://www.sec.gov/news/testimony/testarchive/1997/tsty1997.txt> (testifying that securities class action suits have "the potential for substantial rewards.").

32. See *Merrill Lynch, Pierce, Fenner & Smith Inc. v. Dabit*, 547 U.S. 71, 78 (2006) (remarking on the overwhelming need to ensure market-place efficiency for securities trading); S. REP. NO. 105-182, at 23 (maintaining these suits entail significant legal fees, "harming both the business and its shareholders."); S. REP. NO. 104-98, at 4 (noting frivolous litigation "increase[s] the cost of raising capital and chill[s] corporate disclosure"). Some scholars argue by contrast that PSLRA's passage was due to external pressure. See, e.g., Richard W. Painter, *Responding to a False Alarm: Federal Preemption of State Securities Fraud Causes of Action*, 84 CORNELL L. REV. 1, 32 (1998) (arguing that securities-related entities gained significant leverage in Congress after the 1994 elections).

33. S. REP. NO. 104-98, at 8.

Litigation Reform Act of 1995.³⁴ PSLRA provides that for any action that alleges that the defendant “made an untrue statement of a material fact; or omitted to state a material fact necessary in order to make the statements made,”³⁵ the plaintiff must specifically show which statement(s) are misleading, why they are misleading, and must “state with particularity all facts on which that belief is formed.”³⁶ Plaintiffs seeking to recover money damages under claims requiring a specific state of mind must also provide those facts “giving rise to a strong inference that the defendant acted with the required state of mind.”³⁷

PSLRA heightened the pleading requirements for plaintiffs filing in federal court alleging misrepresentation or material omission, making it more difficult for these claims to proceed.³⁸ By enacting PSLRA, Congress intended to dispose of suits designed only to induce defendants to avoid costly litigation by settling.³⁹ Plaintiffs attempted to evade this hurdle by filing actions in state courts, where PSLRA’s heightened pleading requirements did not apply.⁴⁰ This

34. See PSLRA, Pub. L. No. 104-67, 109 Stat. 737 (1995) (codified as amended in scattered sections of the U.S.C.); S. REP. NO. 104-98, at 10. It was difficult to pass the PSLRA because, although both houses of Congress approved the Act, President Bill Clinton vetoed it. Michael A. Perino, *Fraud and Federalism: Preempting Private State Securities Fraud Causes of Action*, 50 STAN. L. REV. 273, 289 (1998) (observing further that despite agreement in Congress that there was a problem, the debates over potential solutions were frequently acrimonious, but noting that once the bill was vetoed by President Clinton, Congress was quick to override the veto).

35. 15 U.S.C. § 78u-4(b)(1)(A)–(B) (2006).

36. 15 U.S.C. § 78u-4(b)(1)(B) (2006).

37. 15 U.S.C. § 78u-4(b)(2) (2006 & Supp. 2012).

38. David M. Levine & Adam C. Pritchard, *The Securities Litigation Uniform Standards Act of 1998: The Sun Sets on California’s Blue Sky Laws*, 54 BUS. LAW. 1, 4 (1998); see also O’Hare, *supra* note 30, at 335 (noting that federal securities law reforms by PSLRA were intended to heighten the procedural requirements plaintiffs must meet to state a private securities fraud claim). Therefore, laws such as PSLRA and SLUSA serve as “exception[s] to the well-pleaded complaint rule.” *Rowinski v. Salomon Smith Barney Inc.*, 398 F.3d 294, 297–98 (3d Cir. 2005). The pleading standards imposed by PSLRA differ from the standard used today for non-securities class action pleadings, which requires that “a complaint must contain sufficient factual matter, accepted as true, to ‘state a claim to relief that is plausible on its face.’” *Ashcroft v. Iqbal*, 556 U.S. 662, 678 (2009) (quoting *Bell Atl. Corp. v. Twombly*, 550 U.S. 544, 570 (2007)); see also Perino, *supra* note 34, at 292 (noting that PSLRA creates a separate class of procedural rules specific to securities fraud cases).

39. *Merrill Lynch, Pierce, Fenner & Smith v. Dabit*, 547 U.S. 71, 82 (2006).

40. See Levine & Pritchard, *supra* note 38, at 7; Perino, *supra* note 34, at 315 (observing the dramatic rise of securities fraud filings in state court, most likely due to plaintiffs attempting to contravene PSLRA’s new requirements). This migration to state courts could also have been encouraged in part by more favorable state securities regulation laws, known as “blue sky laws,” which did not contain the strict pleading and procedural requirements of PSLRA. Levine & Pritchard, *supra* note 38, at 3. Plaintiffs also sought to circumvent SLUSA by filing claims based on allegations other than fraud. O’Hare, *supra* note 30, at 348.

led to a massive increase in the number of securities class action suits filed in state courts.⁴¹

B. The Enactment of SLUSA

Congress passed SLUSA to prevent private parties from circumventing PSLRA by bringing securities class action lawsuits alleging fraud in state court.⁴² SLUSA provides, in part, that “[n]o covered class action . . . may be maintained in any State or Federal court by any private party alleging . . . an untrue statement or omission of a material fact in connection with the purchase or sale of a covered security.”⁴³ Furthermore, SLUSA provides for automatic removal of cases from state court to federal court.⁴⁴ Congress sought to ensure

41. Levine & Pritchard, *supra* note 38, at 7; *see also* Dabit, 547 U.S. at 82 (pointing out that PSLRA had caused many individuals “to avoid the federal forum altogether”). *But see* MARC I. STEINBERG, UNDERSTANDING SECURITIES LAW 247 (4th ed. 2007) (concluding that despite SLUSA, plaintiffs are still likely to appeal on the basis of state securities laws).

42. SLUSA, Pub. L. No. 105-353, sec. 2, 112 Stat. 3227, 3227 (1998); *see also* Kircher v. Putnam Funds Trust, 403 F.3d 478, 482 (7th Cir. 2005), *vacated and remanded on other grounds*, 547 U.S. 633 (2006) (explaining SLUSA prevents plaintiffs from filing in securities class action litigation in state court and sidestepping PSLRA requirements); DAVID A. LIPTON, 15A BROKER-DEALER REGULATION § 5:16 (2012) (noting that SLUSA was passed “to close the state suit loophole and mandate federal jurisdiction over particular class action securities cases.”).

43. 15 U.S.C. § 77p(b)(1) (2006). Despite the phrase “purchase or sale,” the Supreme Court has held SLUSA also applies to individuals who currently hold or did hold securities at the time of the alleged fraud. Dabit, 547 U.S. at 89 (holding it did not matter that a class action was brought by a holder of a security rather than a purchaser or seller); *see also* Backus v. Conn. Comm. Bank, N.A., 789 F. Supp. 2d 292, 305 (D. Conn. 2011) (quoting Fisher v. Kanas, 288 F. App’x 721, 723 (2d Cir. 2008)) (dismissing a suit under SLUSA because the Supreme Court’s holding in *Dabit* mandates a suit must be dismissed when a securities holder, who did not purchase or sell the security, alleges that the security declined in value). While Federal Rule of Civil Procedure 23 prescribes what constitutes a class action, a “covered class action” for purposes of SLUSA is one in which “damages are sought on behalf of more than 50 persons or prospective class members.” 15 U.S.C. § 77p(f)(2)(A)(i)–(ii) (2006). The term “covered security” refers to those securities listed and traded on national exchanges. 15 U.S.C. § 77r(b)(1) (2006 & Supp. 2012). The Second and Eighth Circuits have held that variable annuities are “covered securities” within the meaning of SLUSA. *See* Lander v. Hartford Life & Annuity Ins. Co., 251 F.3d 101, 109 (2d Cir. 2001) (reasoning that according to the 1940 Investment Company Act, accounts used to market variable annuities require SEC registration); *see also* Dudek v. Prudential Secs., Inc., 295 F.3d 875, 878 (8th Cir. 2002) (relying on *Lander* and holding the same). The Eleventh Circuit has held that variable life insurance policies qualify as “covered securities” within the meaning of SLUSA. *See* Herndon v. Equitable Variable Life Ins. Co., 325 F.3d 1252, 1254 (11th Cir. 2003) (reasoning that like the variable annuities considered in *Lander*, variable life insurance policies need to be registered with the SEC under the Investment Company Act).

44. 15 U.S.C. § 77p(c) (2006). SLUSA contains narrow exceptions that permit covered class actions to proceed in state court. *See* Painter, *supra* note 32, at 56–57 (discussing the Delaware carve-out and state action exemptions to SLUSA). One exception is the “Delaware carve out,” which “preserves state jurisdiction over corporate law claims in situations when plaintiffs allege that corporate managers made misleading statements in order to obtain shareholder approval of a transaction.” *Id.* at 56. However, “the carve out is limited to actions ‘based upon the statutory or common law of the State in which the issue is incorporated . . . or organized.’” A.C. Pritchard,

that PSLRA became “the new national standard for most securities fraud class actions.”⁴⁵ Once a lawsuit is filed in state court alleging either misrepresentation or omission relating to covered securities, the suit may be removed to federal court where it will be subject to PSLRA.⁴⁶ Although Congress recognized such a provision could preclude legitimate investor fraud claims,⁴⁷ it did not provide any special exception that would allow individual claims not barred by SLUSA to proceed.⁴⁸ By failing to provide this exception, Congress curbed the litigation brought in state courts.⁴⁹

C. Courts Have Taken Different Approaches in Interpreting SLUSA

Since SLUSA’s enactment, a split has emerged between various Circuit Courts of Appeal over what level of fraud plaintiffs must allege for SLUSA to preclude a suit.⁵⁰ The Sixth Circuit has held that securities class actions that sound in misrepresentation are precluded.⁵¹ The Ninth Circuit has held the same but also allows plaintiffs to amend their complaints and allows the individual

Constitutional Federalism, Individual Liberty, and the Securities Litigation Uniform Standards Act of 1998, 76 WASH. U. L. Q. 435, 493 (2000) (citing 15 U.S.C. § 77p(d)(1) (2006)). While there has been considerable debate over the applicability of this provision, a complete discussion is beyond the scope of this Comment. See, e.g., *Atkinson v. Morgan Asset Mgmt.*, 658 F.3d 549, 554 (6th Cir. 2011) (narrowly construing the carve out and holding plaintiffs’ claim did not fall under the exception). But see *Greaves v. McAuley*, 264 F. Supp. 2d 1078, 1083 (N.D. Ga. 2003) (construing the carve out provision more broadly and holding some of plaintiffs’ claims fell within the exception).

