UIC Law Review

Volume 56 | Issue 2 Article 1

2023

Opaque Skies: The Need for Congress to Constrain SLUSA's Preemptive Reach, 56 UIC L. Rev. 205 (2023)

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OPAQUE SKIES: THE NEED FOR CONGRESS TO CONSTRAIN SLUSA'S PREEMPTIVE REACH

ANTONIO X. MILTON*

Picture this: the stock market is fluctuating, businesses of all sizes have shuttered for good, and the unemployment rate has swung up and down within the prior months. What year is it? Is it 1929 or 2022? Nearly a century after the promulgation of the first federal securities regulations, the country faces numerous economic and sociopolitical challenges – many stemming from the fallout from the coronavirus pandemic. The class action vehicle has emerged as a tool to protect broader classes of aggrieved parties and regulate behavior of corporate officers. Over the course of this past century, the class action lawsuit became the preferred vehicle to adjudicate disputes between business associations and the rights of security-holders.

Overuse of the class action vehicle prompted a series of litigation reforms in the late 1990s. One of those reforms, the Securities Litigation Uniform Standards Act ("SLUSA") has a preemption provision preventing the use of class actions for covered securities. The inconsistent application of this provision threatens the use of the class action vehicle to police violations, which Congress did not intend to preclude. This Article will address a circuit split interpreting the preemption provision of SLUSA, and advocate for a workable legislative solution to the problem.

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* Antonio X. Milton is a Judicial Law Clerk in the U.S. District Court for the Eastern District of Louisiana. I wish to extend thanks to the staff of the UIC Law Review for all their hard work in publishing this Article. And finally, a sincerest thank you to my loving parents, John Wayne and Tatiana, and my brother and sister, John-Paul and Isabel for inspiring me to achieve my dreams.

I. INTRODUCTION

Over the last sixty years, public opinion on class action lawsuits shifted from a policing mechanism to something incredibly unsavory.[1] Through numerous lobbying campaigns, a select group of commonly sued defendants[2] argued that securities class action lawsuits served no regulatory function. These entities painted the class action as a proverbial boogeyman with the capacity to bankrupt big businesses.[3] Those lobbying efforts prompted Congress to take action to reduce the number of "strike suits," or lawsuits specifically designed with a fraudulent or speculative intent aimed at deep-pocket defendants.[4] Securities "strike suits" carried large settlement value because defendant firms would prefer quick settlement of meritless cases, rather than pay tremendous litigation defense costs and persist through periods of protracted litigation.[5] However, not all class actions involving securities are filed for this purpose.

Other class action suits result from investors' efforts to uncover accounting scandals or a corporate officer's breach of fiduciary duty. The unchecked mismanagement of funds carries wide-reaching impacts in financial markets. A firm's fraudulent misrepresentation of their financials can cause a tremendous ripple effect across multiple industries.[6] The ripple's waves will engulf the firm's

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1. Diana B. Henriques, *Making it Harder for Investors to Sue*, N.Y. TIMES (Sept. 10, 1995), www.nytimes.com/1995/09/10/business/investing-it-making-it-harder-for-investors-to-sue.html [perma.cc/L32U-FK5P]. Some commentators have gone as far as declaring the class action vehicle to be something "akin to molesting a child." *Id.*

2. Richard W. Painter, *Responding to a False Alarm: Federal Preemption of State Securities Fraud Causes of Action*, 84 CORNELL L. REV. 1, 4-5 (1998).

3. *See* Henriques, *supra* note 1; *see also* Shannon Rose Selden, *Self-Policing the Market: Congress's Flawed Approach to Securities Law Reform*, 33 J. LEGIS. 57, 71-73 (2006) (describing Congress's overreaction to the alleged abuses of the system and enactment of far-reaching "reform").

4. *See, e.g.*, Newby v. Enron Corp., 338 F.3d 467, 471 (5th Cir. 2003) (describing strike suits as meritless suits which precipitated SLUSA's passing); H.R. Rep. No. 104-369, at 730 (1995) (Conf. Rep.), *as reprinted in* 1995 U.S.C.C.A.N. 730, 730.

5. H.R. Rep. No. 104-369, at 730 (1995) (Conf. Rep.), *as reprinted in* 1995 U.S.C.C.A.N. 730, 730; Joel Seligman, *The Merits Do Matter*, 108 HARV. L. REV. 438, 442-44 (1994) (citing *Private Litigation Under the Federal Securities Laws: Hearings Before the Subcomm. On Securities of the Senate Comm. on Banking, Housing & Urban Affairs*, 103d Cong., 1st Sess. 280 (1993) (detailing alleged securities fraud abuses precipitated by the plaintiff's bar in Subcommittee hearing)).

6. *See, e.g.*, Urska Velikonja, *The Cost of Securities Fraud*, 54 WM. & MARY L. REV. 1887, 1892 (2014); Cynthia A. Glassman, Comm'r, U.S. Sec. & Exch. Comm'n, Financial Reform: Relevance and Reality in Financial Reporting, SEC SPEECH ARCHIVE (Sept. 16, 2003), www.sec.gov/news/speech/spch091603cag.htm [perma.cc/FL8Q-X8BP]).

employees—enticing them to make career decisions based on their employer's misrepresentations—while creditors will underprice credit, and investors will suffer losses from investing in companies with inflated values.[7] Private shareholder litigation via the class action vehicle operates as a proverbial levee system, protecting the public from a destructive downpour because it keeps corporate officers honest and minimizes repeated instances of fraudulent conduct, due to the power of the collective.[8] As such, it can prevent such ripples in the event of a failure of corporate disclosure.

Securities litigation "reform" advocates argued that the class action vehicle was used commonly in the form of a "strike suit," a scenario in which investors sued the defendant-firm announcing bad news or a period of poor performance, alleging injury from the firm's announcements or performance in the form of a drop in stock price.[9] Congressional Republicans and pro-reform commentators painted a nasty picture of the state of securities fraud litigation to promote regulation based on full corporate disclosure rather than through private litigation.[10] They marshaled this sentiment to promptly enact the legislative reform in favor of the defense bar and high tech companies.[11] Their efforts resulted in the promulgation of the Private Securities Litigation Reform Act of 1995 ("PSLRA")[12] and the Securities Litigation Uniform Standards Act of 1998 ("SLUSA").[13]

This legislation aimed to prevent "strike suits" from advancing past the pleading stage in any court.[14] When enacted in 1998, SLUSA preempted securities fraud or deceptive practice class actions filed under state law or the common law if they could have

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7. *See supra* citations accompanying note 6.

8. *See* Gregory Kendall, *The Artful Dodgers: Securities Fraud, Artful Pleading, and Preemption of State Law Causes of Action Under the Securities Litigation Uniform Standards Act*, 81 U. CIN. L. REV. 657, 657 (2013); Henriques, *supra* note 1, at F5 ("Society used to encourage [Securities class actions] as a way of policing the system.") (interviewing a prominent securities plaintiffs' attorney on the impact of the Congressional proposals of sanctions or a "loser-pays" provision inflicted against plaintiffs which bring preempted claims or perceived strike suits).

