

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?

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I. INTRODUCTION

In the Securities Litigation Uniform Standards Act of 1998 (SLUSA),¹ Congress took the unusual step of preempting state law, deciding that federal courts should be the exclusive venue for many securities fraud class actions. Specifically, Congress preempted class actions alleging “a misrepresentation or omission of a material fact in connection with the purchase or sale of a covered security.”² SLUSA clearly preempts the typical state securities fraud action. Thus, for example, if a company issues a press release containing false information—such as overstated corporate earnings—plaintiffs are no longer permitted to file state securities fraud class actions. Instead, the sole remedy available for investors is a federal securities fraud action, where plaintiffs are subject to the rigorous procedural requirements of the Private Securities Litigation Reform Act of 1995.³ Plaintiffs will ordinarily find it much more difficult to prevail in federal court.⁴

Preemption of false corporate publicity cases was expected and, in fact, intended by SLUSA. However, many courts have also extended SLUSA to preempt very different types of claims, including breach of fiduciary duty

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1. 15 U.S.C. §§ 77p, 78bb (2000).
2. Securities Act of 1934, § 28(f)(1), 15 U.S.C. § 78bb(f)(1) (2000).
3. *See infra* Part II.A.2.
4. *See infra* notes 64-65 and accompanying text.

claims,⁵ breach of contract claims,⁶ and claims based on state deceptive and unfair trade practices acts.⁷ Not surprisingly, plaintiffs have argued that Congress never intended to preempt these types of claims, while defendants have argued just as forcefully that plaintiffs should not be able to circumvent the strong federal policies⁸ set forth in SLUSA through artful pleading. The result is an obvious policy clash—the concern for federalism versus the prevention of frivolous actions and strike suits.

The courts have struggled to interpret SLUSA's preemption provision, and the case law is in disarray.⁹ Some courts have held that SLUSA only preempts cases where the plaintiff expressly asserts a theory of securities fraud,¹⁰ while other courts have preempted non-fraud claims.¹¹ Some courts have looked to the allegations in the complaint to determine whether SLUSA applies,¹² while other courts have looked beyond those allegations.¹³ Some courts permit plaintiffs to avoid preemption by carefully pleading around the SLUSA,¹⁴ while others do not.¹⁵ In short, some courts believe that “if it looks like a securities fraud claim, sounds like a securities fraud claim and acts like a securities fraud claim, it is a securities fraud claim, no matter how you dress it up.”¹⁶ Other courts, however, are not as confident that they can identify claims that are “intrinsicly” securities fraud claims.

In this Article, I try to clarify how courts should interpret SLUSA's preemption provision. Part II of this Article provides the legal framework for this discussion, beginning with an overview of the anti-fraud provisions of the federal securities laws and continuing with an in-depth discussion of SLUSA's preemption provision, as well as its related removal provision. I also discuss the interrelationship between preemption and the removal of

5. For example, SLUSA has been applied to preempt a claim that a brokerage firm breached its fiduciary duty to its customers by not disclosing a special commission structure. *See Denton v. H&R Block Fin. Advisors, Inc.*, No. 01C4185, 2001 U.S. Dist. LEXIS 15831, at *5 (N.D. Ill. Oct. 3, 2001). For additional examples, see *infra* note 144.

6. For example, SLUSA has been applied to preempt a claim that a brokerage firm breached a contract to provide objective research to customers. *See Rowinski v. Salomon Smith Barney, Inc.*, No. 3:02CV2014, 2003 U.S. Dist. LEXIS 20918, at *6 (M.D. Pa. Nov. 20, 2003). For additional examples, see *infra* note 144.

7. For example, SLUSA has been applied to preempt a claim that an investment company violated a state Deceptive and Unfair Trade Practices Act by misrepresenting facts about an investment fund to induce consumers to invest. *See Riley v. Merrill Lynch, Pierce, Fenner & Smith, Inc.*, 292 F.3d 1334, 1334 (11th Cir. 2002). For additional examples, see *infra* note 144.

8. *See infra* notes 74-77 and accompanying text.

9. As one recent case noted, “[t]he district court cases appear to be all over the map on the issue of what state law claims are preempted by SLUSA.” *See Magyery v. Transamerica Fin. Advisors, Inc.*, 315 F. Supp. 2d 954, 959 (N.D. Ind. 2004).

10. *See infra* Part III.A.1.

11. *See infra* Part III.A.2.

12. *See infra* Part III.B.1.

13. *See infra* Part III.B.2.

14. *See infra* Part III.C.2.

15. *See infra* Part III.C.1.

16. *See Feitelberg v. Merrill Lynch & Co.*, 234 F. Supp. 2d 1043, 1051 (N.D. Cal. 2002), *aff'd*, 353 F.3d 765 (9th Cir. 2003).

actions to federal court, paying particular attention to the well-pleaded complaint rule and complete preemption doctrine.

In Part III, I survey the case law that has construed SLUSA's preemptive scope, organizing the discussion along the four main interpretive questions addressed by the courts. First, does SLUSA preempt only class actions alleging a theory of securities fraud? Second, if it preempts claims alleging other types of theories, when *is* SLUSA triggered? Third, may plaintiffs engage in careful pleading to avoid SLUSA's preemption provision? And, finally, how should SLUSA's "in connection with"¹⁷ requirement be interpreted?

In Part IV, I offer reasoned answers to these questions. I conclude that SLUSA is not limited to state securities fraud claims. Instead, the statute requires courts to examine the allegations actually made in the complaint to determine if SLUSA is triggered. If the complaint alleges a materially misleading statement in connection with the purchase or sale of a covered security, the class action should be preempted, regardless of the theory of liability chosen by the plaintiff. Because I argue that SLUSA is triggered by the allegations made in the complaint, I reject those cases that have looked beyond the complaint to determine if the case is preempted. In addition, I demonstrate that plaintiffs should be permitted to avoid preemption through careful pleading. Thus, for example, a plaintiff should be able to avoid preemption if he alleges that the defendant's fraud induced him to *hold*, rather than purchase or sell, his securities. Finally, I argue that SLUSA's "in connection with"¹⁸ requirement should be narrowly construed. In reaching these conclusions, I argue that the courts have failed to sufficiently consider federalism concerns in interpreting SLUSA, potentially leading to a dangerous expansion of SLUSA's preemptive scope.

II. THE LEGAL FRAMEWORK

A. *The Federal Securities Laws*

1. *The Anti-Fraud Provisions of the Federal Securities Laws*

a. *Generally*

The federal securities laws set forth numerous anti-fraud provisions.¹⁹ However, Rule 10b-5, the general anti-fraud provision of the federal securi-

17. Securities Act of 1933 § 16(b), 15 U.S.C. § 77p(b) (2000); Securities Exchange Act of 1934 § 28(f)(1), 15 U.S.C. § 78bb(f)(1) (2000).

18. *See supra* note 17.

19. *See* Securities Act of 1933 § 11, 15 U.S.C. § 77k (2000) (fraud in registration statement); Securities Act of 1933 § 12(a)(2), 15 U.S.C. § 77l(a)(2) (2000) (fraud in prospectus); Securities Act of 1933 § 17, 15 U.S.C. § 77q(a) (2000) (fraud in offer or sale of security); Securities Exchange Act of 1934 § 18, 15 U.S.C. § 78r (2000) (fraud in document filed with the SEC); Securities Exchange Act of 1934 § 10(b), 15 U.S.C. § 78r(b) (2000) (fraud in connection with purchase or sale of security); Securities Exchange Act of 1934, Rule 14a-9, 17 C.F.R. § 240.14a-9 (2004) (fraud in proxy statement); Securities

ties laws, is probably the most significant. Under Rule 10b-5, it is unlawful for a person to make an “untrue statement of a material fact or . . . omit to state a material fact necessary in order to make the statements made, in the light of the circumstances under which they were made, not misleading . . . in connection with the purchase or sale of any security.”²⁰

To recover under Rule 10b-5, a plaintiff must plead and prove several different elements: (1) fraud,²¹ (2) “in connection with” the purchase or sale of security,²² (3) reliance,²³ (4) causation,²⁴ (5) damages,²⁵ and (6) scienter.²⁶ In addition, in order to have standing to bring the action, the plaintiff must have purchased or sold securities.²⁷ Put another way, an investor who has been defrauded into *holding* securities is not permitted to bring a private action under Rule 10b-5. According to the Supreme Court, the standing requirement follows directly from the “in connection with” language of Rule 10b-5.²⁸

b. *The “In Connection With” Requirement*

The “in connection with” element provides the necessary nexus between the fraud and a securities transaction. In other words, just because a transaction involves both a fraudulent act and the purchase or sale of a security does not necessarily mean that Rule 10b-5 has been violated. The

Exchange Act of 1934 § 14(e), 15 U.S.C. § 78n(e) (2000) (fraud in connection with tender offer).

20. Rule 10b-5 reaches a wide variety of deceptive or fraudulent conduct, making it unlawful for any person:

- (1) To employ any device, scheme, or artifice to defraud,
- (2) To make any untrue statement of a material fact or to omit to state a material fact necessary in order to make the statements made, in the light of the circumstances under which they were made, not misleading, or
- (3) To engage in any act, practice, or course of business which operates or would operate as a fraud or deceit upon any person, in connection with the purchase or sale of any security.

See Securities Exchange Act of 1934, Rule 10b-5, 17 C.F.R. § 240.10b-5 (2004).

21. By fraud, I mean either deceptive behavior or a false or misleading statement of material fact. *See id.*

22. For further discussion of the “in connection with” element, see Part II.A.1.

23. For further discussion of the reliance element, see THOMAS LEE HAZEN, *THE LAW OF SECURITIES REGULATION* § 12.10 (4th ed. 2002).

24. For further discussion of the causation element, see *id.* § 12.11.

25. For further discussion of the damages element, see *id.* § 12.12.

26. In *Ernst & Ernst v. Hochfelder*, the Supreme Court held that scienter is an element of a Rule 10b-5 action, holding that a plaintiff must show that the defendant acted with an “intent to deceive, manipulate, or defraud.” 425 U.S. 185, 192 n.7 (1976). Although the Supreme Court has not yet ruled on the issue, the appellate courts have generally accepted that scienter includes reckless conduct.

27. This standing requirement was imposed by the Supreme Court in *Blue Chip Stamps v. Manor Drug Stores*, 421 U.S. 723, 731 (1975).

28. In *Blue Chip Stamps*, the Supreme Court reasoned that because the language of Rule 10b-5 prohibited fraud “in connection with the purchase or sale” of a security, standing should be limited to actual purchasers or sellers. *Id.* The Court also noted that the express private right of action under the federal securities laws uniformly limited standing to actual purchasers or sellers. *Id.* at 735-36. In addition, the Supreme Court based its holding on several policy considerations, primarily a concern that “litigation under Rule 10b-5 presents a danger of vexatiousness different in degree and in kind from that which accompanies litigation in general.” *Id.* at 739; see generally *id.* at 737-55. Therefore, the Court decided that the protections of Rule 10b-5 should not be extended to investors who were defrauded into holding their securities.

fraudulent act must have been made “in connection with” that purchase or sale.

As many commentators have acknowledged, the courts have struggled with the meaning of the “in connection with” element.²⁹ This difficulty is most likely due to the very different types of fact patterns implicating Rule 10b-5. For example, one commentator has identified six different kinds of Rule 10b-5 cases: (1) classic securities fraud cases (in which the defendant has defrauded the other party to the securities transaction); (2) false corporate publicity cases (in which a company has issued press releases or other public documents containing purportedly false or misleading statements); (3) cases involving fraud by non-issuers (such as brokers and accountants); (4) corporate mismanagement cases; (5) insider trading cases; and (6) cases involving the conversion of securities.³⁰

Because the fact patterns differ so significantly, it has been challenging for courts to establish a unitary definition or test for the “in connection with” requirement.³¹ In some cases, the courts have had no difficulty finding the requirement met. For example, in a classic securities fraud case in which a person selling securities lies to the purchaser, there is no question that the fraud was “in connection with” the purchase or sale of a security because the wrongdoer defrauded the victim into purchasing or selling his securities. Thus, the courts generally rely on a causation justification to hold that the “in connection with” requirement is met in these types of cases. Similarly, in false corporate publicity cases, the courts have adopted a foreseeability test, asking if the company’s “assertions are made . . . in a manner reasonably calculated to influence the investing public.”³² However, as the connection between the fraud and the securities transaction becomes more attenuated, these causation-based tests fail, and the courts have been forced to establish different tests for the “in connection with” requirement.

29. See JOHN C. COFFEE JR. & JOEL SELIGMAN, *SECURITIES REGULATION: CASES AND MATERIALS* 1164 (9th ed. 2002) (stating that “[f]ew securities laws topics are more complicated than the in connection with and causation requirements of Rule 10b-5”); LOUIS LOSS & JOEL SELIGMAN, *SECURITIES REGULATION* § 9-B-7 (3d ed. 1995) (stating that the “in connection with” requirement is “not the least difficult aspect of the [Rule] 10b-5 complex to tie down”); C. Edward Fletcher III, *The “In Connection With” Requirement of Rule 10b-5*, 16 PEPP. L. REV. 913, 915 (1989) (describing the “in connection with” requirement as “particularly confusing”); Lewis D. Lowenfels & Alan R. Bromberg, *Rule 10b-5’s “In Connection With”: A Nexus for Securities Fraud*, 57 BUS. LAW. 1, 1 (2001) (stating that the “precise meaning” of the “in connection with” requirement “has never been completely clear”); Cameron S. Matheson, *Transvestite Cowboys, Thieving Brokers, and the Securities Litigation Uniform Standards Act: SLUSA’s Trap for the Unwary Plaintiff*, 35 MCGEORGE L. REV. 121, 130 (2004) (stating that “courts and commentators have acknowledged that ‘courts have not pinned down with any specificity’ the ‘in connection with’ requirement”); J. Page Scully, Note, *SEC v. Zandford: A Stockbroker’s Coincidental Encounter with the “In Connection With” Requirement*, 54 MERCER L. REV. 971, 973 (2003) (stating that “[c]ourts have . . . found it increasingly difficult to determine when a fraud is, in fact, perpetrated ‘in connection with’ the purchase or sale of a security”).

30. See Fletcher, *supra* note 29, at 929-59.

31. See *id.* at 929 (arguing that the “doctrinally diffuse nature of 10b-5 makes it impossible to establish common principles for universal application of the ‘in connection with’ requirement”). See also Lowenfels & Bromberg, *supra* note 29, at 2 (demonstrating that the courts have adopted different approaches to the “in connection with” requirement depending on the factual setting of the case).

32. See *SEC v. Tex. Gulf Sulphur Co.*, 401 F.2d 833, 862 (2d Cir. 1968).

In this situation, courts look at several different factors to determine whether the “in connection with” element is met. Some courts emphasize the number of intervening steps between the fraud and the securities transaction.³³ The more attenuated the connection, the less likely the court is to find that the “in connection with” requirement has been satisfied. Other courts attempt to identify whether the securities fraud was essential to the defendant’s fraud, or whether the securities transaction was merely “incidental” to the fraud.³⁴

When the wrongdoer is not the issuer—such as a broker—a significant number of courts have held that the “in connection with” requirement is met if the broker’s misrepresentations concern the value or the quality of the security.³⁵ In other words, a broker’s misrepresentations about the value of a security—such as a statement concerning the riskiness of a security—are sufficient to meet the “in connection with” requirement.³⁶ On the other hand, a broker’s misrepresentation concerning his credentials, for example, will not satisfy the “in connection with” requirement.

In addition, many courts look to the policies underlying Rule 10b-5 and the federal securities laws to help determine whether the “in connection with” requirement has been met.³⁷ According to these courts, the anti-fraud provisions of the federal securities laws have two main goals: (1) to protect purchasers and sellers from being deceived in a securities transaction; and (2) to protect the integrity of the securities markets.³⁸ Courts often state that Rule 10b-5’s “in connection with” requirement should be read “flexibly” to further these purposes.³⁹ On the other hand, if applying Rule 10b-5 to the fact pattern before the court does not advance these policies, the “in connection with” element is not met.⁴⁰

33. See Fletcher, *supra* note 29, at 973-74.

34. See *id.* at 974-75.

35. As one court noted, the “in connection with” requirement is satisfied when “the fraud alleged is that the plaintiff bought or sold a security in reliance on misrepresentations as to its value.” Steiner v. Ames Dep’t Stores, Inc., 991 F.2d 953, 967 (2d Cir. 1993). See also Fletcher, *supra* note 29, at 977-78.

36. See Bruschi v. Brown, 876 F.2d 1526, 1531 (11th Cir. 1989) (discussing the “in connection with” requirement and finding that it is met when the defendant “induces a plaintiff to enter into a risky transaction by misrepresenting it as safe and the plaintiff suffers a loss resulting from the risky nature of the investment”).

37. See Fletcher, *supra* note 29, at 979-80.

38. See, e.g., Ernst & Ernst v. Hochfelder, 425 U.S. 185, 195 (1976).

39. See *infra* notes 49-50 and accompanying text.

40. This approach can be seen in *Chemical Bank v. Arthur Anderson & Co.*, 726 F.2d 930 (2d Cir. 1984). In that case, several banks sued the accounting firm of Arthur Anderson, contending that Arthur Anderson certified the financial statements of Frigitemp Corporation knowing that the financial statements were false. *Id.* at 933. The banks, among other things, made loans to Frigitemp’s wholly-owned subsidiary, Elsters. Frigitemp guaranteed the Elsters notes and secured its obligation with a pledge of all of the outstanding shares of Elsters common stock. See *id.* Arthur Anderson did not certify the company’s financial statements. According to the Second Circuit, Arthur Anderson’s alleged fraud was not “in connection with” the pledge of the Elsters stock. *Id.* at 945. In reaching this conclusion, Judge Friendly looked to the policies underlying the federal securities laws, reasoning that

[t]he purpose of § 10(b) and Rule 10b-5 is to protect persons who are deceived in securities transactions—to make sure that buyers of securities get what they think they are getting and that sellers of securities are not tricked into parting with something for a price known to the

More recently, the Supreme Court has emphasized that the “in connection with” requirement is met if the fraud and the securities transaction “coincide.”⁴¹ However, a close examination of cases adopting this approach reveals that the Supreme Court also relied on the underlying policies of Rule 10b-5 to determine whether the “in connection with” requirement was satisfied. This dual approach to the “in connection with” requirement is apparent in *SEC v. Zandford*.⁴²

In *Zandford*, Charles Zandford, a broker, persuaded William Wood to open a discretionary trading account.⁴³ Mr. Wood provided a general power of attorney to Mr. Zandford so that he could buy and sell securities from Mr. Wood’s account.⁴⁴ Although the broker promised to “conservatively invest” Mr. Wood’s money, he did not. In fact, the broker, among other things, sold Mr. Wood’s shares in a mutual fund and then transferred large sums of the proceeds from Mr. Wood’s account to his own account. In four years, all of Mr. Wood’s money was gone.⁴⁵

The SEC brought an enforcement action against the broker, alleging violations of Rule 10b-5. In defense, the defendant argued that the “in connection with” requirement was not met. Although he conceded that the misappropriation of funds was fraudulent, he stated that the fraud was not sufficiently related to the previous lawful sales of Mr. Wood’s securities to constitute a violation of Rule 10b-5.⁴⁶ According to the broker, his actions were no different than a simple theft of cash from an investment account, which, though illegal on other grounds, does not constitute a violation of Rule 10b-5. The district court rejected this argument, granting summary judgment in favor of the SEC, and the defendant appealed.⁴⁷ The Fourth Circuit reversed, holding that the “in connection with” requirement was not met because, among other things, Mr. Zandford’s fraud did not relate to the value of a particular security.⁴⁸ The Supreme Court, in a unanimous decision, disagreed.

buyer to be inadequate or for a consideration known to the buyer not to be what it purports to be.

Id. at 943. Applying this test to the facts before it, the court held that the “in connection with” requirement was not met because the banks “got exactly what they expected” in the pledge of the Elsters stock. *Id.* The court pointed out that Arthur Anderson had not deceived the banks with respect to the pledge of the Elsters stock; any fraud perpetrated by Arthur Anderson related to the *Frigitemp* financial statements. *See id.* Thus, to hold that the “in connection with” element was met would not advance the policies underlying the federal securities laws.

41. *See SEC v. Zandford*, 535 U.S. 813, 820 (2002); *United States v. O’Hagan*, 521 U.S. 642, 655-56 (1997).

42. 535 U.S. 813 (2000). For an in-depth discussion of the *Zandford* case, see Comment, *Leading Cases: Federal Statutes and Regulations: Securities Exchange Act*, 116 HARV. L. REV. 422 (2002); Scully, *supra* note 29, at 971.

43. *See* 535 U.S. at 815.

44. *See id.*

45. *See id.*

46. *See id.* at 820.

47. *Id.*

48. *See id.* at 817.

The Supreme Court began its analysis by restating the policies underlying the federal securities laws. According to the Court, in enacting the federal securities laws, Congress sought (1) to ensure honest securities markets, and (2) “to substitute a philosophy of full disclosure for the philosophy of *caveat emptor* and thus to achieve a high standard of business ethics in the securities industry.”⁴⁹ Therefore, Rule 10b-5 should be construed “flexibly to effectuate its remedial purposes.”⁵⁰

The Court rejected the defendant’s argument that his sales and the fraud were independent events, pointing out that this was not a case where a broker decided to steal the proceeds from a customer’s account after a lawful securities transaction.⁵¹ Instead, the Court viewed the broker’s sales as part of an overall scheme to defraud Mr. Wood. In other words, the Court determined that the fraud “coincided” with the sales.⁵² Therefore, the “in connection with” requirement was met. In reaching this holding, the Court expressly rejected the contention that the “in connection with” element is satisfied only if the defendant makes a misrepresentation about the value of a particular security.⁵³

After applying this “coincidence” test, the Court then relied on the policies underlying the federal securities laws to further support its holding that the “in connection with” requirement had been met. The Court reviewed three of its cases—*Superintendent of Insurance of New York v. Bankers Life & Casualty Co.*,⁵⁴ *Wharf (Holdings) Ltd. v. United International Holdings, Inc.*,⁵⁵ and *United States v. O’Hagan*⁵⁶—and emphasized that the “in connection with” element had been satisfied because one or both of the policies of the anti-fraud provisions of the federal securities laws—either the promotion of the integrity of the markets or the protection of investors from fraud—was furthered by applying Rule 10b-5.⁵⁷

49. *Id.* at 819 (quotations omitted).

50. *Id.*

51. *See id.* at 820.

52. *See id.* at 822.

53. The Supreme Court stated, “neither the SEC nor this Court has ever held that there must be a misrepresentation about the value of a particular security in order to run afoul of the Act.” *Id.* at 820.