45. Levine & Pritchard, *supra* note 38, at 32 (highlighting the important relationship between SLUSA and PSLRA).

46. *Id.* After its passage, courts were left to determine how SLUSA would apply to conduct occurring before its enactment. See *Blaz v. Belfer*, 368 F.3d 501, 503 (5th Cir. 2004) (deciding that SLUSA could be applied retroactively). Courts have held that SLUSA retroactively applies to suits alleging pre-enactment conduct because the law governs procedural rather than substantive issues. See *id.* at 502 (holding plaintiffs’ claim was retroactively precluded by SLUSA because the law deals with filing the claim rather than its substance); *Winne v. Equitable Life Assurance Soc’y of U.S.*, 315 F. Supp. 2d 404, 415 (S.D.N.Y. 2003) (conceding that while retroactive application should be disfavored, SLUSA retroactively applied because it covers the required procedure rather than the substance of the claim).

47. S. REP. NO. 105-182, at 11–22 (1998) (statements by Senators Bryon, Johnson and Sarbanes opposing the passage of SLUSA due to concerns of precluding legitimate investor suits).

48. The only exceptions Congress granted which would allow claims to proceed under SLUSA include the Delaware carve out and the State action exemptions. See *supra* note 44.

49. See Jennifer J. Johnson, *Securities Class Actions in State Court*, 80 U. CIN. L. REV. 349, 387 (2011) (concluding that Congress has been successful in substantially preventing securities class actions in state court); see also Jennifer J. Johnson, *Secondary Liability for Securities Fraud: Gatekeepers in State Court*, 36 DEL. J. CORP. L. 463, 492 (2011) (arguing that PSLRA’s and SLUSA’s preemption provisions have created a scenario where “most blue sky claims against secondary participants, in securities fraud cases involving public companies, are only viable in state court as individual actions or very small class actions with fewer than fifty class members.”).

50. This circuit split is discussed *infra* Part I.C.1–3.

51. See, e.g., *Segal v. Fifth Third Bank, N.A.*, 581 F.3d 305, 312 (6th Cir. 2009) (construing SLUSA broadly and holding that the law precluded plaintiffs’ claims); see *infra* Part I.C.1.

claims that are not precluded by SLUSA to proceed.⁵² The Third Circuit has held that allegations of misrepresentation must be connected to the purchase or sale of the security and must operate as a “factual predicate” to the legal claim.⁵³ The Third Circuit has also allowed those individual claims not precluded by SLUSA to move forward.⁵⁴

1. The Sixth Circuit Approach: Playing Hardball

In ruling on several SLUSA cases, the Sixth Circuit has developed a unique approach to determine whether a complaint alleges a misrepresentation or omission.⁵⁵ This approach broadly interprets what constitutes a misrepresentation or omission under SLUSA and when plaintiffs have alleged a misrepresentation or omission.⁵⁶ If the allegations fall within the Sixth Circuit’s broad interpretation of SLUSA’s preclusion provisions, the action is immediately dismissed.⁵⁷

For example, in *Segal v. Fifth Third Bank, N.A.*, the beneficiary of trust accounts administered by Fifth Third Bank sued the bank on behalf of himself and all other beneficiaries for which the bank acted as a trustee.⁵⁸ According to the plaintiff, the bank invested assets in its own fund rather than those of its competitors and failed to deliver on its promise that accounts would receive “‘individualized’ management.”⁵⁹ Instead, the bank invested assets in low

52. See, e.g., *Stoody-Broser v. Bank of America, N.A.*, 442 F. App’x 247, 249 (9th Cir. 2011) (remanding and granting plaintiffs leave to amend); see also *infra* Part I.C.2.

53. See *Rowinski v. Salomon Smith Barney Inc.*, 398 F.3d 294, 300 (3d Cir. 2005) (holding that SLUSA precluded plaintiffs’ claims because allegations of misrepresentation operated as “factual predicates[.]” to plaintiffs’ claims).

54. See, e.g., *LaSala v. Bordier et Cie*, 519 F.3d 121, 143 (3d Cir. 2008) (allowing corporate claims not precluded by SLUSA to proceed); see *infra* Part I.C.3.

55. *Segal*, 581 F.3d at 311–12 (6th Cir. 2009) (holding that when a complaint meets SLUSA’s preclusion requirements—contains allegations of misrepresentation related to securities sale or purchase—it must be dismissed); *Atkinson v. Morgan Asset Mgmt., Inc.*, 658 F.3d 549, 555 (6th Cir. 2011) (applying the *Segal* approach to dismiss the plaintiffs’ claims alleging “pure and simple” misrepresentation and omission in connection with a securities transaction). In *Brown*, the Seventh Circuit referred to the Sixth Circuit’s approach as the “literalist” approach, explaining that this approach dismisses a complaint when “the complaint can be interpreted as ‘alleging a misrepresentation or [in fact, and] omission of a material fact in connection with the purchase or sale of a covered security.’” *Brown v. Calamos*, 664 F.3d 123, 127 (7th Cir. 2011), *cert. denied* 132 S. Ct. 2774 (2012).

56. See *Segal*, 581 F.3d at 309 (citing *Merrill Lynch, Pierce, Fenner & Smith Inc. v. Dabit*, 547 U.S. 71, 84–86 (2006)) (recognizing “the Supreme Court has construed [SLUSA’s] expansive language broadly.”).

57. See *id.* at 311–12; *Brown*, 664 F.3d at 128 (evaluating the Sixth Circuit’s approach of dismissing a precluded claims with prejudice).

58. *Segal*, 581 F.3d at 308.

59. *Id.*

reward funds to cover the investment accounts' tax liabilities.⁶⁰ Plaintiffs alleged that by doing so, the bank breached its fiduciary and contractual duties.⁶¹

Although the complaint made no explicit mention of misrepresentation or omission, the District Court for the Southern District of Ohio dismissed the case.⁶² In justifying its dismissal, the *Segal* court cast a wide net in search of the presence of misrepresentations.⁶³ The court held that the factual basis for the complaint was misrepresentation, omission, or deception relating to the bank's investment of the plaintiffs' funds,⁶⁴ and found this allegation sufficient to bring the case within SLUSA's preclusive purview.⁶⁵

The Sixth Circuit Court of Appeals affirmed, holding that the suit was barred under SLUSA.⁶⁶ The court reasoned that the complaint still contained allegations of misrepresentation by stating that the bank acted dishonestly when it invested in its proprietary mutual funds without informing the beneficiaries.⁶⁷ Moreover, the court found that these misrepresentations were related to the bank's mutual fund transactions and affirmed the district court's dismissal of the suit.⁶⁸

Rather than look to the specific words used to allege the claims, the Sixth Circuit considered the complaint's substance.⁶⁹ The court gave little credence to the complaint's disclaimer denying any allegations of misrepresentation.⁷⁰ Instead, the court viewed the complaint broadly, looking to the allegations in the

60. *Id.*

61. *Id.*

62. *Segal v. Fifth Third Bank, N.A.*, No. 1:07-cv-348, 2008 WL 819290, at *7 (S.D. Ohio Mar. 25, 2008) (dismissing the plaintiffs' complaint as precluded by SLUSA because the claims allege fraud related to a securities transaction).

63. *See id.* at *4-*7.

64. *Id.* at *4.

65. *Id.* at *7.

66. *Segal*, 581 F.3d at 308.

67. *Id.* at 309-10.

68. *Id.* at 310.

69. *Id.* at 311 (declaring also that a plaintiff "cannot avoid [SLUSA's] application through artful pleading that removes the covered words from the complaint but leaves in the covered concepts").