9. H.R. Rep. No. 104-98, at 8 (1995) (Conf. Rep.), *as reprinted in* 1995 U.S.C.C.A.N. 679, 687.

10. *See id.* at 4, *as reprinted at* 683.

11. *See* H.R. Rep. No. 104-369, at 730 (1995) (Conf. Rep.), *as reprinted in* 1995 U.S.C.C.A.N. 730, 730.

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

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

14. *See* Brendan J. McCarthy, *"In Connection With"; the Need for Limitation to SEC Rule 10b-5 in Dissemination of Misleading Information Cases*, 54 CASE W. RSRV. L. REV. 1347, 1381-83 (2004).

been brought under federal law.[15] Congress empowered defendants to file for removal of such class action suits, filed in state courts, to allow a federal court to consider the immediate termination of the cause of action.[16] If the federal district court finds that the class action is preempted by SLUSA, then "neither the district court nor the state court may entertain it, and the proper course is to dismiss."[17] Notably, SLUSA's preemption provision does not bar individual claims of fraud brought by investors under state law.[18]

SLUSA presents a high barrier for class action plaintiffs in securities fraud cases. Congress over-delivered on its goal to limit "strike suits" or frivolous "stock drop" lawsuits against defendants for fears of crippling capital markets and destroying consumer trust in financial institutions.[19] SLUSA is so effective, that its preemptive reach stretches broadly into categories of securities class action claims that bear no resemblance to the "strike suits" of the mid- to late-twentieth century. Currently, SLUSA encompasses class actions filed against brokerage firms, breach of fiduciary duty claims against institutional trustees, and suits filed against insurance companies which deal in variable annuities.[20] These suits should not fall within the ambit of SLUSA's preemption provision.

Yet, the federal circuit courts are split on how broadly the preemption provision applies, creating incredible variance of outcomes. Some lawsuits not originally contemplated by Congress are inappropriately swept into the category of abusive claims and preempted in some circuits.[21] For example, a group of retail investors might sue their brokerage firm for the management's concealment of hidden fees. In some circuits, the claims could be swept into the ambit of SLUSA's preemption clause and prevented from proceeding past the pleading stage, while other circuits would allow the investors to proceed.[22] The inequitable treatment of

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15. *See* Painter, *supra* note 2, at 2-3.

16. *See, e.g.*, H.R. Rep. No. 105-640, at 16 (1998) ("Any class action described in [SLUSA's preemption provision] that is brought in a State court shall be removable to a Federal district court, and may be dismissed . . .").

17. Kircher v. Putnam Funds Tr., 547 U.S. 633, 643-44 (2006); *see also* Nielen-Thomas v. Concorde Inv. Services, LLC, 914 F.3d 524, 529 (7th Cir. 2019) (citing Brown v. Calamos, 664 F.3d 123, 124-25 (7th Cir. 2011)) (describing the obligation of the federal district court judge to dismiss a claim deemed to be covered by SLUSA).

18. N. Sound Cap. v. Merck & Co., 938 F.3d 482, 494 (3d Cir. 2019) ("SLUSA does not disturb the right to opt out" of a class action suit and proceed individually).

19. *See* McCarthy, *supra* note 14, at 1382-83.

20. *See, e.g.*, Northstar Fin. Adv. v. Schwab Inv., 904 F.3d 821, 826 (9th Cir. 2018); Freeman Inv. v. Pac. Life Ins. Co., 704 F.3d 1110, 1117 (9th Cir. 2013).

21. Brown v. Calamos, 664 F.3d 123, 127 (7th Cir. 2011) (describing the different approaches to SLUSA preemption taken by the different federal circuits).

22. *Compare Northstar Fin. Adv.,* 904 F.3d at 831 (concluding that SLUSA

securities class action plaintiffs in different circuits is problematic because SLUSA should not apply to some common class actions based in state law. Otherwise, defendants will use SLUSA as a broad shield from liability. The present three-way circuit split demonstrates a troubling trend towards broadening and furthering the preemption provision's reach.[23]

This Article will point out the incongruous application of SLUSA's preemption provision to securities class actions across the United States Circuit Courts of Appeals. Current events, like the continuously shifting rates of securities class action suits, emerging concerns of the retail investment community, and the persistence of the online "r/WallStreetBets" community, are germane to the larger discussion of securities litigation reform.[24] Congress should capitalize on this moment to cure the unintended, far- reaching consequences of securities litigation "reform" legislation. Simply put, SLUSA should not apply as broadly as it does because Congress never intended to preempt these state law claims when it enacted "reform" legislation in the 1990s.

Part II of this Article recaps the legislative history regarding securities regulation and litigation reforms and the historical attempts to reduce so-called "abusive" litigation against firms. Part III details the spectrum of SLUSA interpretation, explaining the present circuit split on state law claims of breach of contract and breach of fiduciary duty. The history of the dual system regulating

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barred the investors' state law breach of fiduciary duty and contract claims filed against their investment advisory firm), *with* Segal v. Fifth Third Bank, 581 F.3d 305, 312 (6th Cir. 2009) (holding that SLUSA preempted state law claims of breach of fiduciary duty and contract under a broad interpretation of its preemption provision).

23. *See* Magyery v. Transamerica Fin. Advisors, Inc., 315 F. Supp. 2d 954, 959 (N.D. Ind. 2004) ("District court cases appear to be all over the map on the issue of what state law claims are preempted by SLUSA."). *Contra Northstar Fin. Adv.*, 904 F.3d 821, at 830 (stating that "the legal standard governing SLUSA preemption . . . appears to be uniform across the circuits.") (citing boilerplate statements of law from several federal circuit courts regarding how broadly to apply SLUSA's preemption clause).

24. *See* Dean Seal, *Lawsuits Mount As Robinhood Eases Trading Restrictions*, LAW360 (Feb. 1, 2021, 9:09 PM), www.law360.com/articles/1350187 [perma.cc/GN5E-N3UJ] (listing the dozens of class action civil lawsuits filed against online stock trading platform Robinhood in early 2021 after the platform restricted the sale of certain "meme stocks" which were caught up in a trading frenzy); John McDermott, *How WallStreetBets Redditors Used Their Collective Power to Manipulate the Stock Market*, ESQUIRE (Jan. 27, 2021), www.esquire.com/news-politics/a35339535/game-stop-stock-short-squeeze-explained/ [perma/cc/K5J6-Q7JS]/. The "r/WallStreetBets" community has bound together online to wield their individual money to "troll the stock market—and make millions of dollars doing it." *Id.* A fuller discussion of the impacts of this de-facto pump-and-dump scheme is beyond the scope of this Article. *See Id.*

fraud in securities markets presents interesting concerns of federalism and equity.[25] Part IV provides an amendment to SLUSA, which could kill two birds with one stone by crafting an explicit directive restraining SLUSA's preemptive reach in future legislation. Part V concludes, addressing how Congressional reform of securities class action regulation is the optimal path to clearing ambiguities present in the field.