54. 404 U.S. 6 (1971).

55. 532 U.S. 588 (2001).

56. 521 U.S. 642 (1997).

57. *See Zandford*, 535 U.S. at 821-24. In its discussion of the *O’Hagan* case, the *Zandford* Court did not expressly point to the policies underlying the federal securities laws as factors that were considered in its “in connection with” analysis. *See id.* at 824-26. That omission is surprising, given that the *O’Hagan* case itself placed significant emphasis on the policy of preservation of market integrity to support its conclusion that the “in connection with” requirement had been met in this insider trading case. *See O’Hagan*, 521 U.S. at 655-59.

In *O’Hagan*, an attorney learned that his law firm’s client was about to engage in a takeover of Pillsbury Corporation. *Id.* at 647. Based on that inside information, the attorney purchased Pillsbury stock. *Id.* When the client announced the tender offer, the price of Pillsbury stock dramatically increased, and the attorney realized substantial profits. *Id.* at 648. The Government brought a criminal action against the attorney, contending that his insider trading was a violation of Rule 10b-5. *See id.* Mr. O’Hagan argued that the “in connection with” element was not satisfied. The Court rejected that argument, determining that the fraud and the securities transaction coincided. *See id.* at 656. In addition, the Court reinforced the “coincidence” test with the policies underlying the anti-fraud provisions of the

For example, according to *Zandford*, in *Bankers Life* the “in connection with” requirement had been met because the Court recognized that one of the policies underlying the federal securities laws—protecting investors from fraud—would be furthered if Rule 10b-5 applied.⁵⁸ Similarly, according to the *Zandford* Court, the “in connection with” requirement had been met in *Wharf* in order to promote the same policy of investor protection.⁵⁹ Therefore, the *Zandford* Court examined whether the broker’s actions im-

federal securities laws. *See id.* at 656-59. For example, the Court pointed out that

[t]he [misappropriation] theory is also well tuned to an animating purpose of the Exchange Act: to insure honest securities markets and thereby promote investor confidence. . . . Although informational disparity is inevitable in the securities markets, investors likely would hesitate to venture their capital in a market where trading based on misappropriated nonpublic information is unchecked by law.

Id. at 658.

58. *See Zandford*, 535 U.S. at 822. The *Bankers Life* case involved a rather complex fact pattern in which Bankers Life sold all of the stock of Manhattan Casualty Company to Mr. Begole for \$5 million. Mr. Begole somehow managed to obtain a check for \$5 million from a bank, Irving Trust Company, even though he did not have an account at Irving Trust. After obtaining control of Manhattan, Mr. Begole then deceived Manhattan’s board of directors into selling approximately \$5 million of U.S. Treasury bonds owned by Manhattan. Although the board believed the proceeds of this sale would go to Manhattan, the proceeds were actually credited to the Irving Trust bank account used by Mr. Begole. Thus, through this complicated scheme, Mr. Begole became the owner of all of Manhattan’s stock, but used Manhattan’s own money to pay for his purchase. The liquidator of Manhattan brought suit, contending that Manhattan had been “duped” into selling the bonds in violation of Rule 10b-5. *See id.* at 821.

The Supreme Court agreed, holding that the “in connection with” requirement was met. The Court rejected the defendant’s argument that Rule 10b-5 did not apply because the sale of the bonds did not occur through a securities exchange. *See id.* at 821. The Court agreed that protecting market integrity was an important policy underlying the federal securities laws, but pointed out that the federal securities laws were also intended to protect investors from fraud. *See id.* at 821-22. Because applying Rule 10b-5 to the facts before it would further that policy objective, the Court concluded that the “in connection with” requirement was met. *Id.*

In *Zandford*, the Supreme Court appeared to adopt the policy-based approach. The Court described the *Bankers Life* case as follows:

Although we recognized that the interest in “preserving the integrity of the securities markets” was one of the purposes animating the statute, we rejected the notion that § 10(b) is limited to serving that objective alone. . . . [W]e read § 10(b) to mean that Congress meant to bar deceptive devices and contrivances in the purchase or sale of securities whether conducted in the organized market or face to face.

Id. at 821-22.

59. In *Wharf*, the plaintiff had received an option to purchase 10% of the stock in Wharf’s subsidiary. *See Wharf*, 532 U.S. at 590. Eventually, Wharf refused to allow the plaintiff to exercise the option, and the plaintiff uncovered evidence that Wharf never actually intended to follow through with the option. *See id.* The plaintiff sued under Rule 10b-5. *See id.* Wharf claimed that it had not violated Rule 10b-5 because the “in connection with” requirement had not been met. *See id.* at 596. According to Wharf, “a secret reservation not to permit the exercise of an option falls outside § 10(b) because it does not relat[e] to the value of a security purchase or the consideration paid; hence it does not implicate [§ 10(b)]’s policy of full disclosure.” *Id.* (internal quotations and citation omitted).

The *Wharf* Court rejected this argument, determining that the policies of the federal securities laws would be advanced by holding that the “in connection with” element was met. According to the Court, “[t]o sell an option while secretly intending not to permit the option’s exercise is misleading,” and “[s]ince Wharf did not intend to honor the option, the option was, unbeknownst to [the plaintiff], valueless.” *Id.*

Thus, the *Zandford* Court reasoned, “[i]n *Wharf*, the fraudulent intent deprived the purchaser of the benefit of the sale whereas here the fraudulent intent deprived the seller of that benefit, but the connection between the deception and the sale in each case is identical.” 535 U.S. at 824. Thus, the “in connection with” requirement was satisfied to further Rule 10b-5’s policy of investor protection.

plicated either of the two policies underlying the federal securities laws. According to the Court, the broker's behavior represented a significant threat to investor confidence in the securities markets.⁶⁰ As the Court noted:

Not only does such a fraud prevent investors from trusting that their brokers are executing transactions for their benefit, but it undermines the value of a discretionary [trading] account like that held by the Woods. The benefit of a discretionary [trading] account is that it enables individuals, like the Woods, who lack the time, capacity, or know-how to supervise investment decisions, to delegate authority to a broker who will make decisions in their best interests without prior approval. If such individuals cannot rely on a broker to exercise that discretion for their benefit, then the account loses its added value.⁶¹

Because the policy of promoting the integrity of the markets was furthered by applying Rule 10b-5, the "in connection with" element was satisfied.

In short, although the Supreme Court in *Zandford* used a "coincidence" test to determine if the "in connection with" requirement was satisfied, the test was certainly informed by an examination of the policies underlying Rule 10b-5 and the federal securities laws.

2. *The Private Securities Litigation Reform Act of 1995*

In 1995, Congress enacted the Private Securities Litigation Reform Act (the "Reform Act"), which contains some of the most sweeping amendments since the inception of federal securities law.⁶² The Reform Act was a response to a widely-held perception in Congress and the business community that the anti-fraud provisions of the federal securities laws—and particularly Rule 10b-5—were abused by plaintiffs. Critics complained that whenever a company's stock price declined, plaintiffs rushed to file class actions under the federal securities laws, even though there was, in fact, no evidence of fraud at the time of the suit.⁶³ These so-called strike suits gener-

60. See *Zandford*, 535 U.S. at 822.

61. *Id.* at 822-23.

62. For an in-depth discussion of the Reform Act, see *Symposium on the Private Securities Litigation Reform Act of 1995*, 51 BUS. LAW. 975 (1996).

63. For example, the Statement of Managers prepared in connection with the Reform Act provides: Congress has been prompted by significant evidence of abuse in private securities lawsuits to enact reforms to protect investors and maintain confidence in our capital markets. The House and Senate Committees heard evidence that abusive practices committed in private securities litigation include: (1) the routine filing of lawsuits against issuers of securities and others whenever there is a significant change in an issuer's stock price, without regard to any underlying culpability of the issuer, and with only faint hope that the discovery process might lead eventually to some plausible cause of action; (2) the targeting of deep pocket defendants, including accountants, underwriters, and individuals who may be covered by insurance, without regard to their actual culpability; (3) the abuse of the discovery process to impose costs so

ally involved charges of false corporate publicity in which plaintiffs alleged that a company issued misleading press releases or other public documents causing investors to purchase (or sell) their securities at artificially elevated (or depressed) prices. Plaintiffs commonly sued the issuer and issuer's management, as well as other deep-pocket defendants, such as accounting firms, law firms, and banks. Defendants often decided to settle even non-meritorious actions because the settlement amount would cost the defendant less than litigation expenses associated with discovery requests.

The Reform Act was a series of mostly procedural reforms intended to make it more difficult for plaintiffs to successfully bring private securities fraud actions—particularly actions alleging false corporate publicity—under the federal securities laws. In the Reform Act, Congress adopted several new rules of procedure that would apply whenever a private securities fraud action was brought in federal court. Among the most significant of these procedural reforms were a heightened pleading standard⁶⁴ and an automatic stay of discovery upon the filing of a motion to dismiss.⁶⁵ In addition to the heightened pleading standard and the automatic stay, the Reform Act contains other important reforms. For example, it includes a lead plaintiff provision, requiring courts to presume that the plaintiff entitled to control the private class action (and therefore appoint counsel) is the largest share-

burdensome that it is often economical for the victimized party to settle; and (4) the manipulation by class action lawyers of the clients whom they purportedly represent.

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

64. Under the Reform Act's heightened pleading standard, plaintiffs are required to "state with particularity facts giving rise to a strong inference that the defendant acted with the required state of mind." Securities Exchange Act of 1934 § 21D(b)(2), 15 U.S.C. § 78u-4(b)(2) (2000). The meaning of this "strong inference" language has led to a split in the circuits. Currently, the courts have developed three different approaches to pleading scienter. The Second and the Third Circuits have held that the Reform Act merely codifies the Second Circuit's pre-Reform Act approach to pleading scienter. Under this approach, a plaintiff can adequately plead scienter by alleging facts showing motive for committing securities fraud and the opportunity for doing so. *See Press v. Chem. Inv. Servs. Corp.*, 166 F.3d 529, 529 (2d Cir. 1999); *In re Advanta Corp. Sec. Litig.*, 180 F.3d 525, 525 (3d Cir. 1999). The Ninth Circuit, on the other hand, has taken the opposite approach, holding that a plaintiff is required to "plead, in great detail, facts that constitute strong circumstantial evidence of deliberately reckless or conscious misconduct." *See In re Silicon Graphics, Inc. Sec. Litig.*, 183 F.3d 970, 974 (9th Cir. 1999). In other words, the Ninth Circuit rejected motive and opportunity as a separate method of establishing the "strong inference" standard. Finally, the remaining circuits have taken an intermediate approach, holding that, under certain circumstances, pleading motive and opportunity *might* be enough to meet the strong inference standard. *See Greebel v. FTP Software, Inc.*, 194 F.3d 185, 197 (1st Cir. 1999); *Bryant v. Avado Brands, Inc.*, 187 F.3d 1271, 1284 (11th Cir. 1999); *In re Comshare, Inc. Sec. Litig.*, 183 F.3d 542, 551 (6th Cir. 1999). *See generally* Charles F. Hart, *Interpreting the Heightened Pleading of the Scienter Requirement in Private Securities Fraud Litigation: The Tenth Circuit Takes the Middle Ground*, 80 DENV. U. L. REV. 577 (2003); Kim Ferchau, *The Circuits Divide: Pleading Scienter Under the Private Securities Litigation Reform Act of 1995*, 31 U. TOL. L. REV. 449 (2000); Janine C. Guido, Note, *Seeking Enlightenment from Above: Circuit Courts Split on the Interpretation of the Reform Act's Heightened Pleading Requirement*, 66 BROOK. L. REV. 501 (2000).

65. The statute provides:

In any private action arising under this sub-chapter, all discovery and other proceedings shall be stayed during the pendency of any motion to dismiss, unless the court finds, upon the motion of any party, that particularized discovery is necessary to preserve evidence or to prevent undue prejudice to that party.

Securities Act of 1933 § 27(b), 15 U.S.C. § 77z-1(b) (2000); *See* Securities Exchange Act of 1934 § 21D(b)(3), 15 U.S.C. § 78u-4(b)(3) (2000).

holder, as opposed to the first plaintiff to file the action.⁶⁶ It includes a proportionate liability provision, providing that defendants who unknowingly commit a violation of the anti-fraud provisions are only proportionately liable for damages, not jointly and severally liable,⁶⁷ and a provision requiring courts to undertake an inquiry at the conclusion of each case to determine whether counsel has complied with Rule 11 and to impose mandatory sanctions for any violation.⁶⁸ These procedural reforms are intended to weed out non-meritorious actions at the pleading stage, thereby discouraging strike suits.

In addition to discouraging strike suits, Congress hoped that the Reform Act would encourage companies to make projections, forecasts, and other kinds of forward-looking statements.⁶⁹ Prior to enacting the Reform Act, Congress heard testimony from the business community indicating that the disclosure of forward-looking statements increased the risk that a company would be sued under the anti-fraud provisions of the federal securities laws. The testimony pointed out that when a company made a projection and the projection later failed to materialize, the company could expect to be hit with lawsuits claiming that the company had committed fraud—simply because the projection did not come true. According to the business community, companies often choose not to disclose forward-looking statements to the public rather than face this risk. Because this kind of information is widely recognized as extremely helpful to investors,⁷⁰ Congress agreed that the Reform Act should take steps to encourage companies to make forward-looking statements. Therefore, the Reform Act added a safe-harbor for forward-looking statements.⁷¹ Under the safe harbor, plaintiffs cannot recover under the anti-fraud provisions of the federal securities laws if the forward-looking statement is “accompanied by meaningful cautionary statements identifying important factors that could cause actual results to differ materially from those in the forward-looking statement.”⁷²

66. See Securities Act of 1933 § 27(a)(3), 15 U.S.C. § 77z-1(a)(3) (2000); Securities Exchange Act of 1934 § 21D(a)(3), 15 U.S.C. § 78u-4(a)(3) (2000).

67. See Securities Exchange Act of 1934 § 21D(g), 15 U.S.C. § 78u-4(f) (2000).

68. See Securities Act of 1933 § 27(c), 15 U.S.C. § 77z-1(c) (2000); Securities Exchange Act of 1934 § 21D(c), 15 U.S.C. § 78u-4(c) (2000).

69. “[F]orward-looking statements” disclose prospective, as opposed to historical, information. Carl W. Schneider, *Nits, Grits, and Soft Information in SEC Filings*, 121 U. PA. L. REV. 254, 255 (1972). In general, they are “statements concerning the future, such as projections, forecasts, predictions, and statements concerning plans and expectations.” *Id.* The Reform Act has adopted a specific definition of forward-looking statement. See Securities Act of 1933 § 27A(I)(1); 15 U.S.C. § 77z-2(I)(1) (2000); Securities Exchange Act of 1934 § 21E(I)(1), 15 U.S.C. § 78u-5(I)(1) (2000).

70. Testifying before Congress prior to the enactment of the Reform Act, former SEC Chairman Richard Breeden stated that “[u]nderstanding a company’s own assessment of its future potential would be among the most valuable information shareholders and potential investors could have about a firm.” H.R. REP. NO. 104-369, at 42-43 (1995).

71. See Securities Act of 1933 § 27A(c), 15 U.S.C. § 77z-2(c) (2000); Securities Exchange Act of 1934 § 21E(c), 15 U.S.C. § 78u-5(c) (2000).

72. Securities Act of 1933 § 27A(c)(1)(A)(i), 15 U.S.C. § 77z-2(c)(1)(A)(i) (2000); Securities Exchange Act of 1934 § 21E(c)(1)(A)(i), 15 U.S.C. § 78u-5(c)(1)(A)(i) (2000). The Reform Act’s safe harbor for forward-looking statements was modeled on the “bespeaks caution doctrine,” developed by the courts and now accepted in virtually all federal circuits. The bespeaks caution doctrine provides that

3. *The Securities Litigation Uniform Standards Act of 1998*

As discussed above,⁷³ the Reform Act is intended to make it more difficult for plaintiffs to bring suit and recover under the anti-fraud provisions of the federal securities laws, and is especially aimed at protecting issuers and deep-pocket defendants from strike suits. Nevertheless, because the reforms are procedural in nature, they apply *only* if the securities fraud action is filed in federal court. Therefore, it became apparent that plaintiffs could evade the Reform Act by choosing to bring suit under state law in state court.⁷⁴ Rather than filing an action in federal court under Rule 10b-5, a plaintiff could file an action in state court for violations of the anti-fraud provisions of the applicable state blue sky laws or for common-law fraud.⁷⁵ In that way, the plaintiff would not be subject to any of the procedural burdens of the Reform Act. Critics objected, arguing that state actions permit plaintiffs to circumvent the protections of the Reform Act.⁷⁶

Ultimately, Congress was persuaded by this argument.⁷⁷ To prevent the evasion of the Reform Act, Congress enacted SLUSA, which expressly preempts many class actions based on misrepresentations or omissions made in connection with the purchase or sale of a nationally traded security.

a forward-looking statement, if accompanied by sufficient cautionary language, will not be actionable under the anti-fraud provisions of the federal securities laws. *See, e.g., In re Donald J. Trump Casino Sec. Litig.-Taj Mahal Litig.*, 7 F.3d 357, 357 (3d Cir. 1993). For an excellent introduction to the bespeaks caution doctrine, see Donald C. Langevoort, *Disclosures That "Bespeak Caution,"* 49 BUS. LAW. 481 (1994).

73. *See supra* Part II.A.2.

74. The plaintiff could not bring an action in state court under Rule 10b-5, the general anti-fraud provision of the federal securities laws, because the Securities Exchange Act of 1934 provides that federal courts have exclusive jurisdiction over claims arising under the Exchange Act. *See* Securities Exchange Act of 1934 § 27, 15 U.S.C. § 78aa (2000).

75. *See* Douglas M. Branson, *Securities Litigation in State Courts—Something Old, Something New, Something Borrowed . . .*, 76 WASH. U. L.Q. 509, 512-23 (1998) (discussing common-law fraud as an alternative to the federal securities laws); Michael G. Dailey, Comment, *Preemption of State Court Class Action Claims for Securities Fraud: Should Federal Law Trump?*, 67 U. CIN. L. REV. 587, 602-06 (1999) (comparing requirements of state law claims for common-law fraud and negligent misrepresentation with federal securities laws).

76. Dailey, *supra* note 75, at 589-90.

77. Congress stated the purpose for SLUSA in the "findings" provision of the statute. H.R. CONF. REP. NO. 105-803, at 1-2 (1998). According to SLUSA, Congress found that

- (1) the Private Securities Litigation Reform Act of 1995 sought to prevent abuses in private securities fraud lawsuits;
- (2) since enactment of that legislation, considerable evidence has been presented to Congress that a number of securities class action lawsuits have shifted from Federal to State courts;
- (3) this shift has prevented that Act from fully achieving its objectives;
- (4) State securities regulation is of continuing importance, together with Federal regulation of securities, to protect investors and promote strong financial markets; and
- (5) in order to prevent certain State private securities class action lawsuits alleging fraud from being used to frustrate the objectives of the Private Securities Litigation Reform Act of 1995, it is appropriate to enact national standards for securities class action lawsuits involving nationally traded securities, while preserving the appropriate enforcement powers of State securities regulators and not changing the current treatment of individual lawsuits.

Id.

a. *SLUSA's Preemption Provision*

SLUSA's preemption provision states:

No covered class action based upon the statutory or common law of any State or subdivision thereof may be maintained in any State or Federal court by any private party alleging—

- (1) an untrue statement or omission of a material fact in connection with the purchase or sale of a covered security; or
- (2) that the defendant used or employed any manipulative or deceptive device or contrivance in connection with the purchase or sale of a covered security.⁷⁸

If SLUSA applies, state law is entirely displaced. A plaintiff not only loses the right to litigate the claim in state court, he also loses the right to litigate the state claim in federal court through supplemental jurisdiction.⁷⁹

The legislative history indicates that although Congress was concerned with closing the Reform Act's perceived loophole, SLUSA's main concern is protecting issuers from strike suits. The Conference Report expressly states that

[t]he purpose of this title is to prevent plaintiffs from seeking to evade the protections that Federal law provides against abusive litigation by filing suit in State, rather than in Federal, court. The legislation is designed to protect the interests of shareholders and employees of public companies that are the target of meritless "strike" suits. The purpose of these strike suits is to extract a sizeable settlement from companies that are forced to settle, regardless of the

78. Securities Act of 1933 § 16(b), 15 U.S.C. § 77p(b) (2000); Securities Exchange Act of 1934 § 28(f)(1), 15 U.S.C. § 78bb(f)(1) (2000). Not surprisingly, the decision to preempt class actions based on state law was controversial. For further discussion of the issues and debate leading up to SLUSA, see Richard W. Painter, *Responding to a False Alarm: Federal Preemption of State Securities Fraud Causes of Action*, 84 CORNELL L. REV. 1 (1998); Michael A. Perino, *Fraud and Federalism: Preempting Private State Securities Fraud Causes of Action*, 50 STAN. L. REV. 273 (1998); Robert B. Thompson, *Preemption and Federalism in Corporate Governance: Protecting Shareholder Rights to Vote, Sell, and Sue*, 62 LAW & CONTEMP. PROBS. 215 (1999); Manning Gilbert Warren III, *Federalism and Investor Protection: Constitutional Restraints on Preemption of State Remedies for Securities Fraud*, 60 LAW & CONTEMP. PROBS. 169 (1997).

79. Supplemental jurisdiction empowers a federal court to hear certain state law claims that would otherwise be outside the federal court's subject matter jurisdiction when the state law claims are joined with a related federal claim. See 28 U.S.C. § 1367(a) (2000) (stating that "the district courts shall have supplemental jurisdiction over all other claims that are so related to claims in the action within such original jurisdiction that they form part of the same case or controversy under Article III of the United States Constitution"). Thus, supplemental jurisdiction would allow a plaintiff bringing an action in federal court under Rule 10b-5 to join a state securities fraud claim or a breach of fiduciary duty claim with the federal securities claim.

lack of merits of the suit, simply to avoid the potentially bankrupting expense of litigating.⁸⁰

This concern for issuers is highlighted throughout SLUSA's legislative history. For example, Congress pointed out that uniform national rules for securities class actions were necessary to protect issuers from exposure to litigation in fifty different jurisdictions under fifty different state laws.⁸¹ Similarly, Congress pointed out that issuers were being denied the protections of the Reform Act's statutory safe harbor for forward-looking statements.⁸²

Although Congress enacted SLUSA to protect issuers from strike suits, not all fraud claims involving securities brought under state law are preempted by SLUSA. First, the preemption provision is limited to "covered securities."⁸³ In general, covered securities are nationally traded securities—securities traded on the New York Stock Exchange, the American Stock Exchange, or the Nasdaq National Market System.⁸⁴ Thus, securities traded

80. H.R. CONF. REP. NO. 105-803, at 13 (1998).

81. As the Conference Report notes:

It is important to note that companies can not control where their securities are traded after an initial public offering As a result, companies with publicly-traded securities cannot choose to avoid jurisdictions which present unreasonable litigation costs. Thus, a single state can impose the risks and costs of its peculiar litigation system on all national issuers.