70. *Id.* at 310. The disclaimer in the complaint stated: "None of the causes of action stated herein are based upon any misrepresentation or failure to disclose material facts to plaintiff." *Id.* The lower court also gave little weight to this disclaimer. *See Segal v. Fifth Third Bank, N.A.*, 1:07-cv-348, 2008 WL 819290, at *4 (S.D. Ohio Mar. 25, 2008) (declaring that "the court can and should disregard the particular labels or titles Plaintiffs may affix to their claims when determining if SLUSA precludes those claims."). Other courts have also explained that the concept, and not the words used to express it, is the operative issue courts consider when determining if there is SLUSA preclusion. *See, e.g., Miller v. Nationwide Life Ins. Co.*, 391 F.3d 698, 702 (5th Cir. 2004) (stating preemption by SLUSA is not based on the label one uses when referring to a claim, but the content of the claim itself).

complaint as a whole to determine if there were allegations of fraud.⁷¹ Based on its review, the court concluded that the plaintiff's breach of fiduciary duty, unjust enrichment, and breach of contract counts were based on the bank's purchase of mutual shares, which inextricably connects them with the purchase of a covered security.⁷² The court found that because the substance of the complaint included allegations of misrepresentation in connection with the purchase of covered securities, the entire complaint was precluded under SLUSA.⁷³

Similarly, in *Atkinson v. Morgan Asset Management, Inc.*, a group of shareholders brought a class action suit in state court against mutual fund advisors alleging, *inter alia*, breach of contract, breach of fiduciary duty, and negligent misrepresentation, on the grounds that the "[d]efendants took unjustified risks" with fund assets without shareholders' knowledge.⁷⁴ When the case was removed to federal court, the plaintiffs argued that their suit was not precluded by SLUSA because, although the complaint may have included fraud-based allegations, "SLUSA bars only claims that *require* fraud as a *necessary element*."⁷⁵ Plaintiffs further contended that any allegations of fraud or misrepresentation were merely "background information" and not part of the "necessary elements" required to prove their claims.⁷⁶ Plaintiffs argued that even if some of their claims were precluded by SLUSA, others, which fell outside SLUSA's reach, should be allowed to proceed.⁷⁷

The District Court for the Western District of Tennessee held that the entire action fell within SLUSA's preclusive provisions, because all of the claims alleged involved some sort of misrepresentation.⁷⁸ The Sixth Circuit Court of Appeals affirmed, looking to the substance of the complaint and holding the suit was barred by SLUSA because "'allegations of omissions or other deceitful activity' pervaded each of Plaintiffs' claims."⁷⁹ The court dismissed the suit

71. *Segal*, 581 F.3d at 311 (stating SLUSA does not distinguish between different types of allegations of misrepresentation in connection with securities; it only looks to see if these allegations are present); *see also* *Daniels v. Morgan Asset Mgmt., Inc.*, 743 F. Supp. 2d 730, 737 (W.D. Tenn. 2010) (highlighting that courts must analyze a complaint's substance to determine whether it includes concepts precluded by SLUSA).

72. *Segal*, 581 F.3d at 310.

73. *Id.* at 312.

74. 658 F.3d 549, 552 (6th Cir. 2011).

75. *Id.* at 555.

76. *Id.*

77. *Id.* at 554.

78. *Atkinson v. Morgan Asset Mgmt., Inc.*, 664 F. Supp. 2d 898, 907 (W.D. Tenn. 2009).

79. *Atkinson*, 658 F.3d at 555 (citing *Atkinson*, 664 F. Supp. 2d at 906–07). Other circuits have made similar rulings. *See, e.g.*, *Dudek v. Prudential Secs., Inc.*, 295 F.3d 875, 879 (8th Cir. 2002) (affirming dismissal of a suit barred by SLUSA, which contained no specific allegations of fraud or misrepresentation, but the gravamen of the complaint alleged misrepresentation or omission).

without leave to amend, finding that since each of the claims relied on fraud or misrepresentation, any attempt to amend the complaint would be “futile.”⁸⁰

2. *The Ninth Circuit Approach: Playing Hardball . . . With the Chance of Reprieve*

The Ninth Circuit has adopted a similar approach to the Sixth Circuit by requiring courts to consider the whole complaint when determining whether an action is precluded by SLUSA.⁸¹ However, unlike the Sixth Circuit, it has dismissed complaints without prejudice, granting plaintiffs leave to amend, and has dismissed only those claims specifically barred by SLUSA, allowing others to proceed.⁸²

In *Stoody-Broser v. Bank of America, N.A.*, a trust beneficiary filed a class action suit against the trustee who invested the trust assets in affiliated mutual funds, alleging breach of the fiduciary duties of loyalty and care.⁸³ Plaintiff argued that SLUSA did not apply to these allegations because the claims for breaches of fiduciary duties were not based on misrepresentations or

80. *Atkinson*, 658 F.3d at 556. This ruling reflects the difficulties plaintiffs face in seeking to avoid SLUSA preclusion under the Sixth Circuit approach when alleging misrepresentation or omission. *See supra* note 55; William O. Fisher, *Caselaw Developments 2011*, 67 BUS. LAW. 803, 926 (2012) (noting that *Atkinson* signifies a judicial predilection for precluding claims through strict application of SLUSA’s provisions). Other courts have adopted approaches similar to the Sixth Circuit. *See, e.g.*, *Anderson v. Merrill Lynch, Pierce, Fenner & Smith, Inc.*, 521 F.3d 1278, 1286 (10th Cir. 2008) (declaring claims may be precluded by SLUSA if all the elements are met even if plaintiffs have employed clever arguments to circumvent SLUSA’s requirements). In *Anderson*, the Tenth Circuit Court of Appeals held Plaintiffs’ claims contained allegations of misrepresentation and dismissed the case without leave to amend. *Id.* at 1288. In *Behlen v. Merrill Lynch*, the Eleventh Circuit Court of Appeals held similarly to *Anderson*. 311 F.3d 1087, 1094–95 (11th Cir. 2002) (holding plaintiff’s claim alleged misrepresentations and omissions regarding the sale of stock).

81. *See Stoody-Broser v. Bank of America*, 442 F. App’x 247, 249 (9th Cir. 2011) (reviewing the entire complaint and determining it was precluded by SLUSA but refusing to dismiss the complaint with prejudice). The *Brown* court referred to the Ninth Circuit’s approach as an “intermediate approach” similar to the Sixth Circuit, but granting leave to amend. *Brown v. Calamos*, 664 F.3d 123, 127 (7th Cir. 2011), *cert. denied* 132 S. Ct. 2774 (2012).

82. *See Stoody-Broser*, 442 F. App’x at 249; *Hanson v. Morgan Stanley Smith Barney, LLC*, 762 F. Supp. 2d 1201, 1208 (C.D. Cal. 2011) (granting Plaintiffs leave to amend their complaint); *Tuttle v. Sky Bell Asset Mgmt., LLC*, No. C. 10-03588 WHA, 2010 WL 4807093, at *3 (N.D. Cal. Nov. 19, 2010) (indicating that even if SLUSA precludes claims removed from state court, plaintiffs whose claims have been removed from state court may still amend their complaints to try to avoid preclusion); *Simon v. Stang*, No. C. 10-00262 JF (HRL), 2010 WL 1460430, at *7 (N.D. Cal. Apr. 12, 2010) (granting plaintiffs leave to amend, reasoning that amending their complaint would avoid SLUSA preclusion); *U.S. Mortg., Inc. v. Saxton*, 494 F.3d 833, 842–43 (9th Cir. 2007) (allowing plaintiff to amend the complaint, reasoning that Congress did not explicitly prohibit granting leave to amend and no court has held that SLUSA completely and categorically bars any amendment of the complaint following removal), *abrogated on other grounds as recognized in Proctor v. Vishay Intertech, Inc.*, 584 F.3d 1208 (9th Cir. 2009).

83. *Stoody-Broser v. Bank of America, N.A.*, No. C 08-02705 JSW, 2009 WL 2707393, at *1 (N.D. Cal. Aug. 25, 2009).

omissions.⁸⁴ The District Court for the Northern District of California rejected this argument and held SLUSA barred the suit because the complaint alleged misrepresentations and omissions relating to the investment, including conflicts of interest and increased expenses.⁸⁵ On appeal, the Ninth Circuit affirmed the district court's decision, agreeing that SLUSA barred the complaint.⁸⁶ In doing so, the court employed a similar approach to the Sixth Circuit's, reasoning that the complaint alleged omissions including the failure to inform the trust beneficiaries about its investment in proprietary mutual funds.⁸⁷ The Ninth Circuit dismissed the complaint with leave to amend, holding that doing so might allow plaintiff to reassert her claims without alleging misrepresentation, thereby avoiding SLUSA preclusion.⁸⁸

The Ninth Circuit has also held that when only some of the claims in a complaint are precluded by SLUSA, the court will not dismiss the entire suit; rather, it will dismiss only those claims barred by SLUSA, allowing the rest of the action to proceed.⁸⁹ For example, in *Crimi v. Barnholt*, shareholders sued a corporation's officers and directors for breach of fiduciary duty, alleging the officers failed to disclose important information in proxy statements.⁹⁰ They further claimed this nondisclosure deprived them of the right to make informed voting decisions.⁹¹ Although the court dismissed the breach of fiduciary claim because it was precluded by SLUSA, it held that the voting claim may be beyond SLUSA's scope, and therefore, remanded the voting claim so the lower court could determine whether it was valid under California state law.⁹² The court

84. *Id.* at *2.

85. *Id.* at *3.

86. *Stoody-Brosier*, 442 F. App'x at 248.

87. *Id.*

88. *Id.* at 249 (explaining that "a complaint may allege a violation of a trust administrator's fiduciary duty to the trust's beneficiaries even where that violation involves trading in covered securities so long as the complaint does not allege, either expressly or implicitly, misrepresentations, omissions, or fraudulent practices coincidental to the violation").

89. *Proctor v. Vishay Intertech, Inc.*, 584 F.3d 1208, 1228 (9th Cir. 2009). This approach was borrowed in part from the Second Circuit. *See, e.g., Gray v. Seaboard Secs., Inc.*, 126 F. App'x 14, 16 (2d Cir. 2005) (rejecting the notion that entire actions containing some claims preempted by SLUSA should be dismissed).

90. No. C. 08-02249 CRB, 2008 WL 4287566, *1 (N.D. Cal. Sept. 17, 2008) (noting that the plaintiffs alleged the corporation violated a fiduciary duty by issuing backdated stock options to officers).

91. *Id.* (alleging the failure to disclose backdated stock options affected their decision-making ability as shareholders).