II. HISTORICAL BACKGROUND ON BLUE SKY LAWS, SECURITIES REGULATION, AND CLASS ACTION LITIGATION

Before addressing the circuit split involving SLUSA preemption, this Article will review the historical background of securities legislation. About a century ago, security prices elevated to exorbitant levels at the end of the roaring twenties as the American stock market underwent rapid expansion.[26] The stock market crashed, due to sky-high prices, among other compounding factors.[27] Predating the stock market crash, individual states were the only sources of law regulating securities markets to prevent fraud via "blue sky laws."[28]

The purpose of blue sky laws is to mandate open markets, or markets where all information pertinent to a stock's performance is publicly available. However, the states' regulatory bodies lacked the manpower needed to enforce their regulations, and the blue sky laws included exceptions from liability for failure to disclose.[29] For example, perpetrators of securities fraud could avoid penalties in one state by simply making offerings to investors across state lines through the mail.[30] Prior to the promulgation of federal securities laws, an author of a fraudulent or highly speculative statement was unlikely to face penalty under another state's blue sky laws because the regulatory agencies of the individual states lacked the funding

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25. *See* Michael A. Perino, *Fraud and Federalism: Preempting Private State Securities Fraud Causes of Action*, 50 STAN. L. REV. 273, 279-80 (1998).

26. *See* H.R. Rep. No. 73-1383, at 7702 (1934) (entering letter from Pres. Franklin D. Roosevelt to Rep. Sam Rayburn into the record). "The people of this country are . . . fully aware of the fact that unregulated speculation in securities and in commodities was one of the most important contributing factors in the artificial and unwarranted 'boom' which had so much to do with the terrible conditions of the years following 1929." *Id.*

27. Julie Marks, *What Caused the Stock Market Crash of 1929?*, HIST. (Apr. 6, 2020), www.history.com/news/what-caused-the-stock-market-crash-of-1929 [perma.cc/G5GZ-SUC2]. "In 1929, security prices escalated to exorbitant levels and, ultimately, the stock market crashed." *Id.*

28. *See, e.g.*, Jonathan R. Macey & Geoffrey P. Miller, *Origin of the Blue Sky Laws*, 70 TEX. L. REV. 347, 359-64 (1991) (chronicling the implementation of the first state securities laws in Kansas in 1911); Merrick v. N.W. Halsey & Co., 242 U.S. 568, 585-86 (1917) (upholding Michigan Blue Sky laws as constitutional).

29. *See* Perino, *supra* note 25, at 281.

30. *Id.*

and manpower to investigate out of state sources.[31] These regulations, alone, could not prevent the Great Depression. In the decades that followed, a system of dual regulation, comprised of concurrent state and federal laws, arose, surrounding the performance of securities markets.

A. Clearing the Air: Implementation and Tools of Federal Securities Laws

Congress enacted the Securities Act of 1933[32] ("1933 Act") in the aftermath of the crash, due to its dissatisfaction with the states' efforts to regulate securities markets individually.[33] Congress sought to clean up the markets and protect purchasers of securities from fraudulent and deceptive practices on the part of sellers.[34] The Roosevelt Administration pushed the 1933 Act through Congress within the Administration's first 100 days, a period which broadly expanded the federal government's regulatory authority.[35] The 1933 Act granted concurrent jurisdiction over securities claims to state and federal courts and barred the removal of state law claims to the federal courts.[36] Section 11 of the 1933 Act prohibits the use of misstatements of fact or fraudulent statements in securities registration statements delivered to prospective purchasers of securities.[37]

Less than a year later, Congress passed the Securities Exchange Act of 1934 ("Exchange Act").[38] Congress included an incredibly detailed list of reasons to justify its continued regulation of securities transactions, including justifications absent from the findings incorporated in the 1933 Act.[39] The Exchange Act added

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31. *See id.* at 280-82.

32. 15 U.S.C. § 77a (2022).

33. *See* Selby P. Brown, *Don't Throw the Baby Out with the Bath Water: The Merits of the Intermediate Approach to the Securities Litigation Uniform Standards Act*, 66 OKLA. L. REV. 363, 366-67 (2014).

34. *See* Cent. Bank of Denver v. First Interstate Bank of Denver, 511 U.S. 164, 170-71 (1994); 15 U.S.C. §§ 77f, 77q, 78b (2018).

35. *See* Perino, *supra* note 25, at 281-82 (acknowledging the 1933 Act's passing in the early days of the New Deal); *see also* GARY S. LAWSON, FEDERAL ADMINISTRATIVE LAW 322 (7th ed. 2015) ("The New Deal, however, heralded an expanded conception of federal agency involvement in people's lives, coupled with an across-the-board retreat from constitutional doctrines of federalism and separation of powers that had foreclosed the emergence of an activist administrative state.").

36. *See* 15 U.S.C. § 77k.

37. *Id.*

38. 15 U.S.C. § 78a (2022).

39. 15 U.S.C. § 78b ("For the reasons hereinafter enumerated, transactions in securities as commonly conducted upon securities exchanges and over-the-counter markets are affected with a national public interest which makes it

further language to shield state blue sky laws from complete preemption and cemented a dual structure for the regulation of securities.[40] Congress' disposition to preserve state courts' authority to hear securities claims demonstrates the historical significance of the private right of action based in both federal *and* state laws. Section 10(b) of the Exchange Act, the anti-fraud provision, is one of the sharpest arrows in shareholders' proverbial quiver to fight securities fraud through litigation. The provision also tasks the Securities and Exchange Commission ("SEC") with the authority to promulgate rules prohibiting corporate fraud, insider trading, and other violations which have emerged over time.[41] A portion of Section 10(b) enables the SEC to adopt new rules to prohibit manipulative efforts or cunning artifices to perpetrate fraud.[42] The SEC promulgated Rule 10b-5 in 1934 to address new technologies or methods employed to defraud investors.[43]

For Section 10(b) or Rule 10b-5 claims, plaintiffs must prove both that (1) they relied on the defendant's deceptive statements when deciding to purchase a security; and (2) the defendant's conduct caused, at least in part, the plaintiff's losses, among other elements.[44]

To prove the reliance element in securities fraud class action claims, plaintiffs would invoke the fraud on the market theory.[45] The fraud on the market theory holds that a security traded on an efficient market is a function of all public material information available about an entity company.[46] From this theory, purchasers and sellers argued that they relied on a company's material misrepresentations when those parties were unaware of the fraudulent conduct at the time of the purchase or sale of the security.[47] Essentially, the element of reliance in securities fraud

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necessary to provide for regulation and control of such transactions and of practices and matters related thereto. . . .").

40. *See* Securities Exchange Act of 1934, ch. 404, § 28(a), 48 Stat. 881, 903 (codified as amended in 15 U.S.C. § 78bb(a)); Leroy v. Great W. United Corp., 443 U.S. 173, 182 (1979) (noting that section 28(a) of the Exchange Act was "plainly intended to protect, rather than to limit, state authority" over securities suits).