H.R. CONF. REP. NO. 105-803, at 15 (1998). *See also* S. REP. NO. 105-182, at 5 (1998).

82. *See* S. REP. NO. 105-182, at 4 (1998) (stating that the increase in state actions had a "chilling effect" on the Reform Act's safe harbor for forward-looking statements). President Clinton echoed this concern that issuers were being denied the protections of the Reform Act's statutory safe harbor. When signing SLUSA into law, President Clinton stated:

Since passage of the Reform Act, there has been considerable concern that the goals of the Reform Act have not been realized. In particular, there was testimony that firms are not using the Federal safe harbor for forward-looking statements because they fear State court litigation over the same representations that are protected under Federal law. In addition, concerns have been raised that State actions are being used to achieve an "end run" around the Reform Act's stay of discovery.

Statement on Signing the Securities Litigation Uniform Standards Act, 2 PUB. PAPERS 1998, 1974-75 (Nov. 3, 1998).

83. Securities Act of 1933 § 16(b), 15 U.S.C. § 77(b)(2000); Securities Exchange Act of 1934 § 28(f)(1), 15 U.S.C. § 78bb(f)(1)(2000).

84. SLUSA incorporates the definition of covered securities from Section 18 of the Securities Act of 1933. According to SLUSA, a covered security "satisfies the standards for a covered security specified in paragraph (1) or (2) of section [18(b)] . . . at the time during which it is alleged that the misrepresentation, omission, or manipulative or deceptive conduct occurred." Securities Act of 1933 § 16(f)(3), 15 U.S.C. § 77p(f)(3) (2000); Securities Exchange Act of 1934 § 28(f)(5)(E), 15 U.S.C. § 78bb(f)(5)(E) (2000). Section 18(b)(1) provides that nationally traded securities are covered securities. In particular, it states that a security is a covered security if it is

(A) listed, or authorized for listing, on the New York Stock Exchange or the American Stock Exchange, or listed, or authorized for listing, on the National Market System of the Nasdaq Stock Market (or any successor to such entities);

(B) listed, or authorized for listing, on a national securities exchange (or tier or segment thereof) that has listing standards that the [SEC] determines by rule (on its own initiative or on the basis of a petition) are substantially similar to the listing standards applicable to securities described in subparagraph (A); or

(C) is a security of the same issuer that is equal in seniority or that is a senior security to a security described in subparagraph (A) or (B).

Securities Act of 1933 § 18(b)(1); 15 U.S.C. § 77r(b)(1) (2000). The SEC has exercised its delegated

over-the-counter on the Nasdaq Small Capital Market are not covered securities, and anti-fraud actions for these securities are not preempted.

Second, only “covered class actions” are preempted by SLUSA.⁸⁵ A covered class action is not identical to a class action brought under Rule 23 of the Federal Rules of Civil Procedure.⁸⁶ A covered class action includes three different types of actions: (1) actions brought on behalf of more than 50 persons, (2) actions brought on a representative basis, and (3) a group of joined or consolidated actions.⁸⁷ Even if a class action falls into one of these

authority under Section 18(b)(1)(B) by promulgating Rule 146(b), which expands the definition of covered securities to include securities listed on the following exchanges: (1) Tier I of the Pacific Stock Exchange, (2) Tier I of the Philadelphia Stock Exchange, and (3) the Chicago Board Options Exchange. 17 C.F.R. § 230.146(b) (2004).

In addition to nationally traded securities, a security is a covered security if it was issued by an investment company that is registered, or that has filed a registration statement, under the Investment Company Act of 1940. *See* Securities Act of 1933 § 18(b)(2); 15 U.S.C. § 77r(b)(2) (2000).

85. *See supra* note 78 and accompanying text.

86. Rule 23 provides:

(a) Prerequisites to a Class Action. One or more members of a class may sue or be sued as representative parties on behalf of all only if (1) the class is so numerous that joinder of all members is impracticable, (2) there are questions of law or fact common to the class, (3) the claims or defenses of the representative parties are typical of the claims or defenses of the class, and (4) the representative parties will fairly and adequately protect the interests of the class.

(b) Class Actions Maintainable. An action may be maintained as a class action if the prerequisites of subdivision (a) are satisfied, and in addition:

(1) the prosecution of separate actions by or against individual members of the class would create a risk of

(A) inconsistent or varying adjudications with respect to individual members of the class which would establish incompatible standards of conduct for the party opposing the class, or

(B) adjudications with respect to individual members of the class which would as a practical matter be dispositive of the interests of the other members not parties to the adjudications or substantially impair or impede their ability to protect their interests; or

(2) the party opposing the class has acted or refused to act on grounds generally applicable to the class, thereby making appropriate final injunctive relief or corresponding declaratory relief with respect to the class as a whole; or

(3) the court finds that the questions of law or fact common to the members of the class predominate over any questions affecting only individual members, and that a class action is superior to other available methods for the fair and efficient adjudication of the controversy. The matters pertinent to the findings include:

(A) the interest of members of the class in individually controlling the prosecution or defense of separate actions;

(B) the extent and nature of any litigation concerning the controversy already commenced by or against members of the class;

(C) the desirability or undesirability of concentrating the litigation of the claims in the particular forum;

(D) the difficulties likely to be encountered in the management of a class action.

FED. R. CIV. P. 23.

87. The definition of “class action” is much broader than that of Rule 23 of the Federal Rules of Civil Procedure. According to SLUSA, a “covered class action” is

(i) any single lawsuit in which—

(1) damages are sought on behalf of more than 50 persons or prospective class members, and questions of law or fact common to those persons or members of the prospective class, without reference to issues of individualized reliance on an alleged misstatement or omission, predominate over any questions affecting only individual persons or members; or

three categories, SLUSA provides that it is a covered class action only if damages are sought by the plaintiff on behalf of the class.⁸⁸

Finally, the preemption provision is subject to a number of exceptions and exclusions,⁸⁹ including the so-called “Delaware carve-out,” which preserves certain actions for violations of the fiduciary duty of disclosure under state law.⁹⁰ Furthermore, derivative actions brought by shareholders on behalf of a corporation are not preempted by SLUSA.⁹¹

b. SLUSA’s Removal Provision

To help effectuate its preemption provision, SLUSA also includes a corresponding removal provision, which provides that

-
- (II) one or more named parties seek to recover damages on a representative basis on behalf of themselves and other unnamed parties similarly situated, and questions of law or fact common to those persons or members of the prospective class predominate over any questions affecting only individual persons or members; or
- (ii) any group of lawsuits filed in or pending in the same court and involving common questions of law or fact, in which—
- (I) damages are sought on behalf of more than 50 persons; and
- (II) the lawsuits are joined, consolidated, or otherwise proceed as a single action for any purpose.

Securities Act of 1933 § 16(f)(2); 15 U.S.C. § 77p(f)(2) (2000); Securities Exchange Act of 1934 § 28(f)(5)(B), 15 U.S.C. § 78bb(f)(5)(B) (2000).

88. See *supra* note 87.

89. For example, SLUSA expressly preserves actions brought by state governments or state pension plans. See Securities Act of 1933 § 16(d)(2)(A); 15 U.S.C. § 77p(d)(2)(A) (2000); Securities Exchange Act of 1934 § 28(f)(3)(B), 15 U.S.C. § 78bb(f)(3)(B) (2000).

In addition, SLUSA attempts to preserve certain actions based on breach of contract. First, SLUSA preserves actions by a trustee “to enforce a contractual agreement between an issuer and an indenture trustee.” Securities Act of 1933 § 16(d)(3); 15 U.S.C. § 77p(d)(3) (2000); Securities Exchange Act of 1934 § 28(f)(3)(C), 15 U.S.C. § 78bb(f)(3)(c) (2000). This provision was added to clarify that a company that has sold securities pursuant to an indenture containing representations and warranties, and has breached the indenture, can be sued by the indenture trustee. See John C. Coffee Jr., *A Primer on Uniform Standards Act*, N.Y. L.J., Dec. 17, 1998, at 5. In addition, SLUSA excludes from the definition of “covered security” any “debt security that is exempt from registration under this subchapter pursuant to rules issued by the [SEC] under section [4(2)].” Securities Act of 1933 § 16(f)(3); 15 U.S.C. § 77p(f)(3) (2000); Securities Exchange Act of 1934 § 28(f)(5)(E), 15 U.S.C. § 78bb(f)(5)(E) (2000). This exclusion was apparently intended to permit purchasers to sue for breach of contract if a company breached representations or warranties contained in a note purchase agreement. See Coffee, *supra*, at 5.

90. Under the Delaware carve-out, a class action is preserved if it involves

- (i) the purchase or sale of securities by the issuer or an affiliate of the issuer exclusively from or to holders of equity securities of the issuer; or
- (ii) any recommendation, position, or other communication with respect to the sale of securities of the issuer that—
- (I) is made by or on behalf of the issuer or an affiliate of the issuer to holders of equity securities of the issuer; and
- (II) concerns decisions of those equity holders with respect to voting their securities, acting in response to a tender or exchange offer, or exercising dissenters’ or appraisal rights.

Securities Act of 1933 § 16(d), 15 U.S.C. § 77p(d)(2000); Securities Exchange Act of 1934 § 28(f)(3), 15 U.S.C. § 78bb(f)(3)(ii) (2000). For further discussion of the Delaware carve-out, see Jennifer O’Hare, *Director Communications and the Uneasy Relationship Between the Fiduciary Duty of Disclosure and the Anti-Fraud Provisions of the Federal Securities Laws*, 70 U. CIN. L. REV. 475 (2002).

91. See Securities Act of 1933 § 16(f)(3); 15 U.S.C. § 77p(f)(2)(B) (2000); Securities Exchange Act of 1934 § 28(f)(5)(C), 15 U.S.C. § 78bb(f)(5)(c) (2000).

[a]ny covered class action brought in any State court involving a covered security, as set forth in subsection (b) . . . , shall be removable to the Federal district court for the district in which the action is pending, and shall be subject to subsection (b).⁹²

Subsection (b) is SLUSA's preemption provision.

Thus, a defendant in a state action who believes that SLUSA preempts the plaintiff's claims can rely on SLUSA's removal provision to remove the action to federal district court, where the judge will determine if the removal provision applies. If it does, the court will ordinarily dismiss the action immediately pursuant to SLUSA's preemption provision.⁹³ If the court determines that the removal provision does not apply, the court will remand the case back to state court.⁹⁴

The legislative history concerning SLUSA's removal provision is sparse.⁹⁵ Presumably, Congress concluded that a specific removal provision was necessary because, as explained in more detail below,⁹⁶ removal under the general federal removal statute contained in 28 U.S.C. § 1441 would be problematic.

92. Securities Act of 1933 § 16(c), 15 U.S.C. § 77P(c) (2000); Securities Exchange Act of 1934 § 28(f)(2), 15 U.S.C. § 78bb(f)(2) (2000). Thus, the party seeking removal must show that (1) the suit is a "covered class action," (2) the plaintiffs' claims are based on state law, (3) one or more "covered securities" has been purchased or sold, and (4) the defendant misrepresented or omitted a material fact "in connection with" the purchase or sale of such security. *Herndon v. Equitable Variable Life Ins. Co.*, 325 F.3d 1252, 1253 (11th Cir. 2003). This four-part test is identical to the test used to determine whether the state action should be preempted. *See infra* Part II.B.4.

93. *See, e.g., Herndon*, 325 F.3d at 1253. The case will be dismissed unless the court determines that SLUSA does not apply, or that an exception to preemption applies, such as the "Delaware carve-out" discussed above. *See supra* note 90. If so, the court will remand the action to state court.

94. SLUSA provides that: "[i]n an action that has been removed from a State court pursuant to [SLUSA's removal provision], if the Federal court determines that the action may be maintained in State court . . . the Federal court shall remand such action to such State court." Securities Act of 1933 § 16(d)(4), 15 U.S.C. § 77k(d)(4) (2000); Securities Exchange Act of 1934 § 28(f)(3)(D), 15 U.S.C. § 78bb(f)(3)(D) (2000).

The circuits are split as to whether a remand order is reviewable on appeal. *See Kircher v. Putnam Funds Trust*, 373 F.3d 847, at 850-51 (7th Cir. 2004). The Second, Ninth, and Eleventh Circuits have held that appellate jurisdiction is prohibited by 28 U.S.C. 1447(d), which blocks review when the remand order is based on lack of subject matter jurisdiction. *See Spielman v. Merrill Lynch, Pierce, Fenner & Smith, Inc.*, 332 F.3d 116, 129 (2d Cir. 2003) (holding that denial of SLUSA preemption and remand is tantamount to finding that there is no subject matter jurisdiction); *United Investors Life Ins. Co. v. Waddell & Reed, Inc.*, 360 F.3d 960, 967 (9th Cir. 2004) (same); *Williams v. AFC Enters., Inc.*, 389 F.3d 1185, 1190 (11th Cir. 2004) (same). The Seventh Circuit has held that the determination of SLUSA preemption is a substantive decision that requires review because of its tremendous implications on the litigation. *See Kircher*, 373 F.3d at 850 (concluding that an appeal is within the court's appellate jurisdiction and will proceed to its merits). For a good discussion of the issue, see Thomas F. Lamprecht, Note, *How Can It Be Wrong When It Feels So Right? Appellate Review of Remand Orders Under the Securities Litigation Uniform Standards Act*, 50 VILL. L. REV. (forthcoming Mar. 2005).

95. According to the House Report, the specialized removal provision was designed to prevent a state court from "inadvertently, improperly, or otherwise maintaining jurisdiction over an action that is preempted" under SLUSA. H.R. REP. NO. 105-640, at 16 (1998).

96. *See infra* Part II.B.3.

B. Removal

1. In General

Generally,⁹⁷ removal of an action from state court to federal court is made pursuant to 28 U.S.C. § 1441, which provides in relevant part that: “any civil action brought in a state court of which the district courts of the United States have original jurisdiction, may be removed by the defendant . . . to the district court of the United States for the district and division embracing a place where such action is pending.”⁹⁸

Thus, in order for an action to be removed, the federal court must have original jurisdiction over the action. Original jurisdiction of federal district courts is defined in Article III of the Constitution,⁹⁹ which empowers these courts to hear cases “arising under” under the Constitution, laws, or treaties of the United States (also known as federal question jurisdiction).¹⁰⁰

A party seeking removal has the burden of proving that original jurisdiction exists, and the courts have repeatedly emphasized that this is a heavy burden.¹⁰¹ Similarly, the courts have strictly construed the removal statute, holding that any doubts regarding removal should be construed in favor of remand.¹⁰²

Judicial caution towards removal can primarily be traced to federalism concerns.¹⁰³ Federal courts are courts of limited jurisdiction; any power not granted to the federal courts by the Constitution remains with the state courts. Thus, federal courts construing Article III and related statutes do so carefully, so that they do not exceed the jurisdiction granted by the Constitution. The courts are concerned that “if a federal court reaches the merits of

97. In addition to the general removal statute contained in 28 U.S.C. § 1441, there are various other specialized removal statutes. *See infra* Part II.B.5.

98. 28 U.S.C. § 1441(a) (2000).

99. U.S. CONST. art III.

100. *See* U.S. Const. Art. III, § 2. Congress then empowered federal district courts to hear cases involving federal questions. *See* 28 U.S.C. § 1331 (2000). In addition to federal question jurisdiction, federal courts have the power to hear other cases, including cases involving diversity of citizenship. *See* 28 U.S.C. § 1332 (2000). However, because jurisdiction based on diversity of citizenship is not implicated by SLUSA, it is not addressed in this Article.

101. *See, e.g.,* *Shamrock Oil & Gas Corp. v. Sheets*, 313 U.S. 100, 100 (1941).

102. *See id.* at 108-09. *Shamrock Oil* is the seminal case holding that removal statutes should be strictly construed. In that case, the Supreme Court noted that

[n]ot only does the language of the Act of 1887 evidence the Congressional purpose to restrict the jurisdiction of the federal courts on removal, but the policy of successive acts of Congress regulating the jurisdiction of federal courts is one calling for the strict construction of such legislation. The power reserved to the states under the Constitution to provide for the determination of controversies in their courts, may be restricted only by the action of Congress in conformity with Judiciary Articles of the Constitution.

Id.

103. In addition to federalism concerns, courts also state that the removal statute must be strictly construed to preserve the plaintiff’s right to choose his forum. *See* 14B CHARLES ALAN WRIGHT ET AL., FEDERAL PRACTICE AND PROCEDURE § 3721 (3d ed. 1998). Courts have also adopted a strict construction to avoid inefficient or duplicative litigation and to avoid exposing a plaintiff to a risk of litigating a case in a court lacking jurisdiction over the plaintiff’s claim. *Id.* § 3721, at 351.

a pending motion in a removed case where subject matter jurisdiction may be lacking it deprives a state court of its right under the Constitution to resolve controversies in its own courts.”¹⁰⁴ As the Supreme Court has recognized, “[d]ue regard for the rightful independence of state governments, which should actuate federal courts, requires that they scrupulously confine their own jurisdiction to the precise limits which the statute has defined.”¹⁰⁵

Even if a federal court has original jurisdiction, a defendant does not necessarily have the right to remove an action brought in state court to federal district court. Instead, removal is limited by the well-pleaded complaint rule.¹⁰⁶

2. *The Well-Pleaded Complaint Rule*

The well-pleaded complaint rule provides that removal is proper “only when a federal question is presented on the face of the plaintiff’s properly pleaded complaint.”¹⁰⁷ Put another way, the rule generally prohibits a court from looking behind the plaintiff’s complaint to determine the “true nature” of the plaintiff’s claim. Under the well-pleaded complaint rule, a plaintiff can ordinarily avoid removal simply by omitting federal claims. Similarly, a defendant cannot remove a case by asserting a federal defense, even if both parties concede that the federal defense is the only real issue in the case.¹⁰⁸

Commentators have identified several different justifications for the well-pleaded complaint rule. First, the well-pleaded complaint rule limits federal jurisdiction, which helps ensure that federal district courts do not inadvertently hear cases beyond the scope of Article III’s grant of power.¹⁰⁹ Second, it provides certain important administrative benefits. If original

104. *Univ. of S. Ala. v. Am. Tobacco Co.*, 168 F.3d 405, 411 (11th Cir. 1999).

105. *Healy v. Ratta*, 292 U.S. 263, 270 (1934).

106. *See Caterpillar v. Williams*, 482 U.S. 386, 392 (1987).

107. *See, e.g., id.* at 392. The well-pleaded complaint rule has been the subject of numerous scholarly articles and commentary. For a good discussion of the well-pleaded complaint rule, see Karen A. Jordan, *The Complete Preemption Dilemma: A Legal Process Perspective*, 31 WAKE FOREST L. REV. 927 (1996); Arthur R. Miller, *Artful Pleading: A Doctrine in Search of Definition*, 76 TEX. L. REV. 1781 (1998); Mary P. Twitchell, *Characterizing Federal Claims: Preemption, Removal, and the Arising-Under Jurisdiction of the Federal Courts*, 54 GEO. WASH. L. REV. 812 (1986); Tristin Green, Comment, *Complete Preemption—Removing the Mystery from Removal*, 86 CAL. L. REV. 363 (1998); Richard E. Levy, Comment, *Federal Preemption, Removal Jurisdiction, and the Well-Pleaded Complaint Rule*, 51 U. CHI. L. REV. 634 (1984).

108. *See Caterpillar*, 482 U.S. at 393.

109. As one commentator noted:

It is clear . . . that the well-pleaded complaint rule serves an important purpose in the scheme of federal jurisdiction by limiting the reach of original federal question jurisdiction. In contrast to appellate jurisdiction, where the questions before the court are fixed by the decision below and by the questions presented on appeal, it is unclear at the time a court exercises original jurisdiction precisely which issues will arise during the course of the litigation. A federal question might be raised during the course of virtually any litigation. Thus, to base original federal question jurisdiction on the existence of merely potential federal questions in a case would render illusory the limitation of federal jurisdiction in article III to specifically enumerated classes of cases. The well-pleaded complaint rule avoids this consequence.

Levy, *supra* note 107, at 638-39.

jurisdiction could be based on a potential federal defense, what would happen if the federal defense was never posed? Would the federal court have to send the case back to state court?¹¹⁰ Third, the well-pleaded complaint rule helps conserve scarce judicial resources. Without the well-pleaded complaint rule, federal courts might be forced to expend considerable time and effort—sorting through claims, defenses, and counterclaims—to determine whether the “true nature” of the claim involves a federal question. A bright-line rule based only on the plaintiff’s articulation of his claim certainly simplifies the jurisdictional inquiry. Finally, “the well-pleaded complaint rule respects the power of the state courts to articulate and develop their own substantive law even when a federal issue may constitute an ingredient of a case.”¹¹¹

3. *Preemption and Removal*

Because the well-pleaded complaint rule requires the federal district court to look only at what appears in the plaintiff’s statement of his claim, an action cannot be removed to federal court based on a federal defense, even the defense of preemption.¹¹² In this case of “ordinary” preemption,¹¹³ a defendant who believes that federal law preempts the plaintiff’s state law claims may not remove the action. Instead, the action will remain in state court, and the state court will determine if the state claims are preempted by federal law. If the claims are preempted, the state court will dismiss the action.

4. *The Complete Preemption Doctrine*

An important exception to the well-pleaded complaint rule and ordinary preemption is the “complete preemption” doctrine,¹¹⁴ which permits removal of a state action that alleges only state law claims. According to the complete preemption doctrine, the preemptive force of a federal statute may be so extraordinary that it “converts an ordinary state common-law complaint into one stating a federal claim for purposes of the well-pleaded complaint rule.”¹¹⁵ As the Supreme Court has explained, “Congress may so completely pre-empt a particular area that any civil complaint raising this

110. As one noted commentator explained, the well pleaded complaint rule “prevents the disruption, to both the system and the litigants, of shifting a case between state and federal fora in the middle of an action as federal issues arise or fall out.” See Miller, *supra* note 107, at 1783.

111. *Id.*

112. See *Louisville & Nashville R.R. v. Mottley*, 211 U.S. 149, 152 (1908) (stating that “[a]lthough [allegations of a federal defense] show that very likely, in the course of the litigation, a question under the Constitution would arise, they do not show that the suit, that is, the plaintiff’s original cause of action, arises under the Constitution”).

113. See 14B WRIGHT, *supra* note 103, § 3722.1 (discussing the difference between “ordinary” preemption and “complete” preemption).