92. *Id.* at *7. The court stated that the voting right claim likely fell within the Delaware carve out. *Id.* at *4. Defendants argued this claim was outside the carve-out exception because it was a derivative allegation. *Id.* at *5. Assuming, *arguendo*, that the Defendants were correct, the court held the claim still would not be dismissible because SLUSA does not apply to derivative actions. *Id.*

explained that if the state court determined the voting claim was valid, that claim would be allowed to proceed in state court.⁹³

3. *The Third Circuit Approach: Playing Softball*

The Third Circuit has adopted a more lenient approach, taking a narrower view of the degree to which allegations of misrepresentation relate to the purchase or sale of covered securities.⁹⁴ For example, in *Rowinski v. Salomon Smith Barney Inc.*, investors sued the brokerage and investment bank firm Salomon Smith Barney, Inc., for breach of contract and various consumer protection violations.⁹⁵ Plaintiffs alleged Smith Barney gave them misleading advice designed only to help its other clients.⁹⁶ After the case was removed to federal court, the District Court for the Middle District of Pennsylvania dismissed the case, declaring the plaintiffs alleged misrepresentation sufficiently related to the purchase and sale of securities, bringing the plaintiffs' claims within SLUSA preclusion.⁹⁷

On appeal, the Third Circuit held the complaint contained numerous allegations of misrepresentation, which served as factual predicates to the claims.⁹⁸ However, the court acknowledged the relative difficulty in determining whether the "in connection with the purchase or sale of any [covered] security" requirement was met.⁹⁹ Although the plaintiffs contended that the complaint alleged breach of contract, the court sought to clarify what was meant by "in connection with" in order to determine whether the action was precluded by SLUSA.¹⁰⁰

93. *Id.* at *7.

94. *See, e.g.,* *LaSala v. Bordier et Cie*, 519 F.3d 121, 141 (3d Cir. 2008) (holding that a suit is not precluded under SLUSA if it is not essential for the plaintiff to prove misrepresentation or omission in order to succeed); *see also* *Brown v. Calamos*, 664 F.3d 123, 127 (7th Cir. 2011) (comparing the Third Circuit approach to the Sixth Circuit approach), *cert. denied*, 132 S. Ct. 2774 (2012).

95. 398 F.3d 294, 296 (3d Cir. 2005).

96. *Id.* at 297.

97. *Rowinski v. Salomon Smith Barney, Inc.*, No. 3:02CV2014, 2003 WL 22740976, at *2–4 (M.D. Pa. Nov. 20, 2003).

98. *Rowinski*, 398 F.3d at 299–300 (noting Plaintiff's complaint alleged that Defendant provided biased and misleading information).

99. *Id.* at 300 (stating the issue in the case hinges on whether Plaintiffs' allegations that Smith Barney misrepresented its clients' ratings are "connected" to the purchase or sale of securities); *see also* O'Hare, *supra* note 30, at 328–29 (highlighting the importance of the "in connection with" requirement and noting that courts have difficulty interpreting this element).

100. *Rowinski*, 398 F.3d at 300–01. The "in connection with" requirement has been a source of debate in numerous circuits. *See, e.g.,* *Roland v. Green*, 675 F.3d 503, 520 (5th Cir. 2012) (citing *Madden v. Cowen & Co.*, 576 F.3d 957, 965–66 (9th Cir. 2009)) (holding that for the "in connection with" requirement to be met and a claim to be barred by SLUSA, the alleged fraud and the stock sale must coincide or "be more than tangentially related"); *Romano v. Kazacos*, 609 F.3d 512, 522 (2d Cir. 2010) (quoting *Dabit v. Merrill Lynch, Pierce, Fenner & Smith, Inc.*, 395 F.3d 25, 48–50 (2d Cir. 2005), *vacated* 547 U.S. 71 (2006)) (holding that SLUSA's "in connection with"

In evaluating the connection requirement, the Third Circuit looked to the Supreme Court case *Securities and Exchange Commission v. Zandford*.¹⁰¹ In *Zandford*, the Court held that plaintiffs alleging fraud had stated a cause of action.¹⁰² The Court reasoned that the “in connection with” requirement was satisfied by a securities fraud scheme that coincided with breaches of fiduciary duty.¹⁰³ Applying this precedent, the *Rowinski* court considered whether the investors’ allegations “coincided” with the purchase or sale of securities.¹⁰⁴ The court also considered several other factors: (1) whether reasonable investors would rely on the method the allegedly misrepresented information was distributed by;¹⁰⁵ (2) whether the parties’ relationship entailed the buying or selling of securities; and (3) whether there was a nexus between the requested damages and securities transactions connecting the transactions to the state law claims.¹⁰⁶

The *Rowinski* court held that the coincidence factor was met because the complaint alleged the company misrepresented the value of securities to benefit other clients and earn banking fees.¹⁰⁷ The court held that the method reliance factor was satisfied because the plaintiff alleged the investment bank’s misrepresentation came in the form of research reports upon which investors rely.¹⁰⁸ The court also found that the relationship between investors and Smith Barney met the purchase or sale requirement.¹⁰⁹ Finally, the court found that the plaintiffs’ prayer for relief connected their state law claims to the purchase or sale of securities.¹¹⁰ Unlike the Sixth and Ninth Circuits’ approaches, the *Rowinski* court’s approach not only emphasized whether the suit contained allegations of misrepresentation, but also considered the allegations themselves

requirement is satisfied “where plaintiff’s claims ‘necessarily allege,’ ‘necessarily involve,’ or ‘rest on’ the purchase or sale of securities”); see also Lisa R. Bugni & Jason R. Outlaw, *Recent Developments under the Securities Litigation Uniform Standards Act of 1998 (“SLUSA”)*, 27 SEC. LITIG. FORMS & ANALYSIS § 1:4 (2013) (emphasizing the disagreement among courts over what constitutes “coincide”). The Supreme Court has granted certiorari to decide the meaning of the “in connection with” requirement. See *Roland v. Green*, 675 F.3d 503, 506 (5th Cir. 2012), cert. granted in part sub nom. *Chadbourne & Parke LLP v. Troice*, 133 S. Ct. 977.

101. *Rowinski*, 398 F.3d at 302 (citing *Secs. and Exch. Comm’n v. Zandford*, 535 U.S. 813 (2002)).

102. *Id.* at 825.

103. *Id.* The fraud alleged in *Zandford* was based on Rule 10b-5 of the Securities and Exchange Act of 1934, which makes it unlawful to make a “misstatement of fact in connection with the purchase or sale of any security.” 15 U.S.C. § 78j(b) (2006); 17 C.F.R. § 240.10b-5 (2011).

104. *Rowinski*, 398 F.3d at 302.

105. *Id.* (quoting *Semerenco v. Cendant Corp.*, 223 F.3d 165, 176 (3d Cir. 2000)).

106. *Id.*

107. *Id.*

108. *Id.*

109. *Id.* at 303 (quoting *Angelastro v. Prudential Secs., Inc.*, 764 F.2d 939, 944 (3d Cir. 1985)) (reasoning the transaction was based on plaintiff and defendant’s broker/investor relationship).

110. *Id.* (stating “plaintiff seeks recovery of ‘any and all fees and charges collected from Plaintiff and the Class,’ as well as ‘all available compensatory damages’”).

to determine whether they were “in connection with the purchase or sale of securities.”¹¹¹ Still, the court determined the plaintiffs’ misrepresentation allegations were “in connection with the purchase and sale of securities” and thus barred by SLUSA.¹¹²

In *LaSala v. Bordier et Cie*, the Third Circuit further emphasized the necessary relationship between the allegations and the purchase or sale of securities.¹¹³ In *LaSala*, investors alleged that a software company had inflated its stock price by stating that it was in better condition than it actually was.¹¹⁴ When the company’s true financial condition was revealed, its stock price dropped, causing substantial losses to investors.¹¹⁵ After the company filed for bankruptcy, investors created a state-law trust to state claims on behalf of all investors together rather than try them separately.¹¹⁶ The trustees filed suit on behalf of the trust against Swiss banks for “aiding and abetting a breach of fiduciary duty” by failing to investigate various transactions made by the company’s directors.¹¹⁷

The District Court for the District of New Jersey dismissed the action, reasoning that the claims were based on misrepresentations and omissions of material fact.¹¹⁸ On appeal, the Third Circuit reversed and remanded the case.¹¹⁹ In doing so, the court clarified its *Rowinski* holding, indicating that the case did not mean that any misrepresentation alleged in a complaint precluded the action under SLUSA.¹²⁰ The court stated that *Rowinski* precludes only those misrepresentations that are a “factual predicate” to plaintiffs’ claim.¹²¹

111. See *id.* at 300; Brown, 664 F.3d at 127 (noting “the contrary approach taken by the Third Circuit . . . that if proof of a misrepresentation or of a material omission is inessential to the plaintiff’s success, the allegation is no bar to the suit.”).

112. *Rowinski*, F.3d at 305.

113. 519 F.3d 121, 141 (3d Cir. 2008).

114. *Id.* at 126. The actions by the software company’s directors are known as a “pump and dump” scheme where an individual “touts (‘pumps’) a stock by making baseless projections about its future share price and/or unjustified forecasts about the company’s future earnings” causing the stock price to rise substantially. David B. Kramer, *The Way It Is and the Way It Should Be: Liability Under § 10(b) of the Exchange Act and Rule 10b-5 Thereunder for Making False and Misleading Statements as Part of a Scheme to “Pump and Dump” a Stock*, 13 U. MIAMI BUS. L. REV. 243, 245 (2005). After prices have sufficiently risen, but before the truthful information is discovered, the individual dumps the investment and profits from the difference.” *Id.*

115. *LaSala*, 519 F.3d at 126.

116. *Id.* at 127.

117. *Id.*

118. *LaSala v. Bordier et Cie*, 452 F. Supp. 2d 575, 588 (D. N.J. 2006).

119. *LaSala*, 519 F.3d at 143.

120. *Id.* at 141.