41. *See* McCarthy, *supra* note 14, at 1350-51.

42. *See* Ernst & Ernst v. Hochfelder, 425 U.S. 185, 203 (1976).

43. *See* 17 C.F.R. § 240.10b-5 (2022).

44. *See* Robbins v. Koger Properties, Inc., 116 F.3d 1441, 1447 (11th Cir. 1997). The remaining elements required for a section 10(b) claim are material misstatement or omission of fact itself, scienter, which is the intent to defraud the plaintiff, that was made *in connection with* the purchase or sale of the security. *See* Dura Pharms., Inc. v. Broudo, 544 U.S. 336, 341-42 (2005).

45. *See* Barbara Black, *Fraud on the Market: A Criticism of Dispensing with Reliance Requirements in Certain Open Market Transactions*, 62 N.C. L. REV. 435, 435-36 (1984).

46. *See id.*

47. Jeanne F. Doyle, *The Fraud on the Market Theory: A Unified Concept of*

claims could be satisfied if a company lied about its business affairs or recent performance after the truth is found out and the price of the company's stock would drop.[48]

In *Basic v. Levinson*, the United States Supreme Court articulated that the fraud on the market theory can be used to support this rebuttable presumption of reliance.[49] Federal courts thereby allowed shareholders to sue for fraud without providing specific examples of misrepresentation or fraudulent conduct which they may have relied on in buying the stock.[50] Frequently sued defendants despised these developments in the law.

Over time, class action litigation filed in federal courts under Section 10(b) of the Exchange Act and Section 11 of the 1933 Act garnered a reputation for being abusive.[51] In *Blue Chip Stamps v. Manor Drug Stores*, Justice Rehnquist stated that there was "widespread recognition that litigation under Rule 10b-5 presents a danger of vexatiousness different in degree and in kind from that which accompanies litigation in general."[52] The *Blue Chip Stamps* decision in 1975 carried a profound effect on the landscape of securities fraud lawsuits because the Supreme Court was perturbed by the usage of the class action vehicle among securities plaintiffs alleging fraud.[53] The Supreme Court decisions in *Basic* and *Blue Chip Stamps* spurred a movement for stricter procedural reforms in securities litigation.

B. The Legislative Solution to Strike Suits

In the late 1980s and 1990s, the securities litigation reform movement kicked into high gear, as lobbyists representing Silicon Valley tech and venture capital firms played an active role in the enactment of securities reforms on the state and federal level.[54] The TechNet Political Action Committee, funded by many California based tech companies, raised millions of dollars for Congressional Republicans and Democrats in the 1990s,[55] and acted on that clout

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Causation in Rule 10b-5 Open Market Actions, 12 LOYOLA U. CHI. L.J. 727, 742-45 (1981).

48. *See* Black, *supra* note 45, at 459-60.

49. Basic v. Levinson, 485 U.S. 224, 241-42 (1988).

50. *See id.* at 250.

51. *See* Blue Chip Stamps v. Manor Drug Stores, 421 U.S. 723, 741 (1975).

52. *Id.* at 739.

53. *See id.*

54. *See* Painter, *supra* note 2, at 4-7.

55. Mark Simon, *How Tech Leaders Talk Politics: Silicon Valley Approach Confuses Washington*, S.F. CHRON. (Nov. 13, 1997), www.sfgate.com/news/article/MARK-SIMON-How-Tech-Leaders-Talk-Politics-2796096.php [perma.cc/9CQZ-LEZB].

to narrow their scope of liability.[56] TechNet and other proponents of those reforms portrayed the plaintiff's bar as unscrupulous retainer check chasers that initiated lawsuits for stock price drop events without any showing of wrongdoing on the part of corporate officers, agents, or representatives.[57]

In 1995, Congress passed the PSLRA to limit fraudulent securities lawsuits by amending the 1933 Act and the Exchange Act.[58] Proponents of the bill gathered enough support to pass it over a presidential veto.[59] Congress intended for the PSLRA to "put an end to vexatious litigation," which "drain[ed] value from the shareholders and employees of public companies."[60] The legislative records indicate that Congress agreed with the Supreme Court's findings in *Blue Chip Stamps* that the class action device was unjustifiably employed in securities litigation to injure "the entire U.S. economy."[61] Congress and industry members termed these securities class actions as "abuses [by plaintiffs] of the class action vehicle in litigation involving nationally traded securities."[62]

The PSLRA raised many substantive and procedural barriers in the realm of federal securities law. It imposed stricter pleading standards, harsher discovery rules, and tougher class representation requirements to prevent the filing of frivolous securities lawsuits.[63] A notable protection offered by the PSLRA was the application of an automatic stay of discovery while a motion to dismiss is pending, which forces plaintiffs to accumulate more proof of fraud before filing a suit.[64] Some of the protections afforded to defendants by the PSLRA do not apply in state court because, as written, they apply only to actions "brought as a plaintiff class action pursuant to the Federal Rules of Civil Procedure."[65] As a result, plaintiffs shifted to bringing class action claims under state law in state courts to avoid the heightened procedural burdens in

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56. Painter, *supra* note 2, at 4-6, n.16.
57. *See id.*; Henriques, *supra* note 1, at F5.
58. Private Securities Litigation Reform Act of 1995, 15 U.S.C. § 78u-4 (2018).
59. Painter, *supra* note 2, at 75-77.
60. H.R. Rep. No. 105-640, 105th Cong. 2d Sess., 9 (1998).
61. H.R. Rep. No. 104-369, 104th Cong. 1st Sess. 31 (1995) (Conf. Rep.), *as reprinted in* 1995 U.S.C.C.A.N. 730, 731. That same House Conference Report accompanied an early draft of the PSLRA, and noted that private securities litigation was "an indispensable tool with which defrauded investors can recover their losses." *Id.*
62. Merrill Lynch, Pierce, Fenner & Smith Inc. v. Dabit, 547 U.S. 71, 81-82 (2006).
63. *Id.*
64. Medhekar v. U.S. District Court (*Patel*), 99 F.3d 325, 327-28 (9th Cir. 1996) (declaring that the PSLRA's heightened pleading requirements and stay of discovery force plaintiffs to accumulate more information before filing suit); 15 U.S.C. § 78u-5(c)(1)(A)(i) (2018).
65. 15 U.S.C. § 77z-1(a) (2022).

federal courts, which retained exclusive jurisdiction over claims based on federal securities law.[66]

In response to these perceived avoidance tactics, Congress passed SLUSA in 1998 to further amend the 1933 Act and the Exchange Act.[67] Importantly, a 1997 SEC report told Congress and the President that it was far too early to assess the impacts of the PSLRA and some members of the Commerce Committee thought that SLUSA was too premature.[68] Richard Painter, a prominent securities law professor, testified at congressional hearings that SLUSA's enactment could be disastrous because it would preempt state law class action claims in all fifty states based only on a single year of data, in which it was projected that only 39 lawsuits were filed in state courts to "avoid" the requirements of the PSLRA.[69] In the face of inadequate data, the Congressional Republican majority pushed SLUSA through committee and a full vote with light opposition.[70] SLUSA's fast-track passage caused several interpretation and application issues for the courts.