114. See generally *id.* (discussing the complete preemption doctrine). For additional discussions of the complete preemption doctrine, see *supra* note 107.

115. See *Caterpillar v. Williams*, 482 U.S. 386, 393 (1987).

select group of claims is necessarily federal in character.”¹¹⁶ In this situation, the plaintiff’s state law claim is recharacterized as a federal claim, permitting the defendant to remove the plaintiff’s action to federal court under Section 1441, the general removal statute.

The obvious difference between ordinary preemption and complete preemption is the court deciding the preemption issue. Under complete preemption, a defendant removes a case to federal court where the federal court decides if the state claim is preempted by federal law. Under ordinary preemption, the case remains in state court, and the state court decides the same preemption issue. Thus, the complete preemption doctrine expands the jurisdiction of federal courts, while at the same time restricting the right of state courts to decide certain cases.

Federal courts are sensitive to federalism concerns and have generally recognized that the complete preemption doctrine should be applied sparingly.¹¹⁷ In addition, federal courts have recognized that while state law may ultimately be preempted by federal law, preemption should not automatically confer jurisdiction on federal courts.¹¹⁸ Moreover, federal courts are confident that state courts are just as competent as federal courts to determine whether state law is preempted.¹¹⁹

When does the complete preemption doctrine apply? Although the lower courts have struggled with this question,¹²⁰ congressional intent seems to be the most significant factor. Specifically, the Supreme Court has indicated that courts should examine the relevant federal statute to determine if Congress intended that statute to provide the exclusive cause of action.¹²¹ If

116. See *Metro. Life Ins. Co. v. Taylor*, 481 U.S. 58, 63-64 (1987).

117. In fact, the Supreme Court has held that only three federal statutes completely preempt state law. See *Beneficial Nat’l Bank v. Anderson*, 539 U.S. 1, 9 (2003) (holding that Section 85 and Section 86 of the National Bank Act completely preempted state usury claims against national bank); *Metro. Life Ins. Co.*, 481 U.S. at 58 (holding that Section 502(a) of the Employee Retirement Income Security Act of 1974 completely preempted state claims asserting improper processing of benefit claims under a plan regulated by ERISA); *Avco Corp. v. Aero Lodge No. 35, Int’l Ass’n of Machinists*, 390 U.S. 557, 561 (1968) (holding that Section 301 of the Labor Management Relations Act completely preempted state claims that the union had violated a no-strike provision in a collective bargaining agreement governed by LMRA).

118. As one court stated, “[t]he supremacy clause of the Constitution, which authorizes pre-emption by Congress, is concerned with promoting the supremacy of federal law, not federal courts.” *Cablevision Ltd. v. Flynn*, 710 F. Supp. 23, 26 (D. Mass.), *aff’d* 589 F.2d 377 (1st Cir. 1989).

119. If the state court errs and does not dismiss the action, the defendant can certainly appeal the preemption issue in the state court system. In addition, the decision of the state supreme court will be subject to the review of the United States Supreme Court.

120. See 14B WRIGHT, *supra* note 103, § 3722.1. The treatise addresses complete preemption as follows:

An examination of the wide divergence among lower federal courts as to the contexts in which complete preemption is applicable and the different judicial formulations of the test for identifying them makes it clear that the recent Supreme Court cases on the subject have failed to create a clear rule for identifying completely preempted claims beyond the LMRA and ERISA context that the lower federal courts can apply easily and consistently.

Id.

121. Initially, the lower courts focused on whether Congress intended to permit defendants to remove the action, even though the plaintiff relied only on state law. More recently, however, the Supreme Court stated that “the proper inquiry focuses on whether Congress intended the federal cause of action to be

so, the complete preemption doctrine applies, and the action may be removed to federal court under Section 1441.

5. *Specialized Removal Statutes*

As discussed above,¹²² a state law claim may be removed from state court to federal court under Section 1441 if the state law claim is displaced through the complete preemption doctrine. In addition, a state law claim can be removed to federal court if there is a specialized removal provision providing for the removal of the state law claim. Several federal statutes contain such specialized removal provisions.¹²³ For example, the Postal Reorganization Act permits removal of any action brought in state court in which the United States Postal Service is a party.¹²⁴ In other words, even if a plaintiff's complaint states only a state law claim—for example, negligence—the Postal Service can rely on the specialized removal provision to remove the action to federal court. If a statute has a specialized removal provision, the defendant will be able to use that specific removal statute—as opposed to the general removal statute set forth in Section 1441—to remove the action to federal court. SLUSA's removal provision¹²⁵ is, of course, another example of a specialized removal statute.

exclusive rather than on whether Congress intended that the cause of action be removable." *Beneficial Nat'l Bank v. Anderson*, 539 U.S. at 9 n.5.

122. See *supra* Part II.B.4.

123. There are several specialized removal statutes in Title 28 of the United States Code. See 28 U.S.C. § 1442 (2000) (permitting removal of state actions brought against federal officers); 28 U.S.C. § 1443 (2000) (permitting removal of civil rights cases); 28 U.S.C. § 1444 (2000) (permitting removal of foreclosure actions against the United States government); 28 U.S.C. § 1452 (2000) (permitting removal of claims relating to bankruptcy cases).

In addition, specialized removal provisions are contained in other federal statutes. Banking law contains a variety of specialized removal provisions. For example, the Financial Institutions Reform, Recovery, and Enforcement Act (FIRREA) permits removal of actions involving a financial institution by the Resolution Trust Corporation. See 12 U.S.C. § 1441a(a)(11) (2000). Similarly, the Federal Deposit Insurance Corporation is permitted to remove actions in which it is a party. See 12 U.S.C. § 1819(b)(2)(B) (2000). Cases involving the federal regulation of international or foreign banking may also be removed. See 12 U.S.C. § 632 (2000). Additionally, cases involving the International Monetary Fund and the International Bank for Reconstruction and Development may also be removed to federal court. See 22 U.S.C. § 286g (2000).

The Federal Tort Claims Act contains a specialized removal provision, which permits the removal of actions against federal employees upon certification by the Attorney General that the incident was within the scope of the employee's governmental employment. See 28 U.S.C. § 2679(d)(i) (2000). The Price-Anderson Act contains a provision permitting removal of tort actions arising out of nuclear accidents. See 42 U.S.C. § 2210(n)(2) (2000). The Jones Act also contains a removal provision, permitting the removal of cases involving the injury or death of a seaman. See 46 U.S.C. § 688 (2000). Finally, the Convention on Recognition and Enforcement of Foreign Arbitral Awards Act also contains a specialized removal provision, providing that the defendant may remove the action to federal court where the subject matter of an action in a state court relates to an arbitration agreement or award falling under the Convention. See 9 U.S.C. § 205 (2000).

124. See 39 U.S.C. § 409(a) (2000).

125. See *supra* Part II.A.3.

III. JUDICIAL INTERPRETATION OF SLUSA'S PREEMPTION AND REMOVAL PROVISIONS

As discussed above,¹²⁶ SLUSA's specialized removal provision permits any defendant who believes a state action is preempted by SLUSA to remove that action to federal court, where the action will be dismissed. Not surprisingly, plaintiffs seeking to avoid this effect creatively draft complaints, forcing the courts to examine and interpret SLUSA's removal and preemption provisions. These courts have had to answer four main questions. First, does SLUSA preempt only class actions alleging a theory of securities fraud? Second, if it preempts claims alleging other types of theories, when *is* SLUSA triggered? Third, may plaintiffs engage in careful pleading to avoid SLUSA's removal and preemption provisions? Fourth, how should SLUSA's "in connection with" requirement be interpreted? Each of these questions is examined in more detail below.

A. *Does SLUSA Preempt Only Class Actions Alleging a Theory of Securities Fraud?*

From the outset, plaintiffs were aware that SLUSA would preempt any and all claims grounded on securities fraud, whether they used theories of state securities fraud or state common-law fraud. Therefore, plaintiffs seeking to avoid SLUSA have filed actions based on alternate legal theories, such as breach of fiduciary duty, breach of contract, and violations of state deceptive and unfair trade practices acts. These plaintiffs have argued that because their claims were not "securities fraud claims," they were not preempted by SLUSA. In short, these plaintiffs argued that the characterization of each claim in the complaint should determine the applicability of SLUSA's preemption and removal provision. As shown below, a few courts have accepted this argument, but most courts have held that SLUSA preempts more than just cases labeled as fraud actions.

1. *Cases Holding that SLUSA Preempts Only "Fraud" Actions*

Some courts have determined that SLUSA preempts only "fraud" actions, thus placing significant emphasis on the plaintiff's characterization of his claim in determining whether or not SLUSA applies.¹²⁷ A good example of this approach is found in *Simon v. Internet Wire, Inc.*¹²⁸ This case arose out of a fictitious press release written by Mark Jakob, a non-party to the action, which stated that Emulex Corporation would be restating its 1998

126. See *supra* Part II.A.3.

127. See *Burns v. Prudential Sec., Inc.*, 218 F. Supp. 2d 911, 912 (N.D. Ohio 2002); *Green v. Ameritrade, Inc.*, 120 F. Supp. 2d 795, 797 (D. Neb. 2000), *aff'd on other grounds*, 279 F.3d 590 (8th Cir. 2002); *Simon v. Internet Wire, Inc.*, No. CV0013195 CBM (RNBX), 2001 U.S. Dist. LEXIS 4086, at *5 (C.D. Cal. Apr. 3, 2001).

128. No. CV0013195 CBM (RNBX), 2001 U.S. Dist. LEXIS 4086 (C.D. Cal. Apr. 3, 2001).

and 1999 earnings, that the SEC had launched an investigation of its accounting practices, and that Emulex's Chief Executive Officer had resigned.¹²⁹ Internet Wire, a company offering distribution of company press releases, published this fictitious press release, and following its publication, the price of Emulex stock plunged.¹³⁰ Certain shareholders of Emulex brought a class action against Internet Wire, complaining that Internet Wire was negligent because it failed to verify the accuracy of the press release before it was published.¹³¹ The complaint asserted state law claims for negligence, gross negligence, and negligent misrepresentation.¹³² Internet Wire removed the action to federal court, and the plaintiff then filed an amended complaint with a single claim of negligence and sought to have the action remanded back to state court.¹³³

The plaintiff argued that removal was improper and that the action was not preempted because "Congress intended SLUSA to govern securities fraud actions and the [amended complaint] only alleges negligence."¹³⁴ Internet Wire, on the other hand, argued that "the plain language of SLUSA completely preempts this action because the [amended complaint's] negligence allegation rests on an alleged 'misrepresentation or omission of [a] material fact.'"¹³⁵ In other words, Internet Wire argued that SLUSA was not limited to class actions alleging a theory of securities fraud, but instead preempted all class actions containing allegations of materially misleading statements or deception. Internet Wire urged the court to examine the allegations contained in the complaint, and if the complaint included allegations of material misstatements, the action should be preempted—whether or not the action was styled as a fraud action.¹³⁶

The court rejected Internet Wire's argument. Rather than relying on the plain language of the statute, the court reasoned that Congress intended to preempt only class actions alleging fraud or manipulation.¹³⁷ Furthermore, the court was not swayed by Internet Wire's argument that if the court did not preempt the plaintiff's action, "it would eviscerate the purpose of the SLUSA preemption requirement because plaintiffs could merely characterize their lawsuits by not alleging scienter to avoid preemption."¹³⁸ According to the court, SLUSA was intended to reach fraud claims only.¹³⁹ Because the "substance" of the plaintiff's claim did not involve securities fraud,¹⁴⁰ the action was not preempted.

129. *Id.* at *2.

130. *Id.* at *3.

131. *Id.*

132. *See id.*

133. *Id.*

134. *See id.* at *5.

135. *See id.* at *4-*5.

136. *Id.* at *7.

137. *See id.* at *8.

138. *See id.* at *9.

139. *Id.* at *10.

140. *See id.* at *8.

Courts holding that SLUSA only preempts fraud actions must then determine what constitutes a securities fraud action. According to these courts, the answer turns on the scienter element.¹⁴¹ The courts point out that scienter is a required element of a securities fraud claim. They then reason that if a complaint does not allege scienter, then the plaintiff's action can not be a fraud action and therefore is not preempted by SLUSA.¹⁴² For example, because the plaintiff in *Internet Wire* did not allege scienter, but instead limited his complaint to allegations that Internet Wire acted negligently, the court held that the action was not preempted and remanded the case back to state court.¹⁴³

2. Cases Holding that SLUSA Preempts More Than "Fraud" Actions

Most courts, however, have held that SLUSA preempts more than just actions expressly including a theory of securities fraud.¹⁴⁴ These courts have

141. For further discussion of the scienter element, see *supra* note 26 and accompanying text.

142. See *Burns*, 218 F. Supp. 2d at 923; *Green*, 120 F. Supp. 2d at 798; *Internet Wire*, 2001 U.S. Dist. LEXIS 4086, at *1. Other courts have rejected this approach, pointing out that the plain language of the statute does not mention scienter. See, e.g., *Kingdom 5-KR-41, Ltd. v. Star Cruise PLC*, No. 01-CIV2946 (DLL), 2004 U.S. Dist. LEXIS 3527, at *12 (S.D.N.Y. Mar. 10, 2004); *In re WorldCom, Inc. ERISA Litig.*, 263 F. Supp. 2d 745, 769 (S.D.N.Y. 2003); *Winne v. Equitable Life Assurance Soc'y*, 315 F. Supp. 2d 404, 413-14 (S.D.N.Y. 2003); *Feitelberg v. Merrill Lynch & Co.*, 234 F. Supp. 2d 1043, 1050 (N.D. Cal. 2002), *aff'd* 353 F.3d 765 (9th Cir. 2003). For a case discussing the different approaches to the scienter issue, see *Magyery v. Transamerica Fin. Advisors, Inc.*, 315 F. Supp. 2d 954 (N.D. Ind. 2004).

143. See *Internet Wire*, 2001 U.S. Dist. LEXIS 4086, at *10.

144. Thus, courts have regularly preempted breach of contract claims. See *Behlen v. Merrill Lynch*, 311 F.3d 1087 (11th Cir. 2002), *cert. denied*, 539 U.S. 927 (2003); *Cape Ann Investors L.L.C. v. Lepone*, 296 F. Supp. 2d 4 (D. Mass. 2003); *Rowinski v. Salomon Smith Barney, Inc.*, No. 3:02CV2014, 2003 U.S. Dist. LEXIS 20918 (M.D. Pa. Nov. 20, 2003); *Winne v. Equitable Life Assurance Soc'y*, 315 F. Supp. 2d 404 (S.D.N.Y. 2003); *Miller v. Nationwide Life Ins. Co.*, No. CIV03-1236, 2003 U.S. Dist. LEXIS 19332 (E.D. La. Oct. 29, 2003); *Dacey v. Morgan Stanley Dean Witter & Co.*, 263 F. Supp. 2d 706 (S.D.N.Y. 2003); *Araujo v. John Hancock Life Ins. Co.*, 206 F. Supp. 2d 377 (E.D.N.Y. 2002); *Zoren v. Genesis Energy, L.P.*, 195 F. Supp. 2d 598 (D. Del. 2002); *Kenneth Rothschild Trust v. Morgan Stanley Dean Witter & Co.*, 199 F. Supp. 2d 993 (C.D. Cal. 2002); *Gilmore v. MONY Life Ins. Co.*, 165 F. Supp. 2d 1276 (M.D. Ala. 2001); *Prager v. Knight/Trimark Group, Inc.*, 124 F. Supp. 2d 229 (D.N.J. 2000); *Hines v. ESC Strategic Funds, Inc.*, No. 3:99-0530, 1999 U.S. Dist. LEXIS 15790 (M.D. Tenn. Sep. 17, 1999); *Lasley v. New England Variable Life Ins. Co.*, 126 F. Supp. 2d 1236 (N.D. Cal. 1999).

Courts have also preempted breach of fiduciary duty claims. See *Professional Mgmt. Assocs., Inc. Employees' Profit Sharing Plan v. KPMG, L.L.P.*, 335 F.3d 800 (8th Cir. 2003); *Behlen v. Merrill Lynch*, 311 F.3d 1087 (11th Cir. 2002); *Dudek v. Prudential Sec., Inc.*, 295 F.3d 875 (8th Cir. 2002); *Zoren v. Genesis Energy, L.P.*, 195 F. Supp. 2d 598 (D. Del. 2002); *McCullagh v. Merrill Lynch & Co.*, No. 01CIV7322, 2002 U.S. Dist. LEXIS 3758 (S.D.N.Y. Mar. 5, 2002); *Korsinsky v. Salomon Smith Barney, Inc.*, No. 01CIV6085, 2002 U.S. Dist. LEXIS 259 (S.D.N.Y. Jan. 10, 2002); *Hardy v. Merrill Lynch, Pierce, Fenner & Smith, Inc.*, 189 F. Supp. 2d 14 (S.D.N.Y. 2002); *Gilmore v. MONY Life Ins. Co.*, 165 F. Supp. 2d 1276 (M.D. Ala. 2001); *Denton v. H&R Block Fin. Advisors, Inc.*, No. 01-C4185, 2001 U.S. Dist. LEXIS 15831 (N.D. Ill. Oct. 3, 2001); *Burekovitch v. Hertz*, No. 01-CV-1277, 2001 U.S. Dist. LEXIS 12173 (E.D.N.Y. July 24, 2001); *Prager v. Knight/Trimark Group, Inc.*, 124 F. Supp. 2d 229 (D.N.J. 2000).

Furthermore, courts have preempted claims based on violations of state deceptive trade practices acts or consumer protection acts. See *Riley v. Merrill Lynch, Pierce, Fenner & Smith, Inc.*, 292 F.3d 1334 (11th Cir. 2002); *Patenaude v. Equitable Life Assurance Soc'y*, 290 F.3d 1020 (9th Cir. 2002); *Cape Ann Investors L.L.C. v. Lepone*, 296 F. Supp. 2d 4 (D. Mass. 2003); *Rowinski v. Salomon Smith Barney, Inc.*, No. 3:02CV2014, 2003 U.S. Dist. LEXIS 20918 (M.D. Pa. Nov. 20, 2003); *Winne v. Equitable Life Assurance Soc'y*, 315 F. Supp. 2d 404 (S.D.N.Y. 2003); *Gray v. Seaboard Sec., Inc.*, 241

focused on the *allegations* in the plaintiff's complaint, not on the plaintiff's characterization of these allegations. As long as the complaint contains allegations meeting SLUSA's preemption provision, the court will preempt the state claims—regardless of whether the plaintiff labels them as fraud claims.

A good example of this approach is found in *Korsinsky v. Salomon Smith Barney, Inc.*¹⁴⁵ The plaintiff purchased stock in AT&T Corp. based on the positive recommendations of Jack Grubman, an analyst employed by Salomon Smith Barney, Inc. (SSB).¹⁴⁶ According to the plaintiff, these recommendations were false. The plaintiff alleged that Mr. Grubman and SSB knew that AT&T faced serious financial problems, but continued to issue buy recommendations to its retail customers in order to court AT&T's valuable investment banking business.¹⁴⁷ The plaintiff filed a class action complaint in state court, alleging that Mr. Grubman and SSB breached their fiduciary duties as broker-dealers by issuing false recommendations to their clients.¹⁴⁸ The defendants then removed the action to federal court, arguing that the plaintiff's action was preempted by SLUSA.¹⁴⁹ The plaintiff sought to remand the action to state court, but the court refused the plaintiff's motion.¹⁵⁰

The court rejected the plaintiff's argument that the action should not be preempted because he had expressly stated in the complaint that "this is not an action for fraud."¹⁵¹ Instead, the court focused on the allegations made in the complaint. The court began its analysis by noting that SLUSA was intended to "prevent plaintiffs from seeking to evade the protections that Federal law provides against abusive litigation by filing suit in State court, rather than Federal court."¹⁵² It then examined the preemption and removal provisions of SLUSA and concluded that "SLUSA bars a private party from bringing a 'covered class action' based upon the statutory or common law of any state *alleging* a misrepresentation or omission of a material fact or the use of any manipulative device or contrivance in connection with the sale of a 'covered security.'"¹⁵³ The court was not swayed by the plaintiff's

F. Supp. 2d 213 (N.D.N.Y. 2003); Feitelberg v. Merrill Lynch & Co., 234 F. Supp. 2d 1043 (N.D. Cal. Oct. 9, 2002), *aff'd*, 353 F.3d 765 (9th Cir. 2003); Kenneth Rothschild Trust v. Morgan Stanley Dean Witter, 199 F. Supp. 2d 993 (C.D. Cal. 2002); McCullagh v. Merrill Lynch & Co., No. 01CIV7322, 2002 U.S. Dist. LEXIS 3758 (S.D.N.Y. Mar. 5, 2002); Bertram v. Terayon Communications Sys., Inc., No. CV00-12653, 2001 U.S. Dist. LEXIS 6215 (C.D. Cal. Mar. 27, 2001); Prager v. Knight/Trimark Group, Inc., 124 F. Supp. 2d 229 (D.N.J. 2000).

These are not the only types of claims that courts have preempted. In addition to breach of contract claims, breach of fiduciary duty claims, and claims based on violations of state deceptive trade practices acts, courts have also preempted unjust enrichment claims, negligence/malpractice claims, and negligent supervision claims.

145. 2002 U.S. Dist. LEXIS 259 (S.D.N.Y. Jan. 9, 2002).

146. *Id.* at *2.

147. *See id.* at *4.

148. *Id.*

149. *See id.*

150. *Id.* at *17.

151. *See id.* at *11.

152. *Id.* at *7 (citing H.R. REP. NO. 105-803 (1998)).