121. *Id.* Other jurisdictions have adopted similar approaches. See, e.g., *Xpedior Creditor Trust v. Credit Suisse First Boston (USA) Inc.*, 341 F. Supp. 2d 258, 268 (S.D.N.Y. 2004) (stating that courts should pay less attention to the words plaintiffs use in the complaint, but focus on “whether a material misstatement or omission in connection with the purchase or sale of a covered security is a *necessary component* of the claim”). But see *Atkinson v. Morgan Asset Mgmt., Inc.*, 658 F.3d

According to the court, factual predicate misrepresentations are those that, if true, would render the defendant liable in the present action.¹²² Allegations that, even if true, would fail to render the defendant liable are “extraneous allegations.”¹²³ The court explained that in light of the heightened pleading standards under PSLRA, plaintiffs might be more apt to include excessive information in complaints, possibly including information that may be misinterpreted as alleging misrepresentation even though it is not actually “in connection with the purchase or sale of covered securities.”¹²⁴ Under Third Circuit precedent, including “extraneous allegations” in a complaint does not preclude a claim under SLUSA.¹²⁵

Applying this distinction between factual predicates and extraneous details, the court held the plaintiffs’ misrepresentation claims against the Swiss banks were extraneous.¹²⁶ The court found that because the claims against the banks were for breaches of fiduciary duty and failure to investigate the directors’ money-laundering transactions, any alleged misrepresentation by the software company regarding its financial condition and stock price was not a factual predicate.¹²⁷ Rather, it was background information necessary to understand the claims against the banks.¹²⁸ As the trust’s allegations of misrepresentation were not in connection with the purchase or sale of a covered security, the *LaSala* court held that the trustees’ claims were not precluded by SLUSA.¹²⁹ As represented by *LaSala*, the Third Circuit allows those individual claims not barred by SLUSA to proceed even when the action contains other claims that are precluded.¹³⁰ As a result, it is easier for plaintiffs in the Third Circuit to avoid SLUSA preclusion.¹³¹

549, 555 (6th Cir. 2011) (rejecting plaintiffs’ claim that their action is not barred by SLUSA because they “do not allege any actual purchases or sales as the factual predicate for any of their claims.”).

122. *LaSala*, 519 F.3d at 141.

123. *Id.*

124. *Id.* (emphasizing the important distinction between extraneous details and factual predicates because many complaints are overinclusive).

125. *Id.*

126. *Id.*

127. *Id.*

128. *Id.*

129. *Id.* at 143 (holding that the Trust’s allegations that the software company aided and abetted the Bank’s alleged breach of fiduciary duties were not barred by SLUSA).

130. *See id.*; *see also In re Lord Abbett Mut. Funds Fee Litig.*, 553 F.3d 248, 254 (3d Cir. 2009) (holding SLUSA does not require an entire action that contains non-SLUSA precluded claims be dismissed).

131. *See, e.g., LaSala*, 519 F.3d at 143; *see also Stephens v. Gentilello*, 853 F. Supp. 2d 462, 468 (D. N.J. 2012) (citing *LaSala*, 519 F.3d at 141) (holding that a securities class action claim was not barred by SLUSA because the misrepresentations plaintiffs alleged served as background details which did not need to be proved for plaintiffs to succeed).

D. Framing the Split: The Brown Perspective

The Seventh Circuit recently addressed the circuit split over how to handle potential SLUSA-related complaints in *Brown v. Calamos*.¹³² In *Brown*, the court considered whether a securities class action complaint “alleged the misrepresentation or omission of a material fact in connection with the purchase or sale of a covered security” and was thereby barred by SLUSA.¹³³

The *Brown* plaintiffs were shareholders who owned common stock in Calamos Convertible Opportunities and Income Fund (“the Fund”), a closed-end investment fund.¹³⁴ The shareholders were considered corporate owners whose assets were investments in the Fund.¹³⁵ The Fund also issued preferred stock known as Auction Market Preferred Stock (“AMPS”), which had low interest rates and no maturity date.¹³⁶ It then invested money obtained from the AMPS and the sale of common stock, the proceeds of which went to benefit common shareholders.¹³⁷ After the market crashed in 2008, the Fund redeemed the AMPS and replaced them with money borrowed from relatively high interest, short-term loans.¹³⁸ In response, shareholders of the Fund’s common stock filed a class action lawsuit alleging breach of fiduciary duty and unjust enrichment.¹³⁹ The shareholders argued that they chose to invest in the Fund based on the indefinite leverage created by the supposedly perpetual AMPS.¹⁴⁰ They also claimed that a conflict of interest was created when the Fund redeemed the AMPS because the Fund did so in part to benefit other banks.¹⁴¹ Notably, the complaint contained a disclaimer stating plaintiffs were not making a claim of misrepresentation connected to securities.¹⁴² The District Court for the

132. 664 F.3d at 127.

133. *Id.* at 125.

134. *Id.* In a closed-end fund, owners cannot redeem their shares. *Id.* This differs from an open-ended fund, in which shareholders can sell their shares at any time. *Id.*

135. *Id.*

136. *Id.* The court noted that the dividends in AMPS functioned more like an interest, rather than a return on equity securities, and that the preferred stock operated more like a type of debt. *Id.* at 126. AMPS paid a dividend at short intervals by auction, in which the highest bidder gets the preferred shares with the lowest interest rates. *Id.* at 125. With no maturity date, AMPS could be held indefinitely. *Id.*

137. *Id.* According to the complaint, the AMPS benefitted common shareholders well because the funds generated by the AMPS, which had low interest rates, were used to buy higher-return investments. *Id.*

138. *Id.* at 126 (indicating unlike the stability offered by the low interest AMPS, high interest, short-term loans increased the Fund’s risk by cutting away at its capital base).

139. *Brown v. Calamos*, 777 F. Supp. 2d 1128, 1129 (N.D. Ill. 2011).

140. *Id.* at 1130.

141. *Id.* Specifically, plaintiffs alleged that the Fund put its strong interest in keeping a positive relationship with the investment banks and brokers, who had sold the AMPS to the investors, ahead of its fiduciary duties to its shareholders because the banks and brokers facilitated its beneficial business model. *Id.*

142. *Id.* at 1131. The complaint specifically stated “[p]laintiff does not assert by this action any claim arising from a misstatement or omission in connection with the purchase or sale of a

Northern District of Illinois concluded that the suit was barred by SLUSA because the plaintiffs' claims included allegations of misrepresentation, the perpetual nature of the AMPS, and omission, defendants' failure to disclose the conflict of interest arising from its dealings with other banks.¹⁴³

On appeal, the Seventh Circuit, like the Sixth Circuit, attributed little significance to the disclaimer in the complaint.¹⁴⁴ The court interpreted the language used in the complaint that referred to the shareholders' belief that leverage from the AMPS would continue indefinitely as alleging a misrepresentation regarding the longevity of the class of stock.¹⁴⁵ The court also found that the complaint alleged a misleading omission by the Fund that the AMPS could be redeemed at any time.¹⁴⁶

After making these determinations, the court examined the different approaches taken by other circuits, weighing how each would rule on whether the complaint contained allegations of misrepresentation or omission in connection with the purchase or sale of covered securities.¹⁴⁷ The court noted that the Sixth Circuit would take a "literalist approach" if hearing the case and would impliedly dismiss the suit because the complaint contains allegations of misrepresentation and omissions of fact.¹⁴⁸ The court also considered the Third Circuit's approach, stating that even under this approach, plaintiffs' claims are likely precluded because the alleged fraud is a factual predicate of plaintiffs' claim.¹⁴⁹ The court then considered taking the Ninth Circuit's intermediate approach by employing a similar "literalist approach" while allowing plaintiffs to file an amended complaint to avoid SLUSA preclusion.¹⁵⁰ The court doubted that this approach would work because it might allow plaintiffs to allege fraud again in a new complaint and thus burden the judiciary with hearing another suit precluded by SLUSA.¹⁵¹ The court acknowledged that the reviewing court could then remove and dismiss the case with prejudice should the new complaint

security, nor does plaintiff allege that defendants engaged in fraud in connection with the purchase or sale of a security.'" *Id.*

143. *Id.* at 1132.

144. *Brown v. Calamos*, 664 F.3d 123, 126 (7th Cir. 2011), *cert. denied* 132 S. Ct. 2774 (2012).

145. *Id.* at 126–27 (noting also that "a reasonable jury might find that the passage insinuated that a significant benefit of investing in the fund was that the investor would obtain leverage indefinitely because the AMPS had no maturity date.").

146. *Id.* at 127 (noting that the language plaintiff used in the complaint amounted to "an allegation of failure to disclose a conflict of interest that if disclosed would have given pause to potential investors").

147. *Id.*

148. *Id.*

149. *Id.* at 127–29 (explaining the fraud alleged by the plaintiffs is a factual predicate to the plaintiffs' claims because it is, arguably, inextricably entwined with the plaintiffs' other claims).

150. *Id.* at 127.