Upon hearing their first case involving the statute, the Supreme Court noted that SLUSA's stated purpose was to prevent state-law class actions from end-running the PSLRA.[71] The United States Court of Appeals for the Ninth Circuit elaborated that:

SLUSA deprives a federal court of jurisdiction to hear '(1) a covered class action (2) based on state law claims (3) alleging that the defendants made a misrepresentation or omission or employed any manipulative or deceptive device (4) in connection with the purchase or sale of (5) a covered security.'[72]

SLUSA defines a "covered class action" as either (1) a single lawsuit filed for damages on behalf of a group larger than fifty people or (2) any collection of independent suits brought on behalf of more than fifty plaintiffs "filed in or pending in the same court and involving common questions of law or fact" if the claims

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66. H.R. Conf. Rep. No. 105-803, at 2 (1998).

67. *See* H.R. Rep. No. 105-640, 105th Cong. 2d Sess. 10 (1998); S. Rep. No. 105-182, 105th Cong. 2d Sess. 3-4 (1998).

68. U.S. SEC. & EXCH. COMM'N, OFFICE OF THE GEN. COUNS., REPORT TO THE PRESIDENT AND THE CONGRESS ON THE FIRST YEAR OF PRACTICE UNDER THE PRIVATE SECURITIES LITIGATION REFORM ACT 61 (Apr. 1997)

69. *The Securities Litigation Uniform Standards Act of 1997: Hearing on H.R. 1689 Before the Subcomm. on Fin. and Hazardous Materials of the House Comm. on Commerce*, 105th Cong. 72 (1998) (statement of Richard W. Painter, Professor of Law).

70. Painter, *supra* note 2, at 42-43, 104 (explaining that the Democrats chose to derail the Republican majority's tort reform legislation and conceded the legislative efforts on securities litigation legislation).

71. *Dabit*, 547 U.S. at 86.

72. *See* Northstar Fin. Advisors, Inc. v. Schwab Invs., 904 F.3d 821, 828 (9th Cir. 2018) (citing Freeman Invs. v. Pac. Life Ins. Co., 704 F.3d 1110, 114-15 (9th Cir. 2013)).

could be consolidated or otherwise go forward as a single action.[73] This means that suits filed in different states based on the same factual occurrence can be consolidated and removed to one federal forum and considered for SLUSA preemption.[74]

The Supreme Court described that SLUSA's preemption provision "does not actually pre-empt any state cause of action," rather "it simply denies plaintiffs the right to use the class action device to vindicate certain claims."[75] Essentially, plaintiffs are free to file suits to vindicate certain state law claims individually or in any group smaller than fifty plaintiffs.[76] However, SLUSA preempts small groups proceeding in separate suits, compelling joinder and forced dismissal of all claims in federal courts if the total number of plaintiffs in the separate suits exceeds fifty and the claims could proceed as one action.[77]

Another key finding to apply SLUSA's preemption provision is the determination that the security involved in the lawsuit is a "covered security." A "covered security" is any security listed on a regulated national exchange which is nationally traded.[78] Most of the jurisprudence governing the extent of SLUSA's applicability to certain state law claims hinged on the nature of the investment product[79] or whether the defendant's particular conduct constituted fraud, omission, or material misrepresentation "*in connection with* the purchase or sale of a covered security."[80] At its genesis, SLUSA was enacted with the clear goal to prevent shareholders from filing typical stock price drop claims.[81] However, SLUSA's preemptive arm has stretched to incorporate suits far different than the ones which originally inspired the reforms of the 1990s.[82]

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73. 15 U.S.C. § 78bb(f)(5)(B)(ii).

74. *See* Chadbourne & Parke LLP v. Troice, 571 U.S. 377, 385-86 (2014) (hearing consolidated claims filed by multiple small groups of plaintiffs in Louisiana and Texas state courts which were deemed to be preempted by SLUSA at the district court level).

75. *Dabit*, 547 U.S. at 87.

76. *See id.*; Holtz v. JPMorgan Chase Bank, 846 F.3d 928, 934 (7th Cir. 2017) ("If [plaintiffs] wish to pursue a contract or fiduciary-duty claim under state law, she has only to proceed in the usual way: one litigant against another.").

77. 15 U.S.C. § 78bb(f)(5)(B)(ii).

78. 15 U.S.C. §§ 78bb(f)(5)(E), 77r(b)(1)-(2).

79. *See Chadbourne & Parke LLP*, 571 U.S. at 381, 387-88 (holding that SLUSA did not preempt a class action claim of fraudulent misrepresentation in connection with the purchase of an uncovered security which was fraudulently presented as backed by a covered security).

80. *See Dabit*, 547 U.S. at 87 (holding that SLUSA preempted state lawsuits which allege misleading statements or omissions to induce for brokers to *hold* securities) (emphasis added).

81. *See* H.R. Rep. No. 105-640, 105th Cong., 2d Sess. 10 (1998); S. Rep. No. 105-182, 105th Cong. 2d. Sess. 3-4 (1998).

82. *See, e.g.*, Knowles v. TD Ameritrade Holdings Corp., 437 F. Supp. 3d 1070, 1078-79 (D. Neb. 2019) (holding that SLUSA preempted breach of contract, breach of fiduciary duty, and negligence claims filed against a

The state-law claims filed by variable insurance policyholders and retail investors are not abusive because they derive from actual transgressions on the part of the banks, insurance companies, and broker-dealers, which provide security products to them.[83] These suits are not of the same tenor of suits which the Supreme Court, securities defense bar, Congressional Republicans, and high technology firms took issue with over the course of the past few decades.[84] SLUSA purports to shield institutional defendants from liability for unethical behavior because Congress has not clearly defined where its preemptive reach ends. Congress's more recent aims to incentivize corporate disclosure have left this void vacant, and the courts are incredibly divided on whether state law breach of contract or breach of fiduciary duty claims are preempted by SLUSA.[85]

III. CIRCUITS SPLIT ON INTERPRETATION OF SLUSA'S PREEMPTION PROVISION

The federal circuit courts have split into three different camps for interpreting whether SLUSA preempts class action claims alleging a state law breach of contract or fiduciary duty claims in connection with the purchase or sale of a nationally traded security.[86] There are instances in which some circuits have deviated from their own standards established by the cases detailed below.[87]

The first approach follows the strict, literalist interpretation of SLUSA's preemption provision. The United States Court of Appeals for the Sixth Circuit applies a literalist approach, where the court ignores the language of the pleadings and examines the essence of the claim to see if it is barred by SLUSA.[88] The second camp applies the narrow approach. This camp includes the United States Courts

brokerage service provider for incomplete disclosure of brokerage fee costs on the investors' investment vehicles).

83. *See* cases and discussion *infra* Part III(A-C).