153. *Id.* at *7-*8 (emphasis added).

labeling of the complaint as one not involving fraud. Because the complaint alleged that the defendants had made misrepresentations, the action was preempted.¹⁵⁴

The court in *Feitelberg v. Merrill Lynch & Co., Inc.*¹⁵⁵—another case involving claims that a brokerage firm issued false analyst reports—came to a similar conclusion. The plaintiff filed an action in state court alleging violations of California’s unfair business practices statute.¹⁵⁶ The plaintiff argued that his case should be remanded because he had not filed a fraud action.¹⁵⁷ According to the plaintiff, because his state claims did not require scienter, they were not fraud claims, and therefore were not preempted by SLUSA.¹⁵⁸ The court easily rejected this argument, noting that “if by merely omitting scienter allegations [a] plaintiff can avoid SLUSA’s preemption effect, SLUSA would be totally eviscerated.”¹⁵⁹ The court continued:

If in fact the claims allege misrepresentations or omissions or use of manipulative or deceptive devices in connection with the purchase or sale of securities and otherwise come within the purview of SLUSA, artful avoidance of those terms or scienter language will not save them from preemption. In other words, *if it looks like a securities fraud claim, sounds like a securities fraud claim and acts like a securities fraud claim, it is a securities fraud claim, no matter how you dress it up.*¹⁶⁰

According to the court, this case looked, sounded, and acted like a securities fraud case.¹⁶¹ Therefore, it was preempted.¹⁶²

B. When Is SLUSA Triggered?

Since most courts have determined that the plaintiff’s characterization of his claim does not determine whether or not SLUSA applies, courts have had to determine what class actions *are* preempted by SLUSA. To answer this question, the great majority of courts have looked to the statute’s plain language and adopted a four-part test. Under this test, SLUSA applies if the defendant can show that (1) the suit is a “covered class action,” (2) the plaintiff’s claims are based on state law, (3) there has been a purchase or sale of a “covered security,” and (4) the plaintiff has alleged a misrepresentation or omission of material fact¹⁶³ “in connection with” the purchase or

154. See *id.* at *10.

155. 234 F. Supp. 2d 1043 (N.D. Cal. 2002), *aff’d*, 353 F.3d 765 (9th Cir. 2003).

156. See *id.* at 1045 (discussing an action based on CAL. BUS. & PROF. CODE § 17200 (West. 2002)).

157. *Id.* at 1046.

158. See *id.*

159. *Id.* at 1051.

160. *Id.* (emphasis added).

161. See *id.*

162. See *id.* at 1053.

163. SLUSA provides for preemption in two circumstances: (1) if there has been an untrue statement

sale of such security.¹⁶⁴ Because the first three prongs are relatively straightforward, most cases have focused on the final prong of this test—whether the plaintiff has alleged a misrepresentation or omission in connection with the purchase or sale of a security. Courts have developed two very different approaches to determining whether the plaintiff's allegations trigger SLUSA. Most courts look at the actual allegations appearing in the complaint. However, other courts look beyond what the plaintiff actually alleges, rewriting the plaintiff's complaint so that SLUSA is triggered.

1. Cases Holding that SLUSA Is Triggered by Allegations Actually Made in the Complaint

Most courts have examined the allegations actually made in a complaint to determine if SLUSA is triggered.¹⁶⁵ In *Burekovitch v. Hertz*,¹⁶⁶ Barry Hertz, the founder, Chairman, and Chief Executive Officer of Track Data Corp., owned 70% of the outstanding shares of Track Data.¹⁶⁷ Mr. Hertz pledged 40% of his Track Data holdings as security for his personal margin trading in other securities, but did not disclose that pledge to Track Data's

or omission of a material fact in connection with the purchase or sale of a covered security, or (2) if the defendant has engaged in a manipulative or deceptive act in connection with the purchase or sale of a covered security. See *supra* note 78 and accompanying text. However, because most cases have fact patterns involving misleading statements of material fact, as opposed to manipulative or deceptive acts, the test fashioned by the courts speaks only to the first circumstance, and not the second. Obviously, if a complaint alleged that the defendant employed a manipulative or deceptive act in connection with the purchase or sale of a security, SLUSA would be triggered. For simplicity's sake, this Article will follow the same approach as the courts.

164. See, e.g., *Herndon v. Equitable Variable Life Ins. Co.*, 325 F.3d 1252, 1253 (11th Cir. 2003) (stating the four-part test) (quoting *Riley v. Merrill Lynch, Pierce, Fenner & Smith, Inc.*, 292 F.3d 1334, 1343 (11th Cir. 2002)); *Behlen v. Merrill Lynch*, 311 F.3d 1087, 1092 (11th Cir. 2002) (stating the four-part test), *cert. denied*, 539 U.S. 927 (2003); *Riley v. Merrill Lynch, Pierce, Fenner & Smith, Inc.*, 292 F.3d 1334, 1342 (11th Cir. 2002) (same), *cert. denied*, 537 U.S. 950 (2002); *Green v. Ameritrade*, 279 F.3d 590, 596 (8th Cir. 2002) (same); *In re Alger*, 320 F. Supp. 2d 352, 354 (D. Md. 2004) (same); *Magyery v. Transamerica Fin. Advisors, Inc.*, 315 F. Supp. 2d 954, 957 (D. Ind. 2004) (same); *Kingdom 5-KR-41, Ltd. v. Star Cruises PLC*, No. 01-CIV2946 (DLC), 2004 U.S. Dist. LEXIS 3527, at *9 (S.D.N.Y. Mar. 9, 2004) (same); *Feitelberg v. Credit Suisse First Boston L.L.C.*, No. C-03-3451SC, 2003 U.S. Dist. LEXIS 19116, at *8 (N.D. Cal. Oct. 24, 2003) (same); *Burns v. Prudential Sec., Inc.*, 116 F. Supp. 2d 917, 921 (N.D. Ohio 2000) (same); *Miller v. Waste Mgmt., Inc. (In re Waste Mgmt., Inc. Sec. Litig.)*, 194 F. Supp. 2d 590, 594 (S.D. Tex. 2002) (same); *Spielman v. Merrill Lynch, Pierce, Fenner & Smith, Inc.*, 2001 U.S. Dist. LEXIS 15943, at *5 (S.D.N.Y. Oct. 9, 2001) (same), *appeal dismissed*, 2003 U.S. App. LEXIS 11719 (2d Cir. June 13, 2003); *Hardy v. Merrill Lynch, Pierce, Fenner & Smith, Inc.*, 189 F. Supp. 2d 14, 17 (S.D.N.Y. 2001) (same); *Shaev v. Claflin*, No. C01-0009, 2001 U.S. Dist. LEXIS 6677, at *5 (N.D. Cal. May 21, 2001) (same); *Prager v. Knight/Trimark Group, Inc.*, 124 F. Supp. 2d 229, 231 (D.N.J. 2000) (same).

165. See, e.g., *Green v. Ameritrade, Inc.*, 279 F.3d 590 (8th Cir. 2002); *Norman v. Salomon Smith Barney, Inc.*, No. 03-CIV-4391, 2004 U.S. Dist. LEXIS 10619 (S.D.N.Y. June 9, 2004); *Gray v. Seaboard Sec., Inc.*, 241 F. Supp. 2d 213 (N.D.N.Y. 2003); *Arlia v. Blankenship*, 234 F. Supp. 2d 606 (S.D. W. Va. 2002); *MDCM Holdings, Inc. v. Credit Suisse First Boston Corp.*, 216 F. Supp. 2d 251 (S.D.N.Y. 2002); *Lazar v. Gregerson*, No. C-02-0652, 2002 U.S. Dist. LEXIS 6152 (N.D. Cal. Apr. 8, 2002); *Burekovitch v. Hertz*, No. 01-CV-1277, 2001 U.S. Dist. LEXIS 12173 (E.D.N.Y. July 24, 2001); *Abada v. Charles Schwab & Co., Inc.*, 127 F. Supp. 2d 1101, 1103 (S.D. Cal. 2000).

166. No. 01-CV-1277, 2001 U.S. Dist. LEXIS 12173 (E.D.N.Y. July 24, 2001).

167. *Id.* at *2.

public shareholders.¹⁶⁸ Eventually, Mr. Hertz's brokers began selling the pledged Track Data stock to cover approximately \$45 million of his trading losses.¹⁶⁹ Following the sales of such a large number of shares, the price of Track Data stock declined.¹⁷⁰ A Track Data shareholder brought a class action in state court against Mr. Hertz for breach of fiduciary duty and for common-law fraud.¹⁷¹ The plaintiff's claim for breach of fiduciary duty alleged that "[b]y failing to disclose that he had offered at least 40% of Track Data's outstanding common stock as security for his personal margin trading of other securities, defendant Hertz breached his fiduciary duty of loyalty, care, and disclosure to Track Data's public shareholders."¹⁷² The plaintiff's claim for common-law fraud alleged that the "[d]efendant made material misrepresentations of fact and omissions of material fact regarding his margin trading for the purpose of inducing plaintiff and other members of the class to purchase Track Data stock."¹⁷³

The defendant removed the action to federal court under SLUSA, and the plaintiff then attempted to amend his complaint to omit the fraud claim.¹⁷⁴ According to the plaintiff, since the amended complaint would then allege only a claim for common-law breach of fiduciary duty, it would not be preempted by SLUSA.¹⁷⁵ According to the defendant, the plaintiff's complaint—even without the fraud claim—should be preempted because "the Uniform Standards Act still would bar plaintiff's fiduciary duty claim since it rests entirely on omissions or misstatements in connection with plaintiff's purchase of securities."¹⁷⁶ The district court agreed.¹⁷⁷

The court noted that the common-law fraud claim was "clearly" preempted by SLUSA because the allegations in the complaint were virtually identical to the language in SLUSA's preemption provision.¹⁷⁸ In addition, the breach of fiduciary duty claim was also preempted by SLUSA because the complaint alleged that the defendant "fail[ed] to disclose" that he had pledged Track Data stock.¹⁷⁹ The court pointed out that SLUSA preempts class actions alleging "an untrue statement or omission of a material fact."¹⁸⁰ Since a failure to disclose information is an omission within the meaning of SLUSA, the plaintiff's action was preempted.¹⁸¹

168. *Id.* at *2-*4.
169. *See id.* at *6.
170. *Id.*
171. *Id.* at *7.
172. *Id.*
173. *Id.*
174. *Id.* at *8-*9.
175. *Id.* at *10.
176. *Id.*
177. *Id.* at *15.
178. *Id.* at *14.
179. *Id.* at *15.
180. *Id.* at *13.
181. *Id.* at *18.

The courts have generally stressed that the focus should be on what the plaintiff *actually* alleges, and not what the plaintiff *could have* alleged.¹⁸² In other words, the courts have refused to look beyond the allegations made in the plaintiff's complaint. *MDCM Holdings, Inc. v. Credit Suisse First Boston Corp.*¹⁸³ illustrates the importance of this distinction. In that case, Mortgage.com engaged Credit Suisse First Boston (CSFB) to act as its underwriter in an initial public offering of common stock.¹⁸⁴ The underwriting agreement provided that CSFB would be entitled to compensation equal to 7% of the IPO's proceeds.¹⁸⁵ The IPO price was \$8 per share, but the trading price increased very rapidly, doubling in value within two weeks.¹⁸⁶ Eventually, however, Mortgage.com went out of business.¹⁸⁷

MDCM Holdings (MDCM), the successor to Mortgage.com, sued CSFB on behalf of the issuers that had engaged CSFB as an underwriter during a two-and-a-half year period.¹⁸⁸ MDCM contended that CSFB had engaged in "laddering"—a practice in which an underwriter purposely undervalues the price of an issuer's public offering of stock and then requires the underwriter's customers who purchased that stock at the low IPO price to pay to the underwriter a share of the substantial profits realized when the customers "flip" the stock on the open market at a much higher price.¹⁸⁹ According to MDCM, issuers that had engaged CSFB were harmed by this behavior because the purposeful underpricing of the IPO price deprived them of a substantial amount of funds that could have been raised in the public offering.¹⁹⁰

MDCM's complaint contained four separate counts: (1) breach of contract, (2) breach of good faith and fair dealing, (3) breach of fiduciary duties, and (4) unjust enrichment.¹⁹¹ Essentially, MDCM alleged that CSFB's laddering was a breach of the underwriting agreement because CSFB did

182. See, e.g., *Green v. Ameritrade, Inc.*, 279 F.3d 590, 599 (8th Cir. 2002) (rejecting the defendant's argument that SLUSA was triggered because the complaint "implicitly" alleged a fraud claim); *Norman v. Salomon Smith Barney, Inc.*, 2004 U.S. Dist. LEXIS 10619, at *13 (S.D.N.Y. June 8, 2004) (stating that "[t]he fact that the actions underlying the alleged breach could also form the factual predicate for a securities fraud action by different plaintiffs cannot magically transform every dispute between broker-dealers . . . into a federal securities claim"); *Arlia v. Blankenship*, 234 F. Supp. 2d 606, 608-13 (S.D. W. Va. 2002) (refusing to look behind plaintiff's allegations to change a derivative action that would be preserved to a securities fraud action that would be preempted); *MDCM Holdings, Inc. v. Credit Suisse First Boston Corp.*, 216 F. Supp. 2d 251, 257 n.12 (S.D.N.Y. 2002) (stating that "the determination of whether SLUSA applies may only be made by reference to what a party has alleged, and not what it could have alleged") (emphasis omitted); *Lazar v. Gregerson*, No. C-02-0652, 2002 U.S. Dist. LEXIS 6152, at *11 (N.D. Cal. Apr. 5, 2002) (rejecting the defendant's "invitation to recast" the plaintiff's allegations of a claim that was preserved under the Delaware carve-out as a securities fraud claim that would be preempted).

183. 216 F. Supp. 2d 251 (S.D.N.Y. 2002).

184. *Id.* at 253.

185. *Id.* at 254.

186. *Id.*

187. *Id.* at 255 n.6.

188. *Id.* at 254.

189. See *id.* at 253-54 nn.3 & 5.

190. *Id.* at 254.

191. See *id.* at 252.

not sell the shares to the public as required by the agreement, but instead sold the shares to certain favored customers.¹⁹² In addition, MDCM alleged that by underpricing the offering, CSFB performed deficient underwriting services in violation of its covenant of good faith and its fiduciary duties, which would unjustly enrich CSFB.¹⁹³ CSFB moved to dismiss the complaint, arguing that MDCM's state law claims were preempted by SLUSA.¹⁹⁴ The district court disagreed.¹⁹⁵

The district court began its analysis by setting forth the four element test for SLUSA.¹⁹⁶ It then noted that the test was not met because the plaintiff had not alleged that the defendant had made a misrepresentation or omission.¹⁹⁷ According to the court, MDCM's complaint alleged only that CSFB "signed numerous contracts in which it promised to do one thing but then did another."¹⁹⁸ In other words, MDCM's complaint had not alleged that CSFB misrepresented a material fact, or omitted to state a material fact. As the court noted:

The requirement that courts look at what the party is alleging is particularly important given that the facts underlying a complaint may often give rise to multiple allegations (e.g., fraud, misrepresentation, and breach of contract). Because the determination of whether SLUSA applies may only be made by reference to what a party has alleged, and not what it could have alleged, courts should be wary of a defendant's attempts to recast the plaintiff's complaint as a securities lawsuit in order to have it preempted by SLUSA.¹⁹⁹

The court rejected CSFB's criticism that it was permitting the plaintiff's labeling of his claims to decide whether SLUSA applied. It distinguished the *MDCM* case from other labeling cases, pointing out that the cases cited by CSFB—including the *Korsinsky* case discussed above²⁰⁰—had involved "explicit" allegations of misrepresentations or omissions.²⁰¹ According to the court, "[i]n none of those cases was it necessary for the court to rewrite the plaintiff's allegations by adding misrepresentation or fraud to the complaint."²⁰² Therefore, MDCM's claims were not preempted. Interesting enough, two years later the same judge came to the opposite conclusion in a case involving a strikingly similar fact pattern, holding that courts must look

192. *Id.* at 255.

193. *Id.*

194. *Id.*

195. *Id.*

196. *Id.* at 256; *see supra* note 164 and accompanying text.

197. *Id.* at 256.

198. *Id.* at 257.

199. *Id.* at 257 n.12 (emphasis omitted).

200. *See supra* notes 145-150 and accompanying text.

201. *MDCM Holdings*, 216 F. Supp. 2d at 257.

202. *Id.* at 257-58.

beyond the plaintiff's actual allegations to determine whether SLUSA is triggered.²⁰³

2. *Cases Looking Beyond the Plaintiff's Actual Allegations to Determine Whether SLUSA Is Triggered*

A case in the influential Southern District of New York recently held that courts should look beyond the plaintiff's actual allegations to determine whether SLUSA applies.²⁰⁴ This approach is seen in *Xpedior Creditor Trust v. Credit Suisse First Boston (USA), Inc.*²⁰⁵ Xpedior Creditor Trust, the successor to Xpedior, Inc., sued Credit Suisse First Boston for underpricing its IPO, thereby breaching the underwriting agreement and violating its fiduciary duties as a broker-dealer.²⁰⁶ CSFB removed the case to district court and moved to dismiss the action under SLUSA.²⁰⁷ The plaintiff argued that SLUSA did not apply because his complaint—like the complaint in *MDCM*²⁰⁸—did not actually allege that CSFB made a misrepresentation or omission of material fact.²⁰⁹ The court conceded that the plaintiff's complaint did not contain express allegations of misrepresentations or omissions, but concluded that the complete preemption doctrine required the court to look beyond the plaintiff's allegations to determine if SLUSA applied.²¹⁰

According to the *Xpedior* district court, the Second Circuit in *Spielman v. Merrill Lynch, Pierce, Fenner & Smith, Inc.*²¹¹ held that SLUSA completely preempts certain state securities class actions.²¹² Since the complete preemption doctrine provides an exception to the well-pleaded complaint rule,²¹³ the district court reasoned that it was required to look behind the

203. See *infra* Part III.B.2.

204. See *Xpedior Creditor Trust v. Credit Suisse First Boston, Inc.*, No. 02CIV9149, 2004 U.S. Dist. LEXIS 3703 (S.D.N.Y. Mar. 9, 2004).

205. *Id.*

206. *Id.* at *2-*3.

207. *Id.* at *3.

208. For further discussion of *MDCM*, see *supra* notes 183-202 and accompanying text.

209. *Id.* at *13.

210. *Id.* at *13-*15.

211. 332 F.3d 116 (2d Cir. 2003). In *Spielman*, a plaintiff sued Merrill Lynch, Pierce, Fenner & Smith, contending that Merrill Lynch misled certain of its account holders to believe that they would not be charged a transaction fee, when in fact Merrill Lynch imposed a fee. *Id.* at 120. The plaintiff's state law claims included breach of contract, breach of the implied covenant of good faith and fair dealing, and violation of New York's deceptive trade practices statute, as well as fraud and negligent misrepresentation under state law. *Id.* at 121. After reviewing SLUSA and the complete preemption doctrine, the Second Circuit held that

Congress could not have spoken more clearly. The clear and unambiguous language [of SLUSA] convinces us that SLUSA was intended to completely preempt the field of certain types of securities class actions by essentially converting a state law claim into a federal claim and creating federal jurisdiction and venue for specified types of state securities fraud claims.

Id. at 123 (emphasis omitted). As demonstrated below, I believe that *Spielman*'s holding that SLUSA triggered the complete preemption doctrine was wrongly decided. See *infra* Part IV.B.2.

212. *Xpedior Creditor Trust*, 2004 U.S. Dist. LEXIS 3703, at *15.

213. See *supra* Part II.B.4.

plaintiff's allegations.²¹⁴ As the court stated, "[a]fter *Spielman*, it is now clear that courts must probe the plaintiff's pleading to determine whether SLUSA preemption applies."²¹⁵ However, because *Spielman* provides no guidance as to "how broad a brush a court should wield in rewriting a complaint,"²¹⁶ the *Xpedior* court had to develop a test that would help determine what the plaintiff's complaint actually alleged.²¹⁷

The district court adopted what it called the "necessary component" test.²¹⁸ According to the court, SLUSA preempts claims which have misrepresentations or omissions of material facts made in connection with the purchase or sale of a security as a "necessary component."²¹⁹ The court stated that "under the necessary component test, a complaint is preempted under SLUSA only when it asserts (1) an explicit claim of fraud (for example, common law fraud or fraudulent inducement), or (2) other garden-variety state law claims that "sound in fraud."²²⁰ According to the district court, a claim "sounds in fraud" when "although not an essential element of the claim, the plaintiff alleges fraud as an integral part of the conduct giving rise to the claim."²²¹

The court then applied the necessary component test to the *Xpedior* facts, concluding that none of the plaintiff's claims were preempted.²²² First, the court pointed out that none of the plaintiff's claims required misrepresentations or omissions as a necessary element.²²³ For example, in New York, a claim for breach of contract requires (1) a valid contract, (2) plaintiff's performance, (3) defendant's failure to perform, and (4) damages resulting from the breach.²²⁴ An examination of these elements indicates that a misrepresentation or omission is not a necessary component of a breach of contract claim. On the other hand, if a misrepresentation or omission is a required element of the claim, the claim is preempted, regardless of the allegations that the plaintiff actually made in the complaint.

Next, the court concluded that the plaintiff's claims did not sound in fraud.²²⁵ The court recognized that a contract claim might sound in fraud if the plaintiff alleged that the defendant entered into the agreement without an intention to perform its obligation under the contract, but noted that this was not the situation in *Xpedior*; the plaintiffs alleged only that CSFB violated

214. *Xpedior*, 2004 U.S. Dist. LEXIS 3703, at *15.

215. *Id.*

216. *Id.*

217. *Id.*

218. *Id.* at *16.

219. *Id.* As the court explained, "[r]egardless of the words used by plaintiffs in their complaints and regardless of the labels they paste on each claim, the question is whether a material misstatement or omission in connection with the purchase or sale of a covered security is a necessary component." *Id.* at *22.

220. *Id.* at *16.

221. *Id.* at *27.

222. *Id.* at *26.

223. *Id.*

224. See, e.g., *Furia v. Furia*, 498 N.Y.S.2d 12 (1986).

225. *Xpedior*, 2004 U.S. Dist. LEXIS 3703, at *26.

its contractual and fiduciary duties.²²⁶ Thus, the court determined that SLUSA had not been triggered, but in reaching this conclusion, the court looked beyond the allegations actually made in the complaint.²²⁷

C. *May Plaintiffs Plead Around SLUSA's Removal and Preemption Provisions?*

As discussed above, the courts have generally agreed that SLUSA applies when the defendant shows that (1) the suit is a “covered class action,” (2) the plaintiff’s claims are based on state law, (3) there has been a purchase or sale of a “covered security,” and (4) the plaintiff has alleged a misrepresentation or omission of a material fact “in connection with” the purchase or sale of such security.²²⁸ This means that a plaintiff may avoid SLUSA through careful pleading, by ensuring, for example, that the suit will not fit the definition of a “covered class action,” or by omitting allegations that the defendant’s conduct was “in connection with” the purchase or sale of a covered security. Some courts permit plaintiffs to plead around SLUSA in this manner, while other courts do not.

1. *Cases Not Permitting Plaintiffs to Plead Around SLUSA*

Several cases have not permitted the plaintiffs to plead around SLUSA.²²⁹ These courts have preempted the plaintiff’s action, even though the plaintiff’s complaint did not on its face fall within SLUSA’s removal and preemption provisions.²³⁰ To reach this result, the courts recharacterized the plaintiff’s complaint as one falling within SLUSA.²³¹

A good example of this approach can be found in *Bertram v. Terayon Communications Systems, Inc.*²³² In this case, Terayon Communications Systems allegedly disseminated false statements to the public concerning its business, including a false statement that its proprietary cable modem technology had been certified by CableLabs, the industry regulating organization. The plaintiff brought a class action in state court “on behalf of and for the benefit of members of the general public” who were harmed by Terayon’s fraudulent business practices and false advertising.²³³ The plaintiff claimed that this behavior violated the unfair business practices provi-

226. *See id.*, at *26-*29.