151. *Id.* (generally disagreeing with the Ninth Circuit's approach as complaints do not dictate the breadth of litigation in American law).

contain allegations precluded by SLUSA.¹⁵² Still, the court feared that allegations of fraud might become entangled in the new, potentially complex, suit after the case had already proceeded beyond pleadings, dragging out the litigation.¹⁵³ For these reasons, the court seemed unwilling to apply the Ninth Circuit's approach.¹⁵⁴

The *Brown* court concluded that the shareholders' claims were barred by SLUSA under both the Sixth and Third Circuit approaches, because the complaint alleged misrepresentation and fraud likely integral to the breach of duty claims.¹⁵⁵ The court affirmed the suit's dismissal and dismissed it without explicitly adopting one of these approaches over the other.¹⁵⁶

II. TRYING TO HEAL A FRACTURE: THE APPROACHES OF OTHER CIRCUITS FAIL TO ACHIEVE THE OBJECTIVES OF SLUSA

The U.S. Supreme Court has yet to resolve the circuit split over allegations of misrepresentations in complaints as it relates to SLUSA and is unlikely to do so in the near future as the Court recently denied a petition for certiorari in the *Brown* case.¹⁵⁷ The three approaches to addressing these complaints are different enough to present potential problems for plaintiffs and defendants trying to litigate these cases. The Third Circuit's approach is far more lenient than the Sixth and Ninth Circuit approaches, both in its interpretation of the requirement that allegations of misrepresentation coincide with the purchase or sale of covered securities, and in its requirement that allegations of misrepresentation operate as factual predicates to plaintiffs' claims.¹⁵⁸ It follows that the current split encourages forum shopping in favor of plaintiff-friendly jurisdictions.¹⁵⁹ Plaintiffs may try to find a way to bring their actions in the Third Circuit, as securities class action lawsuits in that jurisdiction are barred by SLUSA only if allegations of misrepresentation or omission are "essential" to

152. *Id.*

153. *Id.*

154. *Id.*

155. *Id.* at 130.

156. *Id.* at 130–31.

157. *Brown v. Calamos*, 132 S. Ct. 2774 (2012).

158. *See, e.g., Brown v. Calamos*, 664 F.3d 132, 127 (7th Cir. 2011) (noting that the Third Circuit determined that an allegation of misrepresentation that is not vital to a plaintiff's success is one that should not be precluded), *cert. denied* 132 S. Ct. 2774 (2012); *LaSala v. Bordier et Cie*, 519 F.3d 121, 141 (3d Cir. 2008) (refining the Third Circuit's particular take on allegations of misrepresentation).

159. *See O'Brien, supra* note 26 (stating the uncertainty about the way in which to properly interpret securities class action laws such as SLUSA has resulted in inconsistent application of the laws by federal courts, creating uncertainty over outcomes for defendants in suits based on these laws).

plaintiffs' success.¹⁶⁰ Furthermore, under the Third Circuit approach, any claims not barred by SLUSA may proceed even if the complaint contains some claims barred by SLUSA.¹⁶¹ Conversely, plaintiffs are likely to avoid jurisdictions such as the Sixth Circuit because the Sixth Circuit's broad interpretation of what constitutes a claim barred by SLUSA makes it tougher for plaintiffs to succeed.¹⁶² Though *Brown* describes the different approaches, highlighting the strengths and weaknesses of each, it fails to explicitly endorse an approach.¹⁶³ In order to resolve the confusion over this issue and prevent forum shopping, one approach should apply for these cases no matter which circuit the case is tried in. A proper approach would ask whether there is a reasonable relationship between the alleged misrepresentation and plaintiffs' claims. Although the various approaches may seem consistent with SLUSA, each suffers from flaws, rendering it inconsistent with SLUSA.

A. Easier Said Than Done: The Practical Implications of the Ninth Circuit's Approach Make It Inconsistent With the Purpose and Language of SLUSA

1. Language Barrier: The Ninth Circuit's Approach is Inconsistent with the Language of SLUSA

Although the Ninth Circuit's approach is similar to the Sixth Circuit's insofar as it dismisses suits containing any allegations of misrepresentation or omission, the Ninth Circuit allows plaintiffs to amend the complaint and remove any allegations of fraud so the suit may proceed.¹⁶⁴ Supporters of this approach may argue that it presents a prudent course of action because it grants plaintiffs leave to amend if the complaint contains allegations precluded by SLUSA.¹⁶⁵ The Ninth Circuit's approach also prevents plaintiffs from being penalized for

160. *LaSala*, 519 F.3d at 141 (holding a securities class action suit alleging fraud or misrepresentation is only barred by SLUSA when the allegations "operate as a factual predicate to a legal claim").

161. See, e.g., *In re Lord Abbett Mut. Funds Fee Litig.*, 553 F.3d 248, 254 (3d Cir. 2009) (allowing claims not barred by SLUSA to proceed).

162. See, e.g., *Segal v. Fifth Third Bank, N.A.*, 581 F.3d 305, 311 (6th Cir. 2009) (examining not just the words, but the substance of the complaint in holding that a suit alleged misrepresentation and was therefore barred by SLUSA).

163. *Brown*, 664 F.3d at 130–31; see also Part I.D (discussing the *Brown* court's treatment of the circuit split and decision not to select an approach).

164. See, e.g., *Stoody-Brosier v. Bank of America*, 442 F.App'x 247, 249 (9th Cir. 2011) (reviewing the entire complaint and determining it was precluded by SLUSA but refusing to dismiss the complaint with prejudice); see also *supra* Part I.C.2 (discussing the Ninth Circuit's approach to handling complaints containing claims potentially precluded by SLUSA).

165. See *U.S. Mortg., Inc. v. Saxton*, 494 F.3d 833, 843 (9th Cir. 2007) (holding that complaints may be amended after removal to federal court), *abrogated on other grounds* by *Proctor v. Vishay Intertech, Inc.*, 584 F.3d 1208 (9th Cir. 2009); *Gompper v. VISX, Inc.*, 298 F.3d 893, 898 (9th Cir. 2002) (stating that "[d]ismissal without leave to amend is improper unless it is clear, upon de novo review, that the complaint could not be saved by any amendment." (quoting *Polich v. Burlington N., Inc.*, 942 F.2d 1467, 1472 (9th Cir. 1991))).

including too much information in the complaint.¹⁶⁶ But this approach is also not without its shortcomings.

Granting plaintiffs leave to amend their complaints is inconsistent with the language of SLUSA.¹⁶⁷ SLUSA removes those actions containing allegations of misrepresentation or omission “in connection with the purchase or sale of a covered security” to federal court where they will be dismissed.¹⁶⁸ At no point does the statute mention granting plaintiffs leave to amend or provide them the opportunity to remove allegations of misrepresentation or omission so those claims not precluded by SLUSA may proceed.¹⁶⁹ Rather, SLUSA states that the entire action shall be removed to federal court—not just those specific claims alleging misrepresentation.¹⁷⁰

2. *The Ninth Circuit’s Approach Is Inconsistent with the Purpose of SLUSA*

Permitting leave to amend also defeats the purpose of SLUSA by granting plaintiffs the opportunity to learn why the court believes the claim is precluded and allows them to make changes based on these defects.¹⁷¹ Granting leave to amend and allowing a claim to proceed permits plaintiffs to craft a restructured complaint that removes explicit allegations of misrepresentation, but leaves open the possibility that questions of misrepresentation may arise later in the litigation.¹⁷² Allowing plaintiffs to alter their complaints to remove unrelated allegations of misrepresentation or omission runs contrary to SLUSA’s administrative efficiency goal—decreasing the volume of these cases in federal

166. See *U.S. Mortg., Inc.*, 494 F.3d at 843 (pointing out that district courts have noted that it is often unfair to dismiss actions that are valid under state law simply because a plaintiff included a claim that the court could interpret as a federal claim). However, the court also acknowledged that this approach allows plaintiffs to circumvent SLUSA by creatively pleading to avoid bringing the action in federal court. *Id.*

167. The Supreme Court has recognized the importance of focusing on the statute’s plain language when construing the meaning of a statute. See *Blue Chip Stamps v. Manor Drug Stores*, 421 U.S. 723, 756 (1975) (Powell, J., concurring).

168. 15 U.S.C. § 77p(b)–(c) (2006).

169. See *id.* (failing to mention leave to amend complaints). Furthermore, the legislative history indicates that this notion of leave to amend was never discussed during the debate over the bill. See, e.g., S. REP. NO. 105-182 (1998) (failing to discuss whether to incorporate a leave to amend provision in the law); H.R. REP. 105-803 (1998) (Conf. Rep.) (same).

170. 15 U.S.C. § 77p(f)(2) (2006); Mark A. Perry & Indraneel Sur, *SLUSA Precludes “Actions,” Not Claims*, MEALEY’S EMERGING SEC. LITIG., Mar. 2009 at 5–6, available at <http://www.gibsondunn.com/publications/Documents/Perry-Sur-SLUSAPrecludesActionsNotClaims.pdf> (noting that SLUSA refers to the covered suits as “actions” and pointing out that the ordinary legal meaning of “action” is an entire lawsuit and, therefore, a dismissed action should be dismissed in full even if only some of the claims are precluded by SLUSA).

171. See *Brown v. Calamos*, 664 F.3d 123, 127 (7th Cir. 2011) (acknowledging that granting leave to amend allows plaintiffs to amend their complaint so it no longer contains fraudulent allegations and is no longer precluded by SLUSA), *cert. denied* 132 S. Ct. 2774 (2012).

172. *Id.* (expressing concerns that plaintiffs might overtax courts by raising fraud allegations during litigation based on a new state-court complaint filed after the dismissal of the removed suit).

courts by remanding them to state courts.¹⁷³ As the *Brown* court noted, the Ninth Circuit's approach may actually increase the number of complaints if plaintiffs are granted leave to amend because plaintiffs whose initial complaints were dismissed will have the opportunity to file those complaints again.¹⁷⁴ Additionally, allowing leave to amend also frustrates SLUSA's and PSLRA's judicial efficiency goals because it may allow litigation to drag on unnecessarily.¹⁷⁵

B. Easier Said Than Done . . . Again: The Practical Implications of the Third Circuit's Approach Defeat the Language and Intent of SLUSA

Supporters of the Third Circuit approach may point out that this approach helps meritorious claims avoid preclusion based on an unrelated allegation.¹⁷⁶ However, the Third Circuit's approach presents problems when determining whether an allegation is precluded by SLUSA. The approach contradicts the purpose of SLUSA and is inconsistent with the law's language. The Third Circuit's approach contradicts SLUSA's purpose because it allows suits alleging misrepresentation or omission to proceed.¹⁷⁷ It is inconsistent with the law's language, like the Ninth Circuit's approach, because it allows individual claims that not precluded by SLUSA to move forward.¹⁷⁸ The Third Circuit's approach only precludes claims under SLUSA if they contain an allegation of

173. See *supra* note 42 and accompanying text.

174. *Brown*, 664 F.3d at 127 (disagreeing with the Ninth Circuit's approach, which grants plaintiffs leave to amend complaints).