84. *See generally* McCarthy, *supra* note 14 (explaining the legislative history predating SLUSA's passage).

85. *See generally* Sarbanes-Oxley Act, Pub. L. No. 107-204 (2002) (codified at 15 U.S.C. § 7201) (2018).

86. Brown v. Calamos, 664 F.3d 123, 127 (7th Cir. 2011) (delineating the approaches taken by the different federal circuits and briefly describing the Sixth Circuit's "literalist approach to SLUSA.").

87. *Compare La Sala* 519 F.3d at 141 (3d Cir. 2008) (holding that SLUSA did not preempt breach of fiduciary duty claims brought under Delaware and Swiss laws), *with* Rowinski v. Salomon Smith Barney Inc., 398 F.3d 294, 300 (3d Cir. 2005) (holding that SLUSA did preempt a class action complaint containing allegations of systematic misrepresentations tied to the sales of securities products).

88. *See* cases cited *infra* Part III.A and accompanying text.

of Appeals for the Second, Third, and Ninth Circuits.[89] The last camp is the field preemption doctrine. The United States Court of Appeal for the Seventh Circuit applies this approach in barring any claim if it could be pursued under federal securities law.[90]

However, the cases below illustrate the proverbial line in the sand where each circuit stands on the issue of whether SLUSA preempts state law claims like breach of fiduciary duty and breach of contract. The three different camps will be explained in detail below to underscore how congressional clarification on the extent of SLUSA's preemptive power could be helpful. Legislative action can effectively resolve this circuit split, reinforce SLUSA's intended purpose, and prevent retail investors and beneficiaries of trusts from being improperly swept into the ambit of SLUSA's preemption provision.

A. The Literalist Approach: Rejecting the Artful Pleading Doctrine

The United States Court of Appeals for the Sixth Circuit has adopted a strict literalist approach to SLUSA preemption.[91] This approach examines each claim in a complaint and deems that SLUSA bars any state law claims which could be interpreted as either explicitly or *implicitly* alleging "a misrepresentation or omission of fact."[92] The problem with this stance is that there are instances where unethical behavior of corporate officers or trustees could not possibly be explained in pleadings without evoking language akin to that of misrepresentation or fraud claims. The Sixth Circuit has stated that "SLUSA may be unforgiving when it applies, but it details in clear language when that is so."[93] The Sixth Circuit heavily relies on the Supreme Court's broad construction of SLUSA's expansive language to support this rule.[94]

In *Segal v. Fifth Third Bank*, the Sixth Circuit held that SLUSA can preempt state law claims of unjust enrichment, breach of contract, and fiduciary duty when the substance of the complaint's allegations include claims of misrepresentation, deceptive devices, and the like.[95] The lead plaintiff in *Segal* was a beneficiary of trust accounts administered by the defendant bank.[96] The complaint disclaimed any allegation of misrepresentation or

89. *See* cases cited *infra* Part III.B and accompanying text.
90. *See* cases cited *infra* Part III.C and accompanying text.
91. *See Atkinson*, 658 F.3d at 554-55 (6th Cir. 2011); *Segal,* 581 F.3d at 308.
92. 15 U.S.C. §§ 77p(b) 78bb(f)(1)(A).
93. *Segal*, 581 F.3d at 312.
94. *See* Merrill Lynch, Pierce, Fenner & Smith, Inc. v. Dabit, 547 U.S. 71, 85-86 (2006).
95. *Segal*, 581 F.3d at 308, 310.
96. *Id.* at 308.

omission of material facts and alleged that the bank breached its investment contract and fiduciary duty because the officers deliberately chose to invest client funds into proprietary mutual funds over superior funds managed by the bank's competitors.[97] Essentially, the bank invested their client's fiduciary assets in this manner to collect a higher commission, at the expense of their client. Further, the bank promised to provide top-notch individualized management to each of the beneficiaries' accounts. However, the bank provided mostly automated management of the client accounts.[98] The language of the complaint alleged breach of contract and stated that the "defendant's planned corporate scheme" was "intended to and did lure grantors, testators, and others to designate [defendant bank as trustee]."[99]

The Sixth Circuit interpreted the complaint as an exercise of "artful pleading" and held that the beneficiaries "could not avoid [SLUSA's] application" by removing "covered words from the complaint but leav[ing] in the covered concepts."[100] The *Segal* court stated that allowing the claimant to disclaim the applicability of SLUSA through artful pleading would "'frustrate the objectives' of [the PSLRA] and SLUSA."[101] However, the class action suit at issue there was not of the same quality as those cases which would "frustrate the purpose and objectives"[102] of SLUSA because it was not a stock price drop suit. Unjust enrichment is widely considered an equitable remedy,[103] and should not be governed under the same provisions enacted to control abusive "strike suits." The Sixth Circuit decided to dismiss the beneficiaries' individual claims against the defendant without prejudice so that the plaintiffs could file them individually in state court.[104] This is not a suitable remedy for beneficiaries claiming unjust enrichment or breach of fiduciary duty resulting from a trustee's deliberate choices to engage in self-dealing.[105]

Two years after *Segal*, the Sixth Circuit reached the same result in *Atkinson v. Morgan Asset Management*.[106] In *Atkinson*,

97. *Id.* at 311; Amended Class Action Complaint—Demand for Jury Trial at ¶ 2, Segal v. Fifth Third Bank, 2007 WL 4742074 at *2 (S.D. Ohio 2007) (No. 07-0348).

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

99. Amended Class Action Complaint—Demand for Jury Trial at ¶ 25, 29, *Segal*, 2007 WL 4742074 at *10, 12 (No. 07-0348).

100. *Segal*, 581 F.3d at 311.

101. *Id.*

102. *Id.*

103. Xiotech Corp. v. Express Data Prods., 11 F. Supp. 3d 225, 241-42 (S.D.N.Y. 2014) (consulting the law of multiple states).

104. *See Segal*, 581 F.3d at 312.

105. *See* discussion *supra* Part I, pp. 8-9.