227. *Id.*

228. *See supra* note 164 and accompanying text.

229. *See, e.g.*, *Zoren v. Genesis Energy, L.P.*, 195 F. Supp. 2d 598, 605 (D. Del. 2002) (holding that SLUSA applies even though plaintiff did not seek damages); *Bertram v. Terayon Communications Sys., Inc.*, No. CV00-12653SVW (RZX), 2001 U.S. Dist. LEXIS 6215, at *1 (C.D. Cal. Mar. 29, 2001) (same); *Gibson v. PS Group Holdings, Inc.*, No. 00-CV-0372W (RBB), 2000 U.S. Dist. LEXIS 3158, at *1 (S.D. Cal. Mar. 8, 2000) (same).

230. *See supra* note 229.

231. *See id.*

232. No. CV00-12653 SVW (RZX), 2001 U.S. Dist. LEXIS 6215 (C.D. Cal. Mar. 29, 2001).

233. *Id.* at *1.

sion of California's Business and Professional Code,²³⁴ and sought equitable relief available under that statute, including restitution. The California statute did not permit plaintiffs to recover damages.²³⁵

Terayon removed the action, relying on SLUSA's specialized removal statute, and the plaintiff sought remand to state court. The plaintiff argued that his action should be remanded because it did not fall within SLUSA. The plaintiff pointed out that SLUSA permits removal and preemption of only *covered* class actions—which are class actions in which plaintiffs seek money damages²³⁶—and since his class action did not seek damages, it was not a covered class action.²³⁷ Therefore, the plaintiff reasoned, his action could not be removed. The court rejected this argument and dismissed the case.²³⁸

The court conceded that the removal and preemption provisions apply only to covered class actions, but would not permit the plaintiff to circumvent SLUSA simply by omitting a prayer for damages.²³⁹ The court reached this determination by examining the legislative intent of SLUSA, noting that SLUSA was enacted to stop plaintiffs from evading the Reform Act's procedural protections by bringing class actions in state, rather than federal, court.²⁴⁰ According to the court, permitting plaintiffs to avoid removal and preemption through “artful pleading” frustrates the primary purpose of SLUSA.²⁴¹ Because the court would not allow plaintiffs to “eviscerate” SLUSA in such a manner, it held that SLUSA's removal and preemption provisions applied, even though the action did not fall within SLUSA's statutory language.²⁴²

The legislative intent underlying SLUSA—foreclosing the circumvention of the procedural reforms contained in the Reform Act—is certainly an

234. California's statute regulating unfair business practices provides that [a]ny person who engages, has engaged, or proposes to engage in unfair competition may be enjoined in any court of competent jurisdiction. The court may make such orders or judgments, including the appointment of a receiver, as may be necessary to prevent the use or employment by any person of any practice which constitutes unfair competition, as defined in this chapter, or as may be necessary to restore to any person in interest any money or property, real or personal, which may have been acquired by means of such unfair competition.

CAL. BUS. & PROF. CODE § 17203 (West 2004).

“[U]nfair competition” is defined as including “any unlawful, unfair or fraudulent business act or practice and unfair, deceptive, untrue or misleading advertising and any act prohibited by Chapter 1 (commencing with Section 17500)” of California's Business and Professional Code. *See id.* § 17200.

235. *Bertram*, 2001 U.S. Dist. LEXIS 6215, at *10-*11.

236. For further discussion of the definition of “covered class actions,” see *supra* notes 85-89 and accompanying text.

237. *See Bertram*, 2001 U.S. Dist. LEXIS 6215, at *5-*6.

238. *Id.* at *6-*16.

239. *Id.* at *10-*11.

240. *Id.*

241. *Id.*

242. *Id.* The court also noted that the plaintiff's claim for restitution was indistinguishable from a claim for money damages, providing additional support for its holding that SLUSA applied. *Id.* at *8-*9. However, the court concluded that this was not dispositive to its holding that SLUSA applied to this action. According to the court, “even if the [p]laintiffs' claim omitted a claim for restitution, [p]laintiffs' state claims would still be a ‘covered class action.’” *Id.* at *11.

important reason why some courts have refused to allow plaintiffs to plead around SLUSA.²⁴³ In addition, many courts appear to have been influenced by the complete preemption doctrine.²⁴⁴ Interestingly enough, most of these courts do not explicitly rely on the doctrine in their holdings. Instead, a careful examination of these cases reveals that the courts discuss the complete preemption doctrine only at the beginning of their opinions, but then seemingly ignore the complete preemption doctrine when they actually analyze whether SLUSA is triggered.²⁴⁵ Because the complete preemption doctrine prohibits a plaintiff from pleading around a statute's application, it makes sense that these courts might see the doctrine as implicit support for their decisions. Since it is unlikely that a court would discuss a doctrine unless it is somehow significant to its analysis and holding, it is probable that these courts were influenced by the complete preemption doctrine in reaching the conclusion that plaintiffs may not plead around SLUSA.

2. Cases Permitting Plaintiffs to Plead Around SLUSA

Other courts, however, have permitted plaintiffs to plead around SLUSA.²⁴⁶ These courts have strictly construed SLUSA and have refused to expand it beyond the express language of the removal and preemption provisions.²⁴⁷ According to these courts, a plaintiff may avoid SLUSA simply by drafting his complaint so that it does not fall within SLUSA. Thus, plaintiffs have been able to plead around SLUSA by claiming that the defen-

243. See *supra* note 230.

244. See *Spielman v. Merrill Lynch, Pierce, Fenner & Smith, Inc.*, 332 F.3d 116, 123-24 (2d Cir. 2003); *Behlen v. Merrill Lynch*, 311 F.3d 1087, 1090 (11th Cir. 2002), *cert. denied*, 539 U.S. 927 (2003); *Falkowski v. Imation Corp.*, 309 F.3d 1123, 1128 (9th Cir. 2002); *Abada v. Charles Schwab & Co.*, 300 F.3d 1112, 1118-19 (9th Cir. 2002); *Green v. Ameritrade, Inc.*, 279 F.3d 590, 596 (8th Cir. 2002); *Winne v. Equitable Life Assurance Soc'y*, 315 F. Supp. 2d 404, 409 (S.D.N.Y. 2003); *Zoren v. Genesis Energy, L.P.*, 195 F. Supp. 2d 598, 602 (D. Del. 2002); *Gilmore v. MONY Life Ins. Co.*, 165 F. Supp. 2d 1276, 1278 (M.D. Ala. 2001); *Shaw v. Charles Schwab & Co.*, 128 F. Supp. 2d 1270, 1272 (C.D. Cal. 2001), *appeal dismissed*, 45 Fed. Appx. 651 (9th Cir. 2002); *Shaev v. Clafin*, No. C01-0009MJJ, 2001 U.S. Dist. LEXIS 6677, at *7 (N.D. Cal. May 21, 2001); *Simon v. Internet Wire, Inc.*, No. CV0013195CBM (RNBX), 2001 U.S. Dist. LEXIS 4086, at *4-*5 (C.D. Cal. Apr. 3, 2001). For further discussion of the complete preemption doctrine, see *supra* Part II.B.4.

245. A good example of this approach can be found in *Zoren v. Genesis Energy, L.P.*, 195 F. Supp. 2d 598 (D. Del. 2002). In that case, the plaintiff contended that an issuer's prospectus contained materially false statements. The plaintiff brought suit in state court for breach of fiduciary duty and breach of contract, and the defendant removed the case to federal court and then moved to dismiss the action as preempted by SLUSA. The district court dismissed the case. The court began its analysis by discussing the complete preemption doctrine, stating that the doctrine "holds that 'once an area of state law has been completely preempted, any claim purportedly based on that preempted state law is considered, from its inception, a federal claim, and therefore arises under federal law.'" *Id.* at 602 (citing *Franchise Tax Bd. v. Constr. Laborers Vacation Trust*, 463 U.S. 1, 24 (1983)). The court then moved into a discussion of the Reform Act and SLUSA, emphasizing that SLUSA's removal and preemption provisions should be read broadly to prevent the evasion of the Reform Act's procedural protections. *Id.* at 602-03. The court then applied the statute to determine whether SLUSA was triggered and rejected the plaintiff's argument that SLUSA was not triggered because he was seeking equitable relief, and not damages. *Id.* at 603-06. In reaching this conclusion, the court made no mention of the complete preemption doctrine.

246. See *infra* notes 248-50.

247. See *infra* notes 248-50.

dant's fraud induced the plaintiff class to hold their securities,²⁴⁸ by not seeking money damages,²⁴⁹ or by omitting allegations that the defendant made a misrepresentation or omission of material fact or engaged in fraudulent behavior.²⁵⁰

The "holding" cases are the most common example of courts permitting plaintiffs to plead around SLUSA.²⁵¹ For example, in *Gordon v. Buntrock*,²⁵² a plaintiff alleged that Waste Management, Inc. issued false press releases and other public documents.²⁵³ The plaintiff brought a class action in state court on behalf of shareholders who were defrauded into holding their Waste Management securities.²⁵⁴ The defendant removed the case and sought to have it dismissed under SLUSA.²⁵⁵ The plaintiff argued that SLUSA did not apply to non-purchasers and non-sellers of securities.²⁵⁶ The court agreed.²⁵⁷

The *Gordon* court noted that the Supreme Court in *Blue Chip Stamps* interpreted Rule 10b-5's "in connection with" element to require that the

248. See *Riley v. Merrill Lynch, Pierce, Fenner & Smith, Inc.*, 292 F.3d 1334, 1345 (11th Cir. 2002) (holding that SLUSA does not apply to holding claims); *Green v. Ameritrade, Inc.*, 279 F.3d at 598 (concluding that "nonsellers and nonpurchasers of securities are not covered by SLUSA's preemption provision"); *Grabow v. PricewaterhouseCoopers, L.L.P.*, 313 F. Supp. 2d 1152, 1155 (N.D. Okla. 2004) (same); *Meyer v. Putnam Int'l Voyager Fund*, 220 F.R.D. 127, 128-29 (D. Mass. 2004) (same); *Vogeler v. Columbia Acorn Trust*, No. 03-CV-0843-DRH, 2004 U.S. Dist. LEXIS 9182, at *7 (S.D. Ill. Feb. 12, 2004) (same); *Cape Ann Investors, L.L.C. v. Lepone*, 296 F. Supp. 2d 4, 11 (D. Mass. 2003) (same); *Ray v. Citigroup Global Mkts., Inc.*, No. 03C3157, 2003 U.S. Dist. LEXIS 20966, at *16-*17 (N.D. Ill. Nov. 26, 2003) (same); *Feitelberg v. Credit Suisse First Boston, L.L.C.*, No. C-03-3451SC, 2003 U.S. Dist. LEXIS 19116, at *14-*15 (N.D. Cal. Oct. 24, 2003) (same); *Dacey v. Morgan Stanley Dean Witter & Co.*, 263 F. Supp. 2d 706, 710-12 (S.D.N.Y. 2003) (same); *Chinn v. Belfer*, No. CV-02-00131-ST, 2002 U.S. Dist. LEXIS 20343, at *10 (D. Or. June 19, 2002) (same); *Hardy v. Merrill Lynch, Pierce, Fenner & Smith, Inc.*, 189 F. Supp. 2d 14, 18 (S.D.N.Y. 2001) (same); *Gutierrez v. Deloitte & Touche, L.L.P.*, 147 F. Supp. 2d 584, 592 (W.D. Tex. 2001) (same); *Spielman v. Merrill Lynch, Pierce, Fenner & Smith, Inc.*, No. 01CIV3013 (DLC), 2001 U.S. Dist. LEXIS 15943, at *7-*8 (S.D.N.Y. Oct. 9, 2001) (same), *appeal dismissed*, 332 F.3d 116 (2d Cir. 2003); *Shaev v. Clafflin*, No. C01-0009MJJ, 2001 U.S. Dist. LEXIS 6677, at *15 (N.D. Cal. May 21, 2001) (same); *Gordon v. Buntrock*, No. 00CV303, 2000 U.S. Dist. LEXIS 5977, at *3-*4 (N.D. Ill. May 3, 2000) (same).

249. See *Shen v. Bohan*, No. CV02-7268ABC, 2002 U.S. Dist. LEXIS 22485, at *5-*9 (C.D. Cal. Oct. 16, 2002) (holding that SLUSA did not apply because plaintiff did not seek monetary damages); *Wald v. C.M. Life Ins. Co.*, 2001 U.S. Dist. LEXIS 2593, at *16-*17 (N.D. Tex. Mar. 8, 2001) (same). *But see Zoren v. Genesis Energy, L.P.*, 195 F. Supp. 2d 598, 604 (D. Del. 2002) (holding that a plaintiff's prayer for damages is not necessary to trigger SLUSA); *Feitelberg v. Merrill Lynch & Co.*, No. C02-3072MHP, 2002 U.S. Dist. LEXIS 25714, at *13-*14 (N.D. Cal. Oct. 9, 2002) (holding that a plaintiff's claim for equitable remedies of disgorgement and restitution was the same as a claim for damages); *Bertram v. Terayon Communications Sys., Inc.*, No. CV00-12653, 2001 U.S. Dist. LEXIS 6215, at *5-*8 (C.D. Cal. Mar. 27, 2001) (same); *Patenaude v. Equitable Life Assurance Soc'y*, No. 00-CV-1437-K (JFS), 2000 U.S. Dist. LEXIS 22251, at *14-*15 (S.D. Cal. Oct. 11, 2000) (same), *aff'd on other grounds*, 290 F.3d 1020 (9th Cir. 2002); *Gibson v. PS Group Holdings, Inc.*, No. 00-CV-0372W (RBB), 2000 U.S. Dist. LEXIS 3158, at *9-*11 (S.D. Cal. Mar. 8, 2000) (same).

250. See, e.g., *Green v. Ameritrade, Inc.*, 279 F.3d 590 (8th Cir. 2002).

251. See *supra* note 248.

252. No. 00CV303, 2000 U.S. Dist. LEXIS 5977 (N.D. Ill. Apr. 28, 2000).

253. *Id.* at *3.

254. *Id.* at *2.

255. *Id.* at *2.

256. *Id.* at *8.

257. *Id.* at *13.

plaintiff actually purchased or sold securities.²⁵⁸ Under that interpretation, investors defrauded into retaining securities are not permitted to sue under Rule 10b-5.²⁵⁹ The court then reasoned that SLUSA's "in connection with" requirement must be interpreted in an identical manner, stating:

In enacting the Uniform Standards Act, Congress was aware of the interpretation of § 10b of the 1934 Act, which acknowledged that causes of actions for the "nonpurchase" or "nonsale" of securities were not covered by the 1934 Act, and that state law would fill those gaps. Congress could have expanded the scope of actions covered by the Uniform Standards Act by providing that actions alleging misrepresentations in connection with the failure to purchase or sell a covered security also shall be removable to federal court.²⁶⁰

In other words, according to the court, the plain language of the statute permits the plaintiff to craft his complaint to avoid triggering SLUSA.

Furthermore, most courts do not appear to draw a distinction between a complaint initially drafted to avoid SLUSA and a complaint later purposely amended to defeat SLUSA's application.²⁶¹ For example, in *Green v. Ameritrade, Inc.*,²⁶² Ameritrade, an online stock quotation service, advertised that it provided its subscribers with "real time, last sales information" for certain securities.²⁶³ The plaintiff subscribed to Ameritrade, but he even-

258. *Id.* at *8-*9. For further discussion of the Supreme Court's holding in *Blue Chip Stamps*, see *supra* note 28.

259. *Id.* at *9.

260. *Gordon*, 2000 U.S. Dist. LEXIS 5977, at *13.

261. In fact, several courts have invited the plaintiffs to amend their complaints to avoid SLUSA's application. *See, e.g.*, *Ray v. Citigroup Global Mkts., Inc.*, No. 03C3157, 2003 U.S. Dist. LEXIS 20966, at *18 (N.D. Ill. Nov. 20, 2003) (inviting the plaintiff to amend his complaint to avoid SLUSA's application); *Araujo v. John Hancock Life Ins. Co.*, 206 F. Supp. 2d 377, 384 (E.D.N.Y. 2002) (permitting an amended complaint that excised allegations that the defendant engaged in fraudulent conduct); *Gavin v. AT&T Corp.*, No. 01C2721, 2003 U.S. Dist. LEXIS 21552, at *11 (N.D. Ill. Nov. 26, 2003) (granting leave to amend a complaint to a state claim under federal securities laws); *Schuster v. Gardner*, 319 F. Supp. 2d 1159, 1162 (S.D. Cal. Jan. 9, 2003) (allowing the plaintiff to file an amended complaint in which he limited the putative class to "persons who held shares.>").

However a few courts have tried to draw a distinction between plaintiffs acting in good faith and bad faith. These courts have permitted courts to plead around SLUSA if there is no evidence that the plaintiff drafted his complaint for the purpose of avoiding SLUSA. *See Shen v. Bohan*, No. CV02-7268ABC (PJWX), 2002 U.S. Dist. LEXIS 22485, at *7 (C.D. Cal. Oct. 16, 2002) (remanding in part because "there is no evidence that the plaintiffs are fraudulently pleading to circumvent SLUSA"); *Chinn v. Belfer*, CV-02-001310-ST, 2002 U.S. Dist. LEXIS 20343, at *21 (D. Or. June 19, 2002) (remanding the case in part because "[n]o forum manipulation can be found where a plaintiff seeks to eliminate a federal claim that was pled inadvertently"); *In re Waste Management, Inc. Sec. Litig.*, 194 F. Supp. 2d 590, 596 (S.D. Tex. 2002) (remanding the case in part because "there is no allegation, no less any evidence, in this action that Plaintiffs are attempting to fraudulently plead around SLUSA to avoid removal"); *Wald v. C.M. Life Ins. Co.*, No. 3:00-CV2520-H, 2001 U.S. Dist. LEXIS 2593, at *17 (N.D. Tex. Mar. 8, 2001) (remanding the case in part because "there is simply no indication that Plaintiff is attempting to manipulate the system"). *See also CAD/CAM Publ'g, Inc. v. Archer*, No. 00-2413-IEG (CGA), 2001 U.S. Dist. LEXIS 5192, at *9 n.2 (S.D. Cal. Feb. 28, 2001) (stating that the "voluntary dismissal of their federal claims is hardly *prima facie* evidence of bad faith by plaintiffs").

262. 279 F.3d 590 (8th Cir. 2002).

263. *Id.* at 593.

tually came to believe that Ameritrade did not actually provide real-time quotations and contended that Ameritrade's information was stale, often several hours old.²⁶⁴ He brought an action in state court, claiming breach of contract, fraud by intentional misrepresentation, fraud by negligent misrepresentation, deceptive trade practices, and violation of Nebraska's Consumer Protection Act.²⁶⁵ Ameritrade removed the case and moved to dismiss, contending that it was preempted by SLUSA.²⁶⁶ The district court agreed that SLUSA applied, but permitted the plaintiff to amend his complaint.²⁶⁷

The plaintiff then filed an amended complaint, omitting all claims except the first—breach of contract.²⁶⁸ Additionally, the plaintiff revised the factual allegations contained in the complaint, removing all references to Ameritrade's false representation that it was offering real-time quotes.²⁶⁹ Instead, the plaintiff alleged that "Ameritrade [had] promised in the 'Real-Time Quote Agreement' that it would provide [Real-Time] information to subscribers, including Green, but failed to do so."²⁷⁰ In addition, the plaintiff omitted any reference to subscribers' reliance on the stale quotes to purchase or sell securities.²⁷¹ Thus, the amended complaint simply alleged that Ameritrade promised to provide real-time quotes, Ameritrade did not provide that information, and Ameritrade therefore breached the Real-Time Quote Agreement.²⁷²

Following the filing of the amended complaint, Ameritrade once again moved to dismiss.²⁷³ And, once again, the district court refused to do so, holding that the amended complaint did not allege that Ameritrade had made a misrepresentation or omission of a material fact.²⁷⁴ Therefore, SLUSA did not apply.²⁷⁵ The district court remanded the case to state court, and Ameritrade appealed.²⁷⁶

In affirming the district court holding, the Eighth Circuit held that SLUSA did not apply because the plaintiff's amended complaint did not allege that Ameritrade's behavior was "in connection with" the purchase or sale of a security.²⁷⁷ The court noted that the original complaint did contain an allegation that members of the class relied on Ameritrade's quotes to purchase and sell securities, but that the amended complaint did not.²⁷⁸ Ac-

264. *See id.* at 593-94.

265. *Id.* at 594.

266. *Id.*

267. *Id.*

268. *Id.*

269. *See id.*

270. *Id.*

271. *Id.*

272. *Id.*

273. *Id.*

274. *See id.*

275. *Id.*

276. *Id.*

277. *See id.* at 599.

278. *Id.* at 598.

According to the court, the plaintiff's amended complaint "alleges no sale or purchase of a covered security, only that he did not receive the type of information from Ameritrade for which he believed he had contracted and paid twenty dollars monthly."²⁷⁹ The court rejected Ameritrade's argument that the court should preempt the case because the plaintiff should not be permitted to avoid SLUSA through artful pleading.²⁸⁰ According to the court, the plaintiff's complaint had not merely been re-labeled as a breach of contract claim.²⁸¹ Instead, it was a breach of contract claim—because the plaintiff had removed all other allegations—leaving only a breach of contract case behind.²⁸² The fact that the plaintiff deliberately amended his complaint to avoid triggering SLUSA was not at all significant to the Eighth Circuit.

D. How Should SLUSA's "In Connection With" Requirement Be Interpreted?

SLUSA provides that a claim is preempted when a plaintiff alleges that there has been a misstatement or omission of material fact "in connection with" the purchase or sale of a covered security.²⁸³ However, because Congress did not define SLUSA's "in connection with" requirement, courts addressing SLUSA's preemptive scope have had to determine the meaning of this element.

In general, courts have determined that SLUSA's "in connection with" element should be interpreted in the same way as Rule 10b-5's "in connection with" element.²⁸⁴ The courts have reasoned that analogizing to Rule 10b-5 is appropriate because the phrase "in connection with" is a term of art, and Congress must have been aware of the terminology and meaning attached to it at the time SLUSA was enacted. As the Eleventh Circuit reasoned:

279. *Id.*

280. *Id.* at 599.

281. *See id.*

282. *See id.*

283. *See supra* note 78 and accompanying text.