175. *Id.*; see also *Merrill Lynch, Pierce, Fenner & Smith Inc. v. Dabit*, 547 U.S. 71, 82 (2006) (discussing PSLRA's goal of promptly eliminating frivolous suits).

176. One criticism of PSLRA and SLUSA is that the laws may prevent legitimate claims from proceeding. See Painter, *supra* note 32, at 35 (remarking that laws such as PSLRA make it more difficult for defrauded investors to file suit). This was a concern shared by some U.S. Senators and the U.S. Securities and Exchange Commission at the time SLUSA was passed. See S. REP. NO. 105-182, at 19 (1998) (opposing SLUSA because preempting actions from being brought in state courts may leave investors without a remedy); *The Securities Litigation Uniform Standards Act of 1997—S. 1260: Hearing Before the Subcomm. on Securities of the S. Comm. on Banking, Housing, and Urban Affairs*, 105th Cong. 40 (1997) (statement of Arthur Levitt, Jr., Chairman, U.S. Securities and Exchange Commission) (expressing concern that SLUSA may limit protections available to investors under state law). Individuals have also criticized SLUSA on grounds that preempting claims from being brought in state court is inconsistent with America's system of federalism. See *Implementation of the Private Securities Litigation Reform Act of 1995: Hearing Before the Subcomm. on Fin. and Hazardous Materials of the H. Comm. on Commerce*, 105th Cong. 66-67 (1997) (statement of Robert V. Stout, Controller, City of Stamford, CT) (arguing States should be allowed to use their own securities laws to safeguard their citizens); *Securities Litigation Uniform Standards Act of 1997: Hearing Before the Subcomm. on Fin. and Hazardous Materials, of the H. Comm. on Commerce*, 105th Cong. 74 (1998) (statement of Richard W. Painter, Professor, Cornell University School of Law) (arguing that Congress should not preempt state law as it applies to securities fraud because Congress had not demonstrated that state securities laws sufficiently interfered with federal laws so as to justify their preemption).

177. See *supra* Part I.C.3.

178. See *supra* Parts I.C.3 & III.A.1.

misrepresentation or omission that “operates as a factual predicate to a legal claim.”¹⁷⁹

The Third Circuit’s approach, like the Ninth Circuit’s approach, also tends to frustrate judicial efficiency goals. First, the approach may prolong the pleading stage of litigation as plaintiffs may dispute whether allegations are truly factual predicates to the plaintiffs’ claims.¹⁸⁰ Second, by enacting SLUSA, Congress intended to resolve nationally traded securities-based actions in federal, not state, court.¹⁸¹ Allowing certain securities claims to proceed in state court frustrates this objective. Third, the Third Circuit’s approach is likely to prolong litigation and to encourage plaintiffs to manipulate their claims to bring the action in state court over federal court, instead of curbing abusive litigation like PSLRA and SLUSA sought to do.¹⁸² Furthermore, under the Third Circuit’s approach, defendants may be forced to settle when faced with having to waste time and resources arguing over whether a plaintiff’s misrepresentation or omission allegation operates as a factual predicate that should preclude the claim.¹⁸³ This disadvantage to defendants directly contradicts the purpose for which PSLRA and SLUSA were enacted.¹⁸⁴

Furthermore, the Third Circuit’s approach may also encourage “artful pleading,” whereby plaintiffs attempt to disguise allegations of misrepresentation or omission as ancillary to the central claims of the action.¹⁸⁵ The approach may allow claims that appear independent of misrepresentation or omission allegations to proceed, only to discover later in litigation that the claims are, in fact, dependent upon such allegations.¹⁸⁶ Although the court may

179. *LaSala v. Bordier et Cie*, 519 F.3d 121, 141 (3d Cir. 2008).

180. *See id.* at 140–41.

181. H.R. REP. NO. 105-803, at 15 (1998) (Conf. Rep.).

182. *See* H.R. REP. NO. 105-803, at 1 (enacting SLUSA “to prevent certain State private securities class action lawsuits alleging fraud from being used “to frustrate the objectives of [PSLRA]”); S. REP. NO. 104-98, at 10 (1995) (enacting PSLRA to prevent abusive litigation).

183. *See* O’Hare, *supra* note 30, at 335 (explaining that defendants were often forced to settle claims that they would likely have won in court because settling would be cheaper than extensive litigation battles that might ensue in a SLUSA-based suit); *see also* Alexander, *Do the Merits Matter?*, *supra* note 28, at 529 (arguing that defendants in securities class action litigation tend to settle even if the plaintiff’s claims are not meritorious because of the risks and costs associated with litigation).

184. *See* *Merrill Lynch, Pierce, Fenner & Smith Inc. v. Dabit*, 547 U.S. 71, 81 (2006) (stating that that PSLRA was enacted in part to prevent “nuisance filings, targeting of deep-pocket defendants, [and] vexatious discovery requests”); *see also* H.R. REP. NO. 105-803, at 2 (explaining that SLUSA was enacted to prevent state private securities class action lawsuits from circumventing PSLRA’s provisions); H.R. REP. NO. 104-369, at 31 (1995) (Conf. Rep.) (seeking to prevent abusive litigation which may force defendants to pay substantial sums of money to settle).

185. This artful pleading problem, whereby plaintiffs avoid mentioning misrepresentation or omission while still essentially alleging these concepts, caused the Sixth Circuit to look beyond the words of a complaint. *See, e.g.,* *Atkinson v. Morgan Asset Mgmt., Inc.*, 658 F.3d 549, 555 (6th Cir. 2011) (disregarding Plaintiffs’ “artful” disclaimer which denied any allegations of fraud).

186. The discovery process in these suits also allowed plaintiffs to find facts to try to validate claims separate from those that they alleged. *See* H.R. REP. NO. 104-369, at 31, 37.

dismiss the suit once this problem is discovered, defendants may have already incurred substantial litigation costs and may have even settled before discovering the claims should have been dismissed from the beginning.¹⁸⁷ These problems render the Third Circuit's approach inconsistent with the language and intent of SLUSA.

C. Getting Closer: Although Consistent with Many of SLUSA's Goals, the Sixth Circuit's Approach Is Too Broad

Of the approaches currently in use, the Sixth Circuit's approach is most consistent with SLUSA's objectives. The Sixth Circuit's approach bars any suits containing allegations of fraud (including misrepresentations and omissions), regardless of their relationship to the legal claims in the complaint.¹⁸⁸ In doing so, it prevents plaintiffs alleging misrepresentation from dodging SLUSA preclusion merely by omitting words traditionally associated with misrepresentation.¹⁸⁹ Although the Sixth Circuit's approach is more consistent with the SLUSA than the Third or Ninth Circuits' approaches, its broad test for determining when SLUSA preclusion applies is draconian and over-inclusive because it bars all claims having any relationship to allegations of misrepresentation or omission.¹⁹⁰

187. See *id.* (explaining that the discovery process can be extremely expensive for defendants); Alexander, *Do the Merits Matter?*, *supra* note 28, at 514.

188. See *Segal v. Fifth Third Bank, N.A.*, 581 F.3d 305, 311 (6th Cir. 2009) (asking only whether the complaint included allegations prohibited by SLUSA). Of course, the allegations must still be "in connection with the purchase or sale of a covered security." 15 U.S.C. § 77p(b)(1) (2006); see also *Atkinson*, 658 F.3d at 555 (holding plaintiffs' claims satisfied the connection requirement under SLUSA's preclusion provisions).

189. See, e.g., *Atkinson*, 658 F.3d at 555 (holding plaintiffs' claims were precluded by SLUSA based on their substance even though the plaintiffs included a disclaimer stating that the claims did not include the precluded allegations); see also *Brown v. Calamos*, 664 F.3d 123, 126 (7th Cir. 2011) (ignoring plaintiff's insistence that the action was for breach of fiduciary duty and interpreting the claim as alleging a misrepresentation), *cert. denied* 132 S. Ct. 2774 (2012); *Instituto De Prevision Militar v. Merrill Lynch*, 546 F.3d 1340, 1350 (11th Cir. 2008) (reasoning that since plaintiffs' second amended complaint's negligence and breach of fiduciary duty claims alleged misrepresentation, they were precluded by SLUSA). But see *Tuttle v. Sky Bell Asset Mgmt.*, No. C 10-03588 WHA, 2010 WL 4807093, at *6 (N.D. Cal. Nov. 19, 2010) ("SLUSA does not preclude breach of fiduciary duty or contract claims unless they sound in fraud and are thus properly viewed as mislabeled securities law claims."). Critics of this approach have argued that when claims do not contain explicit references to misrepresentations or omissions, but instead allege claims such as breach of fiduciary duty, SLUSA preclusion provisions may infringe upon States' police powers. See Brief of Eleven Law Professors as Amici Curiae in Support of Petitioner at 9, *Brown v. Calamos*, 132 S. Ct. 2774 (2012) (No. 11-1173) (arguing that SLUSA's preclusion provisions are "contrary to constitutionally protected states' interests in policing breaches of fiduciary duty"). The law professors seem to rely on the federalism argument discussed *supra* note 176.