106. *See Atkinson*, 658 F.3d at 552.

mutual fund shareholders brought a class action suit against the management of an open-ended investment company in Tennessee state court.[107] The shareholders alleged that the fund's management took unjustified risks in distributing the fund's assets and failed to notify the shareholders of such risks.[108] The defendants removed the state action to federal court and argued that the shareholders' claims fit within SLUSA's definition of a covered class action for preemption purposes.[109] The shareholders filed a motion to remand the case back to state court, arguing that most of their claims were outside the scope of SLUSA.[110] The district court denied the shareholders' motion to remand and dismissed the claims with prejudice, pursuant to SLUSA.[111]

The shareholders also argued in the alternative that their losses were caused by the fund's mismanagement of assets, and concealment of the true performance to prevent the investors from cashing out.[112] The shareholders purported that fraud or misrepresentation occurred, but argued that a specific exception applied to prevent SLUSA preemption.[113] Both arguments were unsuccessful, as the Sixth Circuit broadly construed the bar on class actions claiming fraud "in connection with the purchase or sale of a security."[114] Ultimately, the Sixth Circuit rejected all of the shareholders' claims and dismissed the collection of state law securities claims in their complaint.[115]

It is clear from the Sixth Circuit's jurisprudence that a class action claim rooted in state law breach of contract or fiduciary duty will be precluded if the plaintiff's complaint includes the type of allegations based upon "misrepresentation or failure to disclose a material fact."[116] The Sixth Circuit rejects all alleged attempts of "artful pleading"—or the crafting of a complaint to avoid preclusion from SLUSA.[117] Under this approach, plaintiffs in the Sixth Circuit alleging state law breach of contract or breach of fiduciary duty claims are far less likely to proceed past the motion to dismiss stage

107. *Id.*
108. *Id.*
109. *Id.*
110. *Id.*
111. *Id.* at 556-57.
112. *Id.* Interestingly, the class action period encompassed losses in value of shares during the financial crisis of 2007 and 2008. *Id.* at 552. Copious amounts of breach of contract and fiduciary duty claims resulted from similar circumstances and ended with similar results. *Id.*
113. *Id.* at 553. The Delaware carve-out exempts a class action otherwise barred by SLUSA if the suit involves "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." *Id.* (citing 15 U.S.C. § 77p(d)(1)(B)).
114. *Id.* at 553-54. (citing 15 U.S.C. § 77p(d)(1)(B)).
115. *Id.* at 556-57.
116. 15 U.S.C. § 77p(b).
117. *Atkinson*, 658 F.3d at 555.

while using the class action vehicle. By that same token, defendant financial institutions could charge hidden fees and argue that SLUSA shields them from liability because a plaintiff's complaint might use similar language that has been categorized as barred by the Sixth Circuit before. Further, there is no consideration from the Sixth Circuit about the fact that these types of claims share few characteristics with the vexatious "strike suits" which Congress intended to prevent when passing SLUSA. In rejecting the artful pleading doctrine, the Sixth Circuit literally applies SLUSA's preemption provision and runs directly contrary to the contention that securities class action claims can serve as policing vehicles to root out impropriety at firms.[118]

B. The Intermediate Approach: Narrowly Construing the Preemption Provision

A group of federal circuit courts have adopted a narrower reading of SLUSA's preemption clause. This intermediate approach reads SLUSA to preempt class action claims for breach of contract or fiduciary duty if the claim requires proof of omission or misrepresentation of a material fact.[119] The Ninth Circuit espouses this view, as they look to the elements which the plaintiff must demonstrate to prove their claim.[120] The Ninth Circuit has determined that a class action under state law is preempted by SLUSA if the plaintiffs are required to show some form of deceit or misrepresentation of the costs or value of the security.[121]

In *Freeman Investments, L.P. v. Pacific Life Insurance*, a group of policyholders sued an insurance company that sold them variable universal life insurance policies.[122] The policyholder of a variable universal life insurance plan would receive periodical returns from the investment of their monthly premiums.[123] The policyholders filed suit in the United States District Court for the Central District of California, and alleged that the insurance company levied excessive "cost of insurance" charges.[124] If true, such conduct would constitute several violations under the California Business and

118. *Cf.* Selden *supra* note 3, at 58-59 (arguing that the high barriers raised by Securities fraud litigation reforms have impeded the best efforts to deter securities malfeasance).

119. *See, e.g.*, Miller v. Metro. Life Ins. Co., 979 F.3d 118, 122-23 (2d Cir. 2020); Freeman Inv., L.P. v. Pac. Life Ins. Co., 704 F.3d 1110, 1115-16 (9th Cir. 2013); *LaSala*, 519 F.3d at 142-43.

120. *See Freeman Inv.*, 704 F.3d at 1115-16.

121. *Id.*

122. *Id.* at 1113-14.

123. *Id.* at 1113.

124. *Id.*

Professions Code, in addition to the common law claims.[125] The insurance company filed a motion to dismiss the suit pursuant to SLUSA and the district court dismissed the case.[126] The Ninth Circuit reversed the dismissal—holding that SLUSA's preemption reach depends upon what the plaintiffs would be required to show to prove each individual claim.[127]

The court succinctly stated the center of the dispute in the form of a query: "Do the [policyholders'] state law claims, no matter how labeled, in substance allege misrepresentation or omission in connection with the purchase or sale of securities?"[128] In turning to the policyholders' complaint, the insurance company pointed to the sharp language indicating fraud or omission to argue that SLUSA applied to preempt the claims.[129] The court's decision hinged on the classification of the claim as one of contractual interpretation.[130] The insurance company argued that SLUSA preempted the plaintiffs' claims because their prospectuses demonstrated that their inflated cost of insurance charges coincided with the sale of the securities while also depleting the value of the investment.[131]

The Ninth Circuit held that SLUSA preempted the plaintiffs' state law unfair competition claim.[132] However, the defendants were not meritorious on the remaining claims. The court stated that "just as plaintiffs cannot avoid SLUSA through crafty pleading, defendants may not recast contract claims as fraud claims by arguing that they 'really' involve deception or misrepresentation."[133] The Ninth Circuit allowed the state law claims for breach of contract and the breach of the duty of good faith and fair dealing to survive SLUSA preemption.[134]

The United States Court of Appeals for the Second Circuit agrees with this construction of SLUSA's preemption provision. In *In re Kingate Management Ltd. Litigation*, the Second Circuit heard twenty-eight unique state law claims brought by a group of investors which were defrauded by Bernie Madoff's Ponzi scheme.[135]

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125. *Id.* at 1114.

126. *See id.*

127. *Id.*

128. *Id.* at 1115.

129. *Id.* (arguing "that plaintiffs 'allege numerous misrepresentations and omissions in furtherance of an inherently deceptive scheme' . . .[and] accuse[d] the company of 'systematic concealment' and 'deceitful conduct' designed 'to generate undeserved revenues.").

130. *Id.*

131. *Id.* at 1117-18.

132. *Id.*

133. *Id.* at 1116 (citing Webster v. N.Y. Life Ins. Ann. Corp., 386 F. Supp. 2d 438, 441 (S.D.N.Y. 2005).

134. *Id.* at 1116.

135. *In re* Kingate Mgmt. Ltd. Litig., 784 F.3d 128, 132-34 (2d Cir. 2015). A ponzi scheme is a system of investment fraud where its organizers pay existing investors with funds collected from new investors joining the fund or scheme.