284. *See Behlen v. Merrill Lynch*, 311 F.3d 1087, 1093 (11th Cir. 2002) (holding that SLUSA's "in connection with" element and Rule 10b-5's "in connection with" element are identical), *cert. denied*, 539 U.S. 927 (2003); *Falkowski v. Imation Corp.*, 309 F.3d 1123, 1129 (9th Cir. 2002); *Riley v. Merrill Lynch, Pierce, Fenner & Smith, Inc.*, 292 F.3d 1334, 1342-43 (11th Cir. 2002); *Green v. Ameritrade, Inc.*, 279 F.3d 590, 597 (8th Cir. 2002) (same); *Grabow v. PricewaterhouseCoopers, L.L.P.*, 313 F. Supp. 2d 1152, 1155 (N.D. Okla. 2004) (same); *Kingdom 5-KR-41, Ltd. v. Star Cruises PLC*, No. 01CIV2946 (DLC), 2004 U.S. Dist. LEXIS 3527, at *13 (S.D.N.Y. Mar. 9, 2004) (same); *Rowinski v. Salomon Smith Barney, Inc.*, No. 3:02CV2014, 2003 U.S. Dist. LEXIS 20918, at *8 (M.D. Pa. Nov. 20, 2003) (same); *Burns v. Prudential Sec., Inc.*, 218 F. Supp. 2d 911, 916 (N.D. Ohio 2002) (same); *Araujo v. John Hancock Life Ins. Co.*, 206 F. Supp. 2d 377, 382 (E.D.N.Y. 2002) (same); *Feitelberg v. Merrill Lynch & Co., Inc.*, 234 F. Supp. 2d 1043, 1052 (N.D. Cal. 2002) (same), *aff'd*, 353 F.3d 765 (9th Cir. 2003); *Gutierrez v. Deloitte & Touche, L.L.P.*, 147 F. Supp. 2d 584, 595 (W.D. Tex. Mar. 19, 2001) (same); *McCullagh v. Merrill Lynch & Co.*, No. 01CIV3722, 2002 U.S. Dist. LEXIS 3758, at *8 (S.D.N.Y. Mar. 5, 2002) (same); *Shaev v. Claffin*, No. C01-0009MJJ, 2001 U.S. Dist. LEXIS 6677, at *13-14 (N.D. Cal. May 16, 2001) (same); *Gordon v. Buntrock*, No. 00CV303, 2000 U.S. Dist. LEXIS 5977, at *13 (N.D. Ill. Apr. 28, 2000) (same).

In using the phrase “in connection with the purchase or sale of a covered security,” Congress was not creating language from a vacuum; instead it was using language that, at the time of SLUSA’s enactment, had acquired settled, and widely-acknowledged meaning in the field of securities law, through years of judicial construction in the context of § 10b-5 lawsuits. Under these circumstances, we must presume that Congress intended the phrase “in connection with the purchase or sale of a covered security” to have the same meaning in SLUSA that it has in § 10b-5.²⁸⁵

Of course, a conclusion that SLUSA’s “in connection with” requirement should be construed identically to Rule 10b-5 is only the first step in determining whether the element is satisfied for SLUSA purposes. Rule 10b-5’s “in connection with” requirement is difficult to apply, to say the least.²⁸⁶ Unfortunately, these interpretative difficulties now extend to SLUSA. Therefore, just as in Rule 10b-5 cases, courts analyzing SLUSA’s “in connection with” requirement have asked whether the defendant’s fraud caused the plaintiff to purchase or sell a security and whether the defendant’s misrepresentation concerns the value or quality of the security.²⁸⁷ In essence, the courts have had to decide whether SLUSA’s “in connection with” requirement should be interpreted broadly or narrowly. Aside from the “holding” cases discussed above,²⁸⁸ most courts have adopted a broad interpretation of the “in connection with” requirement, thereby expanding SLUSA’s preemptive force.²⁸⁹

285. See *Riley*, 292 F.3d at 1342-43.

286. See *supra* Part II.A.1.

287. A number of cases have held that the “in connection with” requirement was met because the misrepresentation concerned the value or quality of a security. See *Rowinski*, 2003 U.S. Dist. LEXIS 20918, at *10 n.4; *Dacey v. Morgan Stanley Dean Witter & Co.*, 263 F. Supp. 2d 706, 710 (S.D.N.Y. 2003); *Winne v. Equitable Life Assurance Soc’y*, 315 F. Supp. 2d 404, 412 (S.D.N.Y. 2003); *Gray v. Seaboard Sec., Inc.*, 241 F. Supp. 2d 213, 220 (N.D.N.Y. 2003); *Araujo v. John Hancock Life Ins. Co.*, 206 F. Supp. 2d 377, 383 (E.D.N.Y. 2002); *Kenneth Rothschild Trust v. Morgan Stanley Dean Witter*, 199 F. Supp. 2d 993, 1003 (C.D. Cal. 2002); *Feitelberg*, 234 F. Supp. 2d at 1052 (N.D. Cal. 2002); *McCullagh*, 2002 U.S. Dist. LEXIS 3758, at *8-*9; *Korshinsky v. Salomon Smith Barney, Inc.*, No. 01-CIV6085, 2002 U.S. Dist. LEXIS 259, at *11 (S.D.N.Y. Jan. 9, 2002).

Several other cases have held that the “value” test is the appropriate test, but determined that the “in connection with” requirement was not met because the misrepresentation did not concern the value of a security. See *French v. First Union Sec., Inc.*, 209 F. Supp. 2d 818, 827-28 (M.D. Tenn. 2002) (holding that the misrepresentations concerned the choice of broker, and not the value of a security); *Shaw v. Charles Schwab & Co.*, 128 F. Supp. 2d 1270, 1274 (C.D. Cal. 2001) (holding that the misrepresentations concerned the efficacy of a broker’s trading system, and not the value of a security); *Spielman v. Merrill Lynch, Pierce, Fenner & Smith, Inc.*, No. 01CIV3013 (DLC), 2001 U.S. Dist. LEXIS 15943, at *10-*16 (S.D.N.Y. Oct. 9, 2001) (holding that the misrepresentations concerned the amount of fees charged by a broker, and not the value of a security), *appeal dismissed*, 332 F.3d 115 (2d Cir. 2003); *Abada v. Charles Schwab & Co.*, 127 F. Supp. 2d 1101, 1103 (S.D. Cal. 2000) (holding that the misrepresentations concerned the relationship with a broker, and not the value of a security).

288. See *supra* notes 248-54 and accompanying text.

289. As an example, defendants in several recent cases have argued that SLUSA’s “in connection with” requirement should be interpreted to reach situations where the plaintiff has held his securities, but a third party has made a purchase or sale of a covered security. See *In re Alger*, 2004 U.S. Dist. LEXIS 10001, at *11 (D. Md. June 2, 2004); *Grabow*, 313 F. Supp. 2d at 1156-57; *Meyer v. Putnam Int’l Voy-*

A review of the cases indicates that courts have seized upon language appearing in Rule 10b-5 cases that encourages courts to interpret the “in connection with” element broadly.²⁹⁰ Specifically, the courts often cite language that the requirement should be construed “not technically and restrictively, but flexibly to effectuate its remedial purposes.”²⁹¹ These courts then reason that SLUSA’s “in connection with” element should therefore also be interpreted broadly. For example, in *Rowinski v. Salomon Smith Barney, Inc.*,²⁹² a plaintiff brought suit against Salomon Smith Barney, contending that the research and analysis services it offered to retail customers were biased by its investment banking relationships with the corporations it covered. According to the plaintiff, “SSB charged its customer clients a premium for providing a valuable product: objective analysis, but it actually provided them with another, valueless product: biased research.”²⁹³ The plaintiff filed a class action in state court for breach of contract, unjust enrichment, and violation of the state deceptive practices act.²⁹⁴

SSB removed the action, arguing that the plaintiff’s case was preempted by SLUSA.²⁹⁵ In response, the plaintiff contended that the “in connection with” requirement was not met because he did not actually allege in his complaint that SSB’s biased research induced him to purchase or sell securities.²⁹⁶ Instead, the plaintiff alleged simply that he had contracted and paid for objective research, but that SSB had provided biased research.²⁹⁷ Therefore, according to the plaintiff, the “in connection with” element had not been satisfied.²⁹⁸

The district court disagreed. It began its analysis by noting that: “[t]he United States Supreme Court has cautioned that the ‘in connection with’ language in section 10(b) should be construed, not technically and restrictively, but flexibly in order to include both typical and novel forms of

ager Fund, 220 F.R.D. 127, 129 (D. Mass. Jan. 27, 2004). Although two of these courts rejected that argument, one court has deferred its ruling until a later stage of the proceeding. See *In re Alger*, 2004 U.S. Dist. LEXIS 10001, at *16-*17.

290. See *Falkowski v. Imation Corp.*, 309 F.3d 1123, 1129 (9th Cir. 2002); *Dacey*, 263 F. Supp. 2d at 710; *Araujo*, 206 F. Supp. 2d at 383; *Feitelberg v. Merrill Lynch & Co.*, 234 F. Supp. 2d 1043, 1052, *aff’d*, 353 F.3d 765 (9th Cir. 2003); *McCullagh v. Merrill Lynch & Co.*, No. 01CIV7322, 2002 U.S. Dist. LEXIS 3758, at *9 (S.D.N.Y. Mar. 6, 2002); *Korshinsky*, 2002 U.S. Dist. LEXIS 259, at *11. Interestingly enough, the courts have not focused on SLUSA’s legislative history and its stated purpose of preventing evasion of the Reform Act as support for a broad interpretation of the “in connection with” requirement.

291. This language first appeared in *SEC v. Capital Gains Research Bureau*, 375 U.S. 180, 195 (1963), a case that did not interpret Rule 10b-5’s “in connection with” element, but has worked its way into the “in connection with” jurisprudence. With the Supreme Court citing this language in its most recent “in connection with” case, the language now appears to be firmly entrenched as a tool to interpret the “in connection with” requirement. See *SEC v. Zandford*, 535 U.S. 813, 819 (2002).

292. No. 3:02CV2014, 2003 U.S. Dist. LEXIS 20918 (M.D. Pa. Nov. 20, 2003).

293. *Id.* at *3.

294. *Id.*

295. *Id.*

296. *Id.* at *7.

297. *Id.*

298. *Id.*

fraud.”²⁹⁹ According to the court, there was an “obvious connection”³⁰⁰ between SSB’s fraudulent statements and the purchase and sale of securities because the “plaintiff would not be concerned with the accuracy of SSB’s analyst reports unless he intended to, and did, in fact, rely on them in deciding to purchase or sell stock.”³⁰¹ Thus, because the court applied a broad interpretation of the “in connection with” requirement, the state action was preempted.

IV. HOW SHOULD COURTS APPLY SLUSA’S REMOVAL AND PREEMPTION PROVISIONS?

As demonstrated above,³⁰² courts have struggled with SLUSA’s removal and preemption provisions. Some courts hold that SLUSA applies only to cases expressly bringing a “fraud” claim, and other courts find that SLUSA also applies to preempt claims grounded on non-fraud theories of liability. Some courts look to the allegations actually made in the complaint to determine whether SLUSA applies, while other courts look beyond the allegations made in the complaint. Some cases permit plaintiffs to plead around SLUSA, other cases do not. Moreover, most courts have had difficulty in interpreting SLUSA’s “in connection with” requirement. In this part, I try to clarify how SLUSA’s removal and preemption provisions should be applied. I begin by demonstrating that SLUSA is not limited to state securities fraud claims; the statute requires courts to examine the allegations actually made in the complaint to determine if SLUSA is triggered. If the complaint alleges a materially misleading statement in connection with the purchase or sale of a covered security, the action should be preempted, regardless of the theory of liability chosen by the plaintiff. Because I argue that SLUSA is triggered by the allegations actually made in the complaint, I reject those cases that have looked beyond the complaint to determine if the case is preempted. In addition, I demonstrate that plaintiffs should be permitted to avoid preemption through careful pleading. Thus, for example, a plaintiff should be able to avoid preemption if he alleges that the defendant’s fraud induced him to *hold*, rather than purchase or sell, his securities. Finally, I argue that SLUSA’s “in connection with” requirement should be narrowly construed in order to give proper consideration to federalism concerns.

299. *Id.* at *8 (internal quotations omitted).

300. *Id.* at *9.

301. *Id.* at *9.*10.

302. *See supra* Part III.

A. *SLUSA Applies to More Than Just Securities Fraud Claims*

SLUSA applies to more than just securities fraud claims. That conclusion is evident from the language of the statute, which does not limit preemption to securities fraud claims. Rather, it provides that

[n]o covered class action based upon the statutory or common law [fraud] of any State or subdivision thereof may be maintained in any State or Federal court by any private party *alleging*—

(A) a misrepresentation or omission of a material fact in connection with the purchase or sale of a covered security; or

(B) that the defendant used or employed any manipulative or deceptive device or contrivance in connection with the purchase or sale of a covered security.³⁰³

Thus, the plain language of the statute itself states that SLUSA is triggered by allegations, not by a plaintiff's characterization of those allegations or choice of legal theory. If the complaint contains allegations that the defendant made a materially misleading statement in connection with the purchase or sale of a covered security, then the action is preempted, regardless of whether it is styled as a breach of contract or breach of fiduciary duty claim. Therefore, cases holding that SLUSA preempts only cases alleging a theory of securities fraud are wrongly decided.³⁰⁴

Focusing on a complaint's allegations—as opposed to the theory of liability—is also entirely consistent with the goals underlying SLUSA. Congress enacted SLUSA to prevent plaintiffs from circumventing the Reform Act by filing securities fraud actions in state, rather than federal, court. In enacting SLUSA, Congress was aware of the danger that plaintiffs might try to circumvent SLUSA by exploiting possible loopholes in the legislation.³⁰⁵ In response, Congress carefully drafted the statute's language to cast a wide

303. Securities Act of 1933 § 16(b), 15 U.S.C. § 77k(b) (2000); Securities Exchange Act of 1934 § 28(f)(1), 15 U.S.C. § 78bb(f)(1) (2000) (emphasis added). For further discussion of SLUSA's preemption provision, see *supra* Part II.A.3.

304. For the same reason, cases holding that SLUSA preempts only claims requiring proof of scienter, see *supra* note 142, are wrongly decided. According to the plain language of the statute, SLUSA is triggered whenever a plaintiff alleges that the defendant made a misrepresentation or omission of material fact in connection with the purchase or sale of a covered security. There is no scienter requirement. Most courts have come to the same conclusion. See *id.*

305. The Senate Banking Committee Report confirms that Congress was concerned with just such an evasion. For example, in discussing the definition of "covered class action," the report states that while the Committee believes that it has effectively reached those actions that could be used to circumvent the reforms enacted by Congress in 1995 as part of the Private Securities Litigation Reform Act, it remains the Committee's intent that the bill be interpreted broadly to reach mass actions and all other procedural devices that might be used to circumvent the class action definition.

S. REP. NO. 105-182, at 8 (1998).

net. Congress must have known that if SLUSA provided, for example, that state securities fraud actions are preempted, plaintiffs would simply re-cast their complaints to omit an express count for securities fraud, perhaps suing for negligent misrepresentation or some other state claim that was not grounded in fraud. To prevent this kind of manipulation, Congress decided to focus on the *allegations* made in a plaintiff's complaint, rather than the plaintiff's *labeling* of the allegations. By providing that SLUSA is triggered by allegations, Congress expanded SLUSA's preemptive scope beyond state securities fraud claims.

*B. SLUSA Is Triggered by the Allegations
Actually Made in the Plaintiff's Complaint*

Since SLUSA's preemptive scope is not limited to securities fraud claims, courts need to determine what allegations are sufficient to trigger SLUSA. Courts should not look beyond the allegations contained in the complaint to determine if SLUSA applies. Instead, courts should examine the allegations actually made in the plaintiff's complaint.

*1. SLUSA's Plain Language Requires the Courts to Examine the
Actual Allegations Made in a Complaint*

As discussed above,³⁰⁶ SLUSA preempts claims *alleging* that the defendant made a misrepresentation or omission of material fact in connection with the purchase or sale of a covered security. The terms "allege" and "allegation" are widely understood in litigation; they signify statements affirmatively made by a plaintiff in a complaint.³⁰⁷ Therefore, SLUSA's plain language directs courts to examine the allegations actually made in the plaintiff's complaint to determine whether SLUSA applies. By choosing a term with such a settled meaning, Congress gave clear instructions to courts: SLUSA is triggered by allegations actually made by plaintiffs, not by allegations that could have been made.

If Congress wanted courts to look beyond the allegations actually made in the complaint, it could have easily drafted SLUSA to provide for that. For example, Congress could have drafted SLUSA to preempt all claims "arising out of" a misrepresentation or omission of a material fact in connection with the purchase or sale of covered security. Congress would certainly have been aware of this alternative; the "arising out of" test appears throughout civil litigation.³⁰⁸ Such expansive language would have required

306. See *supra* Part II.A.3.

307. For example, Black's Law Dictionary defines "allegation" as "the assertion, claim, declaration, or statement of a party to an action, made in a pleading, setting out what he expects to prove." BLACK'S LAW DICTIONARY 48 (6th ed. 1991). The term "allege" is defined as "to state, claim, assert, or charge." *Id.*

308. For example, the "arising out of" test is used to distinguish between compulsory and permissive counterclaims. See FED. R. CIV. P. 13(a) (stating that a counterclaim is compulsory if it "arises out of the

courts to look beyond the allegations made in the complaint. However, Congress did not choose such broad language. Instead, it made the decision to use the term “allege,” which means that SLUSA is not triggered unless the plaintiff actually alleges that the defendant made a materially misleading statement in connection with the purchase or sale of a covered security.

2. *The Complete Preemption Doctrine Does Not Apply to SLUSA*

Although the plain language of SLUSA directs courts to examine the allegations made in the plaintiff’s complaint to determine whether SLUSA applies, defendants regularly argue that the court should look beyond the allegations in the complaint. According to these defendants, even if the complaint does not actually allege a misrepresentation or omission in connection with the purchase or sale of a covered security, the court should preempt the case because the plaintiff is *really* bringing a disguised securities fraud claim. Several courts have reasoned that the complete preemption doctrine requires the court to look beyond the allegations contained in the plaintiff’s complaint.³⁰⁹ Unfortunately, this reasoning is flawed; the complete preemption doctrine does not apply to SLUSA.

In *Spielman v. Merrill Lynch, Pierce, Fenner & Smith, Inc.*, the Second Circuit held that the complete preemption doctrine applies to SLUSA.³¹⁰ This holding is erroneous for several reasons. First, the court failed to recognize that the complete preemption doctrine—an exception to the well-pleaded complaint rule—is a *removal* tool, used by courts to permit removal when there is no specialized removal statute.³¹¹ SLUSA contains a specialized removal provision, permitting the defendant to remove a state action where the plaintiff has alleged that the defendant made an untrue statement of material fact in connection with the purchase or sale of a covered security.³¹² Therefore, a defendant who believes SLUSA preempts the state law claims can remove the action under the SLUSA removal provision. It is not necessary for the court to resort to the complicated and difficult complete preemption analysis to remove the action; the specialized removal provision permits removal. In other words, if a statute contains a specialized removal provision, the complete preemption doctrine is not needed to remove the action.³¹³

transaction or occurrence that is the subject matter of the opposing party’s claim”).

309. See *supra* Part III.B.2.

310. 332 F.3d 116 (2d Cir. 2003). See also *supra* note 211 and accompanying text.

311. At least one judge has recognized that the complete preemption doctrine may not apply to SLUSA. See *Spielman*, 332 F.3d at 131-32 n.1. (Newman, J., concurring) (stating that “[a]rguably, in a case of this sort a court need not consider whether the criteria for complete preemption are met”).

312. See *supra* Part II.A.3.

313. As the Supreme Court has noted, “a state claim may be removed to federal court in only two circumstances—when Congress expressly so provides, such as in the Price-Anderson Act . . . or when a federal statute wholly displaces the state-law cause of action through complete pre-emption.” *Beneficial Nat’l Bank v. Anderson*, 539 U.S. 1, 8 (2003).

Moreover, even assuming that the existence of a specialized removal provision does not preclude the complete preemption doctrine, courts should not apply the complete preemption doctrine in SLUSA cases because the doctrine is not triggered by SLUSA. The complete preemption doctrine is triggered if Congress intended the federal cause of action to be the *exclusive* cause of action.³¹⁴ According to the Second Circuit, SLUSA's "clear and unambiguous language" indicates that Congress intended Rule 10b-5 to completely preempt state law.³¹⁵ However, an examination of SLUSA actually demonstrates that Congress did not intend Rule 10b-5 to be the exclusive cause of action for *all* securities fraud claims. Rather, Congress carefully tailored SLUSA's preemption provision, preserving a wide variety of state claims that involve securities fraud.³¹⁶ In fact, the Second Circuit recognized this limitation itself, noting that Congress intended federal law to be the exclusive cause of action for "*certain* types of [state law based] securities . . . actions."³¹⁷ Since plaintiffs can continue to bring so many claims in state court, it cannot be said that Congress intended federal law to be the exclusive cause of action for securities fraud claims. Congress certainly intended that most securities fraud claims should be brought in federal court. However, it is just as clear that Congress envisioned that many state claims could continue to be brought in state court. Therefore, SLUSA does not trigger the complete preemption doctrine.

Similarly, it is quite strange to say that the complete preemption doctrine applies when Congress deliberately chose to include a specialized removal provision in SLUSA. By including a specialized removal provision, Congress clearly evidenced an intent to permit removal of cases alleging state law claims, but only claims falling within the express language of SLUSA's removal provision. If a court applies the complete preemption doctrine to SLUSA, SLUSA's carefully drafted removal and preemption provisions will be rendered moot. The preemptive scope of SLUSA would be dramatically increased, as courts could potentially preempt all sorts of claims that they determine to be securities fraud claims, whether or not the language of the statute is met. Conceivably, courts could even use the complete preemption doctrine to preempt claims that Congress expressly preserved, such as derivative actions and cases implicating the Delaware carve-out.³¹⁸ Courts should not apply the complete preemption doctrine to expand

314. See *supra* note 121 and accompanying text.

315. See *Spielman*, 332 F.3d at 123.

316. For example, plaintiffs can continue to bring individual claims, as well as derivative claims. Plaintiffs can even bring class actions if the Delaware carve-out applies. See *supra* notes 89-91 and accompanying text. Moreover, plaintiffs can continue to bring class actions in state court if they allege that the defendant's fraud caused them to hold, rather than purchase or sell, their securities. See *infra* notes 320-21 and accompanying text.