190. Some have characterized the Sixth Circuit's broad approach as a "black hole" which prevents claims having any relationship to the misrepresentation or deception at hand. Barry Barnett, *The Black Hole of SLUSA; Sixth Circuit Okays Oblivion (Update)*, BLAWGLETTER, (Sept. 18, 2009), <http://blawgletter.typepad.com/bbarnett/2009/09/the-black-hole-of-slusa-sixth-circuit-okays-oblivion.html>.

III. COURTS SHOULD ADOPT A REASONABLE RELATIONSHIP TEST

To determine whether an allegation is precluded by SLUSA, federal courts should ask whether the misrepresentation alleged is reasonably related to the plaintiffs' claim. If so, the entire suit should be dismissed; if not, all of the claims should be allowed to proceed. This approach best achieves SLUSA's goals because it does not bar all claims alleging misrepresentation, only those reasonably related to plaintiffs' claim. Furthermore, this approach prevents plaintiffs from dodging SLUSA and prevents precluded securities class actions from burdening the judiciary.

The phrase "reasonable relationship" has yet to be employed by courts in judging whether claims are precluded by SLUSA.¹⁹¹ However, this test is prevalent in other areas of law such as assessing takings claims and punitive damage awards in tort actions.¹⁹² The reasonable relationship test has also been used in the context of mutual fund fee litigation.¹⁹³ The reasonable relationship test evinces a standard, which is easy to satisfy.¹⁹⁴ In the SLUSA context, the test will cast a wide net in determining whether claims are precluded.¹⁹⁵

The reasonable relationship test is also consistent with the objectives of SLUSA. It would preclude those claims containing allegations of

191. See *Brown*, 664 F.3d at 127 (discussing the approaches taken by circuit courts in determining whether claims are precluded by SLUSA and failing to indicate any of them use a "reasonable relationship" test).

192. For example, a number of courts have applied this test in the context of zoning and property rights cases. See, e.g., *Dolan v. City of Tigard*, 512 U.S. 374, 390 (1994) (acknowledging that many courts have used a "reasonable relationship" test to determine whether conditionally granting a building permit in exchange for a property owner conveying land for some public use is permissible); see also *Nollan v. Calif. Coastal Comm'n*, 483 U.S. 825, 853 (1987) (Brennan, J., dissenting) (arguing that there was no unconstitutional taking of land because there was a reasonable relationship between a city's conditional grant of a building permit in exchange for homeowners allowing a public easement). Courts have also used this test to determine whether punitive damage awards are excessive. See *BMW of N. Am., Inc. v. Gore*, 517 U.S. 559, 580 (1996) (recognizing the idea that punitive damages must bear a "'reasonable relationship' to compensatory damages has a long pedigree"); *TXO Prod. Corp. v. Alliance Res. Corp.*, 509 U.S. 443, 460 (1993) (declaring that "punitive damages should bear a reasonable relationship to the harm that is likely to occur from the defendant's conduct" (quoting *Games v. Fleming Landfill, Inc.*, 413 S.E.2d 897, 909 (W. Va. 1991))).

193. See *Gartenberg v. Merrill Lynch Asset Mgmt., Inc.*, 694 F.2d 923, 928 (2d Cir. 1982) (stating that adviser-managers of investment funds may be liable for breach of fiduciary duty if they charge a fee that is "so disproportionately large that it bears no reasonable relationship to the services rendered").

194. See Jason R. Biggs, Comment, *Nollan and Dolan: The End of Municipal Land Use Extortion—A California Perspective*, 36 SANTA CLARA L. REV. 515, 545 (1996) (noting that the reasonable relationship test is "easily satisfied" in the context of regulatory takings).

195. See *Segal v. Fifth Third Bank, N.A.*, 581 F.3d 305, 310 (6th Cir. 2009) (examining the "substance of allegations in a complaint" to determine whether claims are precluded by SLUSA).

misrepresentation by dismissing the entire suit with prejudice.¹⁹⁶ As a result, this approach does not suffer from the artful pleading infirmity, nor does it create any exceptions that may still allow certain claims to proceed in state court.¹⁹⁷ In accomplishing the objectives of SLUSA, the reasonable relationship approach serves PSLRA's and SLUSA's purposes by helping to end frivolous securities class action litigation.¹⁹⁸

Moreover, unlike the Sixth Circuit, the reasonable relationship test will not bar claims that have little or no relation to the misrepresentations alleged.¹⁹⁹ As the *Brown* court recognized, the Sixth Circuit's overly broad approach is subject to criticism.²⁰⁰ The court argued that dismissing an entire case is too harsh a result for information which may be "an irrelevancy added to the complaint out of an anxious desire to leave no stone unturned."²⁰¹ The reasonable relationship test serves to counteract this criticism. If information contained in an allegation is in fact an "irrelevancy," then it will bear no reasonable relationship to the claim.²⁰² Consequently, it will fail the test, the claim will not be precluded, and the suit will proceed. However, if information regarding a misrepresentation is relevant and reasonably related to the claim, the test is satisfied and the action should be dismissed.

Critics may argue this approach is too harsh and prevents possible meritorious claims from proceeding.²⁰³ However, the reasonable relationship approach is

196. See *supra* note 170 and accompanying text (explaining that SLUSA's preclusive provisions have been interpreted as referring to dismissal or removal of the entire complaint and not merely the claims containing precluded allegations).

197. Like the Sixth Circuit's approach, the reasonable relationship test would dismiss an entire complaint if the action contains claims precluded by SLUSA. See, e.g., *Segal*, 581 F.3d at 309 (stating that SLUSA bars the whole complaint if it contains any allegations of misrepresentation or omission, rather than just the specific claim). Under the reasonable relationship test, plaintiffs would only be able bring suit in state court without SLUSA preclusion when the Delaware carve out or State action methods, specifically enumerated by Congress, applied. See *supra* note 44 (discussing the exceptions to SLUSA's preclusion provisions).

198. See H.R. REP. NO. 104-369, at 31 (1995) (Conf. Rep.) (seeking to eliminate abusive litigation practices).

199. See *Segal*, 581 F.3d at 311 (asking only whether the complaint refers to "prohibited theories" under SLUSA and precluding those which do).

200. *Brown v. Calamos*, 664 F.3d 123, 128 (7th Cir. 2011), *cert. denied* 132 S. Ct. 2774 (2012).

201. *Id.*

202. Although courts have not ruled on whether an irrelevancy in a SLUSA complaint would fail the reasonable relationship test, *Nollan* provides an example of when this test is not satisfied. *Nollan v. Calif. Coastal Comm'n*, 483 U.S. 825, 838-39 (1987) (holding that there was no reasonable relationship between granting only a conditional permit because a proposed home interferes with "visual access" to the beach when a public easement granting access to the beach is all that is required).

203. See *Painter*, *supra* note 32, at 35 (acknowledging laws such as PSLRA and SLUSA make it difficult for defrauded investors to obtain a judicial remedy); see also S. REP. NO. 105-182, at 23 (1998) (arguing that PSLRA's "provisions prevent investors from bringing meritorious securities fraud class action claims.").

entirely consistent with the aims of SLUSA.²⁰⁴ If individuals believe SLUSA's scope should be narrower, they must rely on the legislature to change the language of SLUSA.²⁰⁵ For example, supporters of the Ninth Circuit's approach could ask Congress to include a specific provision in the statute allowing the opportunity to amend a complaint. Similarly, those in favor of the Third Circuit's approach could ask Congress to raise the threshold for when claims are precluded and adopt language stating that only those misrepresentations which serve as factual predicates to the claim are precluded by SLUSA. Until Congress does this, courts should apply the reasonable relationship test, rather than a test that risks distorting the law's meaning.²⁰⁶

IV. CONCLUSION

The significant circuit split over the proper interpretation of SLUSA's language and the requisite relationship misrepresentation must bear to the claim to incur SLUSA preclusion should be resolved. Unless this split is resolved by adopting one approach over another, plaintiffs might exploit the differences between approaches to their advantage. Plaintiffs may try to file in a circuit with a less stringent approach, so that if the case is removed to federal court, it may be remanded to state court and proceed. Allowing this forum shopping to occur defeats the purpose of SLUSA. Adopting the reasonable relationship approach proposed in this Comment would best prevent this abuse and help to maintain the purpose for which PSLRA and SLUSA were enacted. This approach is not an absolute bar to all securities litigation. Instead, it will permit individuals to confidently invest in securities, thereby promoting market prosperity.

204. See SLUSA, Pub. L. No. 105-353, sec. 2(5), 112 Stat. 3227, 3227 (1998) (codified as amended in scattered sections of 15 U.S.C.) (seeking to prevent "private securities class action lawsuits alleging fraud from being used to frustrate the objectives" of PSLRA").

205. Robert W. Taylor, Note, *Re-Evaluating Holder Actions: Giving Defrauded Securities Holders A Fighting Chance*, 86 NOTRE DAME L. REV. 413, 436-37 (2011) (arguing that "[b]y enacting legislation, Congress could strike a much better balance [than courts] between the interests of defrauded shareholders and corporations.").

206. See *Wash. State Grange v. Wash. State Repub. Party*, 552 U.S. 442, 450 (2008) (emphasizing "the fundamental principle of judicial restraint that courts should [not] . . . 'formulate a rule of constitutional law broader than is required by the precise facts to which it is to be applied.'" (quoting *Ashwander v. TVA*, 297 U.S. 288, 347 (1936) (Brandeis, J., concurring))); see also *In re Lord Abbett Mut. Funds Fee Litig.*, 553 F.3d 248, 254 (3d Cir. 2009) (quoting *Rosenberg v. XM Ventures*, 274 F.3d 137, 141 (3d Cir. 2001)) (declaring that courts should not substitute their own judgment for congressional intent).