317. See *Spielman*, 332 F.3d at 123 (emphasis added).

318. In fact, several defendants have attempted to make a similar argument. See, e.g., *G.F. Thomas Invs., L.P. v. Cleco Corp.*, 317 F. Supp. 2d 673, 676 (W.D. La. 2004) (dismissing the plaintiff's first suit with the stipulation that the second suit would be brought under the Delaware carve-out, but the second suit failed to qualify under the Delaware carve-out and was dismissed). See also *Ctr. Laborer's Pension*

SLUSA's preemptive scope beyond what Congress intended. Instead, courts should look only to the allegations made in the plaintiff's complaint to determine if SLUSA is triggered.

C. Plaintiffs Should Be Able to Plead Around SLUSA

Plaintiffs should be allowed to carefully draft their complaints to avoid triggering SLUSA. At first glance, permitting plaintiffs to plead around SLUSA appears to be counterintuitive. After all, SLUSA's goal is to prevent plaintiffs from circumventing the Reform Act by playing procedural games. Careful pleading could be seen as yet another type of procedural game, but closer examination demonstrates that plaintiffs should be allowed to avoid preemption through careful pleading.

There are several reasons why plaintiffs should be able to avoid preemption through careful pleading. First, such an outcome flows naturally from the plain language of the statute. SLUSA reflects deliberate drafting choices. Congress chose to preempt "covered class actions" and chose to define covered class actions as actions for damages. Therefore, Congress must have been aware that actions for other kinds of relief, such as injunctive relief, would escape preemption. In addition, Congress chose to have SLUSA triggered by allegations, meaning that complaints not containing the appropriate allegations would escape preemption.³¹⁹ Similarly, Congress chose the phrase "in connection with" the purchase or sale of a security. In drafting SLUSA, Congress must have been aware that this phrase had been interpreted to exclude investors who had been defrauded into holding their securities.³²⁰ By choosing to use the "in connection with" language, Congress invited plaintiffs to avoid SLUSA by alleging that the defendant's materially misleading statement or fraud induced investors to hold their securities. If plaintiffs are not permitted to draft their complaints to avoid SLUSA, courts will essentially be rewriting the statute, ignoring Congress's careful tailoring of SLUSA's removal and preemption provisions.³²¹

Fund v. Chellgren, No. 02-220DLB, 2004 U.S. Dist. LEXIS 6066, at *8 (E.D. Ky. Mar. 29, 2004) (discussing the plaintiff's derivative action based on claims of poor corporate governance); Coykendall v. Kaplan, No. C02-02287CW, 2002 U.S. Dist. LEXIS 22483, at *4-*5 (N.D. Cal. Aug. 1, 2002) (stating that "Plaintiff seeks to remand this case to State court, asserting, among other things, that this action is an 'exclusively derivative action' and is therefore not a 'covered class action' under SLUSA"); Burekovitch v. Hertz, No. 01-CV-1277 (ILG), 2001 U.S. Dist. LEXIS 12173, at *15-*16 (E.D.N.Y. July 24, 2001) (stating that the Delaware carve-out did not save a breach of fiduciary duty claim from SLUSA preemption).

319. See *supra* Part IV.B.

320. See *supra* notes 27-28 and accompanying text.

321. Because pleading around SLUSA is an unavoidable consequence of the statute, a plaintiff who uses careful pleading to avoid SLUSA should not be branded with a scarlet "P." Some courts have exhibited a fair amount of hostility to plaintiffs who are viewed as pleading around SLUSA. At a certain level, some suspicion is understandable because of judicial concern that plaintiffs should not be able to evade the Reform Act. However, closer analysis reveals that such judicial hostility is misplaced. When Congress enacted SLUSA, it recognized that large numbers of state cases would not be preempted, including derivative actions and actions brought under the Delaware carve-out. A plaintiff who brings a derivative action avoids preemption under SLUSA, but that plaintiff is not ordinarily seen as manipulat-

Furthermore, permitting plaintiffs to plead around SLUSA will conserve scarce judicial resources. If plaintiffs are not permitted to avoid SLUSA by careful pleading, it is unclear how a court will determine whether a plaintiff is actually attempting to plead around SLUSA. Scarce judicial resources will be expended as courts will be forced to look behind a plaintiff's allegations to determine if the plaintiff is really bringing an action preempted by SLUSA. How will a court do this? In situations where the defendant is claiming that the plaintiff is pleading around SLUSA by choosing not to seek damages or by bringing a holding claim, the courts could simply adopt a blanket rule that SLUSA nonetheless applies. Although such an approach would be wrong for the reasons stated above,³²² at least it does not demand too much of the court's time.

However, if the defendant is claiming that the plaintiff has deliberately omitted allegations that the defendant made a materially misleading statement to avoid SLUSA, what will the court do? Is a failure to plead a misleading statement always impermissible? Is it only impermissible if the plaintiff omitted such allegations in bad faith?³²³ How would a court determine the definition of "bad faith"?³²⁴

In any case, how will a court determine whether this breach of contract claim is really a securities fraud claim in disguise? Although the district court in *Xpedior Creditor Trust v. Credit Suisse First Boston (USA), Inc.*³²⁵ claimed that its "necessary component" test could be "easily followed" by courts,³²⁶ I disagree. The first part of the test—which requires the court to examine the state law claims asserted by the plaintiff to determine if a misrepresentation or omission is a required element—is certainly straightforward. However, the second part of the test—which requires the court to determine if the state claim "sounds in fraud"—is convoluted. Adopting such a subjective test offers an invitation for all defendants to argue that the plaintiff's complaint sounds in fraud or that the gravamen of the plaintiff's

ing his pleading to evade SLUSA. How is it any different if a plaintiff alleges that the defendant made a materially misleading statement that caused investors to hold their stock? In both cases, Congress defined the parameters of SLUSA's preemptive scope, and in both cases SLUSA fails to reach the state action. If Congress does not approve of that outcome, it can amend the statute.

322. See *supra* notes 319-21 and accompanying text.

323. Several courts have tried to draw this distinction. See *supra* note 261.

324. What constitutes "bad faith" would seem to be particularly difficult to determine. Bad faith must mean something more than drafting a complaint to avoid SLUSA's application; otherwise, every plaintiff who carefully drafts his complaint would be acting in bad faith. At least one court has tried to draw a distinction between drafting a complaint to avoid SLUSA—which is ordinarily permissible—and drafting a complaint to *fraudulently* avoid SLUSA—which is impermissible. See *Shen v. Bohan*, No. CV02-7268ABC (PJWX), 2002 U.S. Dist. LEXIS 22485, at *4 (C.D. Cal. Oct. 17, 2002). However, the court did not explain what would make a plaintiff's actions fraudulent.

Moreover, the distinction should not be based on whether the plaintiff amended a complaint to omit language or remove allegations that would have triggered SLUSA. There does not seem to be any difference between a plaintiff's attorney who carefully drafts the initial complaint to avoid SLUSA and an attorney who was not quite as careful when filing the initial complaint, but who later realizes that he wants to avoid SLUSA and therefore amends his complaint. In both cases, the plaintiff wanted to avoid SLUSA.

325. No. 02CIV9149, 2004 U.S. Dist. LEXIS 3703 (S.D.N.Y. Mar. 9, 2004).

326. *Id.* at *23.

complaint is really fraud. If plaintiffs are not permitted to plead around SLUSA, courts will be forced to expend substantial resources to determine whether they should re-write the plaintiff's claim in order to preempt it.

Moreover, permitting plaintiffs to plead around SLUSA will not materially frustrate the statute's objectives. The vast majority of claims that Congress intended SLUSA to preempt—claims alleging that an issuer disclosed false corporate publicity causing investors to purchase or sell their securities³²⁷—will still be preempted. No matter how a plaintiff styles a false corporate publicity complaint, if the court focuses on the factual allegations—which, by definition, will have to include allegations that a company made a false or misleading statement—the action should be preempted.³²⁸

Finally, permitting plaintiffs to plead around SLUSA is consistent with the long history of strict construction of federal removal³²⁹ and express preemption statutes.³³⁰ Federal courts are quite sensitive to federalism concerns. Ordinarily, they will not choose to rewrite a plaintiff's complaint in order to expand the jurisdiction of federal courts and the supremacy of federal law. To preserve the proper balance between state and federal law, courts should not broaden the removal and preemption provisions of SLUSA. Instead, courts should simply construe the language of the statute as it was written by Congress, which permits plaintiffs to plead around SLUSA. Such an approach is consistent with the plain language of the statute, while demonstrating appropriate respect for federalism.

327. See *supra* notes 80-82 and accompanying text.

328. One commentator has argued that courts should not permit plaintiffs to plead around SLUSA by asserting holding claims. See Joshua D. Ratner, Comment, *Stockholders' Holding Claim Class Actions under State Law after the Uniform Standards Act of 1998*, 68 U. CHI. L. REV. 1035 (2001). He argues that courts should use the doctrine of obstacle preemption—which permits courts to preempt state law if it undermines the purpose of the federal law—to preempt holding claims. See *id.* at 1057-64. However, because Congress did not intend to preempt holding claims, see *supra* notes 318-21 and accompanying text, the doctrine of obstacle preemption should not be applied.

329. See *supra* notes 102-05 and accompanying text.

330. As one commentator has explained:

“Express” preemption occurs when a federal statute includes a preemption clause explicitly withdrawing specified powers from the states. Judges confronted with such a clause face a two-fold task: They must decide what the clause means, and they must decide whether the Constitution permits Congress to bar the states from exercising the powers in question. The Court has indicated that in discharging the first part of this task, judges should apply some version of a presumption against preemption; the Court favors “a narrow reading” of express preemption clauses, at least when the states’ traditional powers to legislate for the general health, safety, and welfare are at stake.

Caleb Nelson, *Preemption*, 86 VA. L. REV. 225, 226-27 (2000). Although courts continue to regularly state that there is a presumption against preemption, some academics believe that this presumption is actually more “ceremonial” than real. See Calvin Massey, “Joltin’ Joe Has Left and Gone Away”: *The Vanishing Presumption Against Preemption*, 66 ALB. L. REV. 759, 759 (2003). See also Susan Raeker-Jordon, *A Study in Judicial Sleight of Hand: Did Geier v. American Honda Motor Co. Eradicate the Presumption Against Preemption?*, 17 BYU J. PUB. L. 1 (2002). This constitutional discussion is beyond the scope of this Article.

*D. SLUSA's "In Connection With" Requirement
Should Be Narrowly Construed*

SLUSA's "in connection with" requirement should be narrowly construed. Narrow construction will ensure that appropriate consideration is given to federalism concerns, while still advancing the policies underlying SLUSA.

*1. Courts Should Consider the Policies Underlying SLUSA in
Interpreting SLUSA's "In Connection With" Requirement*

As the vast majority of cases have concluded, SLUSA's "in connection with" requirement should be interpreted in the same manner as Rule 10b-5's "in connection with" requirement.³³¹ This conclusion is relatively easy to reach. The "in connection with" requirement is a term of art, and Congress must have been aware of the significance of the term when it chose to include the phrase in SLUSA.³³² Therefore, Rule 10b-5's "in connection with" jurisprudence should be imported into SLUSA.

In determining whether Rule 10b-5's "in connection with" requirement is satisfied, courts have considered whether its policies are furthered if Rule 10b-5 is applied to the case at hand.³³³ Because courts construing SLUSA's "in connection with" requirement should refer to Rule 10b-5 for guidance,³³⁴ courts interpreting SLUSA should also consider policy issues. Most courts, however, have failed to examine policy considerations in interpreting SLUSA's "in connection with" requirement. Moreover, the cases that *have* discussed policy consider the wrong policies.

The cases that consider policy in analyzing SLUSA's "in connection with" requirement mistakenly examine the policies driving Rule 10b-5: investor protection and market integrity.³³⁵ These are certainly the correct policies to study in determining whether the "in connection with" requirement is met for Rule 10b-5 purposes, but they are not the correct policies for determining whether the "in connection with" requirement has been met for SLUSA purposes. After all, SLUSA was not enacted to further investor protection or to promote market integrity. Instead, its stated objective is to prevent plaintiffs from evading the protections of the Reform Act by filing actions in state, rather than federal, court.³³⁶

In addition to focusing on the wrong policies, courts have compounded this error by leaping to the conclusion that SLUSA's "in connection with" requirement should be broadly construed. Courts have consistently held that Rule 10b-5's "in connection with" requirement should be construed, not

331. See *supra* Part III.D.

332. See *supra* notes 27-28 and accompanying text.

333. See *supra* notes 37-61 and accompanying text.

334. See *supra* notes 254-55 and accompanying text.

335. See *supra* note 38 and accompanying text.

336. See *supra* note 77 and accompanying text.

technically and restrictively, but flexibly in order to promote Rule 10b-5's goals of investor protection and market integrity.³³⁷ SLUSA courts have mistakenly seized on this language to hold that SLUSA's "in connection with" requirement should also be broadly interpreted. Because the policies underlying SLUSA and Rule 10b-5 are quite different, the conclusion that SLUSA's "in connection with" requirement should be broadly construed simply because Rule 10b-5's "in connection with" requirement is broadly construed does not necessarily follow.³³⁸ Broad construction of Rule 10b-5's "in connection with" requirement may be necessary to promote Rule 10b-5's policies. However, it is not necessary to broadly construe SLUSA's "in connection with" requirement in order to further its policies, especially since SLUSA implicates other important policies, including federalism.

2. *Courts Should Consider Federalism Concerns in Interpreting SLUSA's "In Connection With" Requirement*

Once a court identifies the correct policy underlying SLUSA—preventing the circumvention of the Reform Act—it could simply point to that policy and then decide to construe SLUSA's "in connection with" requirement broadly to effectuate that purpose. Such an approach, however, would be misguided. It is true that preventing the evasion of the Reform Act is an important federal policy.³³⁹ However, there is another competing federal policy that is just as important: federalism. That policy is so strong that removal and preemption provisions are generally narrowly construed to ensure that federal law does not unduly interfere with state law.³⁴⁰ Moreover, SLUSA itself evidences a concern for federalism.³⁴¹ Unfortunately, courts interpreting SLUSA's "in connection with" requirement have overlooked the significance of this important policy.

This is demonstrated by *Rowinski v. Salomon Smith Barney, Inc.*,³⁴² discussed above.³⁴³ The plaintiff contended that Salomon Smith Barney analysts provided biased reports to their retail customers. The court held that SLUSA's "in connection with" requirement was met mainly because it concluded that the "in connection with" requirement should be construed broadly.³⁴⁴ In reaching this conclusion, the court did not appear to be concerned that preempting the plaintiff's claim would frustrate several impor-

337. See *supra* notes 49-50 and accompanying text.

338. One court has recognized this distinction. See *Shaw v. Charles Schwab & Co.*, 128 F. Supp. 2d 1270, 1274 (C.D. Cal. 2001) (refusing "to read [SLUSA's 'in connection with'] requirement as broadly as it would be obliged to in the Section 10(b) context").

339. See *supra* note 77 and accompanying text.

340. See *supra* notes 102-05 and accompanying text.

341. This concern is reflected in the express provisions that preserve certain state actions, including derivative actions and actions based on the Delaware carve-out. See *supra* notes 89-91 and accompanying text.

342. No. 3:02CV2014, 2003 U.S. Dist. LEXIS 20918 (M.D. Pa. Nov. 20, 2003).

343. See *supra* notes 292-97 and accompanying text.

344. *Rowinski*, 2003 U.S. Dist. LEXIS 20918, at *8-*9.

tant state policies. For example, by preempting the plaintiff's case, the court essentially permitted SSB to violate Pennsylvania's Unfair Trade Practices and Consumer Protection Law.³⁴⁵

This type of unfair trade practice statute reflects a state's legitimate concern for its consumers. As one court noted, the "basic policy [behind these statutes] is to ensure an equitable relationship between consumers and persons engaged in business."³⁴⁶ An examination of the statutes indicates that most states consider protecting consumers from deceptive trade practices to be an important policy.³⁴⁷ Not only is the language of these statutes extremely broad,³⁴⁸ but the majority of state statutes provide financial motivation for private enforcement by awarding treble damages and attorneys fees for successful actions.³⁴⁹ Because of this strong state policy, courts generally construe consumer protection statutes broadly.³⁵⁰ Thus, when an action for a violation of a state unfair trade practice act is preempted, a significant state policy is frustrated. But even more disturbingly, courts have frustrated this policy without any discussion or analysis whatsoever.

I am not advocating that state policies should necessarily trump preemption. In interpreting SLUSA's "in connection with" requirement, courts should certainly consider the federal interest in preventing evasion of the Reform Act. I am only suggesting that courts should also consider the importance of state policies that might be frustrated if the state action is preempted. To ensure that both of SLUSA's policies—preventing the evasion

345. Although the state Attorney General could enforce Pennsylvania's Unfair Trade Practices and Consumer Protection Law, the Act also provides for a private remedy to recover damages for unfair and deceptive acts or practices that might otherwise escape remedy because they do not affect the public interest. *See Neff v. Gen. Motors Corp.*, 163 F.R.D. 478, 482 (E.D. Pa. 1995) (discussing the limitations on the Attorney General's power to enforce and the need for private actions to fully enforce the Act).

346. *Veranda Beach Club Ltd. v. W. Sur. Co.*, 936 F.2d 1364, 1385 (1st Cir. 1991).

347. *See Blue Cross & Blue Shield v. Phillip Morris*, 178 F. Supp. 2d 198, 231-37 (E.D.N.Y. 2001) (discussing the legislative intent of the Deceptive Trade Practices Act as "[o]wing to the ever-changing types of false and deceptive business practices which plague consumers" (citing N.Y. GEN. BUS. LAW § 349 (McKinney 2001)); *Commonwealth v. Ziomek*, 352 A.2d 235 (Pa. 1976) (stating that the legislative intent "in passing Unfair Trade Practices and Consumer Protection Law was to protect citizens from unfair or deceptive practices" (citing 73 PA. STAT. ANN. § 201-1 (West 1973)); *Searle v. Wyndham Int'l*, 102 Cal. App. 4th 1327, 1333 (Cal. 4th Dist. 2002) (explaining that the intent of the Unfair Competition Law is "directed toward the public's right to protection from fraud, deceit, and unlawful conduct" (citing CAL. BUS. & PROF. CODE § 17200 (West 2002))).

348. For example, "trade" and "commerce" are defined as

the advertising, offering for sale, sale or distribution of any services and any property, tangible or intangible, real, personal or mixed, and any other article, commodity, or thing of value wherever situate, and includes any trade or commerce directly or indirectly affecting the people of this Commonwealth.

73 PA. CONS. STAT. § 201-2(3) (2004).

349. For example, Pennsylvania's Unfair Trade Practices and Consumer Protection Law—which is a fairly typical unfair trade practices statute—provides that a court can, in its discretion, award treble damages and any other relief, including reasonable attorney's fees. 73 PA. CONS. STAT. § 201-9(2) (2004).

350. *See, e.g., Culbreth v. Miller*, 477 A.2d 491, 495 (Pa. Super. Ct. 1984) (stating that consumer protection law "is to be construed broadly so as to effectuate as fully as possible the Legislature's purpose of preventing unfair or deceptive practices").

of the Reform Act and respecting federalism—are furthered, courts should narrowly construe the “in connection with” requirement.

The failure by courts to consider SLUSA’s effect on federalism is troubling. It is also troubling that many courts appear to accept at face value that the policies of SLUSA will *always* be frustrated if the court holds that the “in connection with” requirement is not met. Although it is true that SLUSA’s stated goal is to prevent the circumvention of the Reform Act, SLUSA’s specific concern is to protect issuers and other deep-pocket defendants in false corporate publicity cases,³⁵¹ a much more limited purpose. In many cases, the defendants seeking preemption under SLUSA are not issuers or deep-pocket defendants. Nor do the cases involve claims of false corporate publicity or forward-looking statements. Rather, very different types of defendants have been seeking preemption in very different types of cases, such as claims that a brokerage firm issued false research reports to its customers,³⁵² or claims that a bank misrepresented the interest rate on a certificate of deposit,³⁵³ or claims that a life insurance company charged premiums for a period of time when no coverage existed.³⁵⁴ Preempting these types of claims does not appear to materially advance the specific policies underlying SLUSA. Of course, courts should not refuse to preempt cases brought against non-issuers simply because the defendant is not an issuer.³⁵⁵ However, the fact that SLUSA is primarily concerned with protecting issuers should certainly be considered by courts in determining the importance of SLUSA’s policy. This concern also argues for a narrow construction of SLUSA’s “in connection with” requirement.

V. CONCLUSION

In enacting SLUSA, Congress carefully tailored the preemption provision, choosing to preempt only certain state actions alleging false or misleading statements of material fact made in connection with the purchase or sale of a nationally traded security. Since its enactment, many courts have expansively interpreted SLUSA. These courts appear to believe that “if it

351. See *supra* notes 80-82 and accompanying text.

352. See, e.g., *Rowinski v. Salomon Smith Barney, Inc.*, No. 3:02CV2014, 2003 U.S. Dist. LEXIS 20918 (M.D. Pa. Nov. 20, 2003).

353. See *Kenneth Rothschild Trust v. Morgan Stanley Dean Witter*, 199 F. Supp. 2d 993, 993 (C.D. Cal. 2002).

354. See *Araujo v. John Hancock Life Ins. Co.*, 206 F. Supp. 2d 377 (E.D.N.Y. 2002).

355. Although the legislative history indicates that Congress was concerned primarily with issuers, the language of the statute does not make a distinction between issuers and non-issuers. Therefore, SLUSA is not limited to preempting cases against issuers. A few plaintiffs have tried to make the argument that SLUSA should apply only to issuer defendants, but the courts have rejected that argument. See *Feitelberg v. Merrill Lynch & Co.*, 234 F. Supp. 2d 1043, 1052 n.8 (N.D. Cal. 2002) (stating that “there is no mention anywhere in SLUSA of a requirement that the alleged misrepresentation be made by the issuer”), *aff’d*, 353 F.3d 765 (9th Cir. 2003); *Prager v. Knight/Trimark Group, Inc.*, 124 F. Supp. 2d 229, 233 (D.N.J. 2000) (holding that the defendant does not have to be an “issuer” for SLUSA to apply). See also *Gutierrez v. Deloitte & Touche, L.L.P.*, 147 F. Supp. 2d 584, 591 (W.D. Tex. 2001) (presuming that SLUSA applies to both issuer and non-issuer defendants).

looks like a securities fraud claim and acts like a securities fraud claim,” it should be preempted. Such a subjective approach is misguided. It ignores the plain language of the statute. Moreover, SLUSA evidences deliberate drafting choices intended to further two important federal policies: preventing the circumvention of the Reform Act and ensuring proper respect for the role of state law and state courts. In interpreting SLUSA, many courts have emphasized the first policy but have failed to give sufficient consideration to the second. To prevent a dangerous expansion of SLUSA’s preemptive scope, courts must consider federalism concerns in interpreting SLUSA.