The district court dismissed all of these state law class action claims pursuant to SLUSA's preemption provision, finding that "essentially each of the claims included false conduct in connection with transactions in covered securities."[136] On appeal, the Second Circuit reversed, and held that SLUSA did not preempt the claims for breach of contract or fiduciary duty for the fees grifted by Bernie Madoff and his brokerage firm.[137] In this decision, the Second Circuit agreed with the Ninth Circuit, and allowed certain state law claims not in the contemplation of Congress at the time of SLUSA's passage to proceed when they are truly based on state law breaches of contracts, fiduciary duty, and the like.[138]

The United States Court of Appeals for the Third Circuit aligned with this construction of SLUSA's preemption provision as well.[139] In *LaSala v. Bordier et Cie*, the trustees of a bankrupt corporation's liquidating trust brought state law and Swiss law claims for breach of fiduciary duty and money laundering against private Swiss banks.[140] The Swiss banks allegedly facilitated a pump-and-dump scheme in coordination with the directors of a software company.[141] The Third Circuit held that SLUSA could not preempt the liquidating trust from bringing the breach of fiduciary claims or money laundering claims against the Swiss banks.[142] The court stated that "SLUSA's text and legislative history yield the conclusion that Congress did not intend to preempt direct corporate claims."[143] The court directly stated that SLUSA could not preempt a claim from a bankruptcy trustee brought on behalf of the state because Congress did not intend to significantly change the federal bankruptcy system.[144]

This contention should apply to avoid significantly changing the dual system that Congress has devised and protected. Attempts to preempt state law entirely in the past have failed because of Congress' intent to maintain the dual system.[145] Several proposed bills in Congress—including an early iteration of SLUSA—sought

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See Ponzi Scheme, U.S. SEC. & EXCH. COMM'N, www.investor.gov/protect-your-investments/fraud/types-fraud/ponzi-scheme (last visited Nov. 19, 2022). Most commonly in Ponzi schemes, the organizers are either woefully mismanaging the money of current investors or not investing the money investors provide. *Id.*

136. *Id.* at 135.

137. *Id.* at 151-52.

138. *See, e.g., id.*; *Freeman Inv., L.P.*, 704 F.3d at 1115-1.

139. *LaSala*, 519 F.3d at 142-43.

140. *Id.* at 126-27.

141. *Id.*

142. *Id.* at 143.

143. *Id.*

144. *See id.* at 135-36.

145. *See* Securities Litigation Improvement Act of 1997, H.R. 1653, 105th Cong. § 16 (1997) (unsuccessful bill which sought field preemption of securities class action under state law).

to vest federal courts with exclusive jurisdiction over all securities class actions after the enactment of the PSLRA.[146] All these proposals did not make it past the drafting stage. The intermediate approach is the only approach which considers the historical evolution of securities regulation in this country because it acknowledges that SLUSA should not stretch too far to disturb our present systems of law.

Even though the *LaSala* decision is rooted in a specific exemption regarding bankruptcy law that was raised in a congressional report,[147] it demonstrates the critical importance of examining and respecting Congressional intent in applying laws enacted over a century ago. The *LaSala* court's contentions on the impact from an overly broad application of SLUSA demonstrates that Congress should make SLUSA's boundaries crystal clear. However, more recent case developments have challenged *LaSala*'s impact on the federal landscape regarding SLUSA's preemption provision, as the Sixth Circuit challenged *LaSala* as contrary to the Third Circuit's prior holdings.[148]

In *Rowinski v. Salomon Smith Barney*, the Third Circuit applied a literalist approach and declared that SLUSA applies wherever deceptive conduct or representations form the essence of a claim.[149] The beneficiary-plaintiff in *Segal* relied on *LaSala* to support his position that SLUSA does not always require dismissal of a complaint which contains state law breach of contract claims that include some actions of misrepresentation or deception.[150] However, the *Segal* court remained unmoved by this argument, finding that the existence of any alleged misrepresentation is immaterial to the consideration of SLUSA's preemptive reach.[151] The Sixth Circuit declared that the Third Circuit had contradicted itself and sharpened the divide between the circuits on the application of SLUSA preemption.[152]

This divide between Third Circuit decisions certainly muddies the waters on the *LaSala* decision's efficacy. However, a subsequent decision by the Third Circuit supported the intermediate approach even further by finding that the presence of some claims preempted by SLUSA does not automatically require dismissal.[153] Perhaps the conflicting case law could support the contention that this circuit

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146. A. A. Sommer, Jr., *Preempting Unintended Consequences*, 60 L. CONTEMP. PROBS. 231, 232 (1997).

147. *Id.* (citing S. Rep. No. 105-182, at 8 (1998)).

148. *Segal*, 581 F.3d at 311-312.

149. Rowinski v. Salomon Smith Barney, 398 F.3d 294, 299-300 (3d Cir. 2005).

150. *Segal*, 581 F.3d at 311-312.

151. *Id.* (citing *Rowinski*, 398 F.3d at 300).

152. *See id.*

153. *In re* Lord Abbett Mutual Funds Fee Litigation, 553 F.3d 248, 253-54 (3d Cir. 2009).

split does not result from the application of different law, but rather, of different facts.[154] However, that contention overlooks the drastic consequences resulting from the circuit split, as the cases discussed here demonstrate. It also ignores Congressional intent in enacting SLUSA because challenges to immoral accounting and investment management practices could be unfairly swept into SLUSA's reach in some circuits.

The intermediate approach should control in the Third Circuit, as well as across the nation, because this approach allows a court to examine the timbre of the state law claim before it. In total, this collection of decisions from the Second, Third, and Ninth Circuits stresses the need for narrowing SLUSA's preemptive reach so certain types of shareholder claims against corporate officers, trustees, and brokerages should not be barred. To do otherwise would upset the legislative history surrounding securities regulation and litigation reforms.

C. The Field Preemption Approach: The Seventh Circuit Stands Alone

The United States Court of Appeals for the Seventh Circuit released a pair of decisions on SLUSA preemption in 2017 that complicated the field of jurisprudence by introducing a new approach.[155] The Seventh Circuit held that if a claim could be pursued under federal securities law, then it is preempted by SLUSA—even if it could be pursued under certain state laws on breach of fiduciary duty and breach of contract.[156] The Seventh Circuit stated that "there are plenty of ways to bring wrongdoers to account," other than by the private securities class action,[157] but those ways did not prevent previous financial scandals or abuse of the present regulatory regime. The Seventh Circuit found that most of SLUSA would be superfluous if it allowed plaintiffs to work around securities litigation standards by bringing state law breach of contract or fiduciary duty claims.[158] This approach is somewhat nonsensical, as it ignores the core purpose of SLUSA's preemption provisions, which is to prevent frivolous "strike suits" from

154. *See Northstar Fin. Adv.*, 904 F.3d at 829-30 (opining that the different outcomes in the case law are due to different facts present in these cases). However, these cases have one key similarity. They are not the "vexatious" claims which Congress sought to prevent with SLUSA.

155. *See* Goldberg v. Bank of Am., 846 F.3d 913, 916 (7th Cir. 2017); Holtz v. J.P. Morgan Chase Bank, 846 F.3d 928, 929-30 (7th Cir. 2017).

156. *E.g. Holtz*, 846 F.3d at 930 (stating "nondisclosure is a linchpin of this suit no matter how [the plaintiff] chose to frame the pleadings.").

157. *Id.* at 934.

158. *See id.* at 933-34.

bankrupting emerging publicly traded companies.

The Seventh Circuit's approach has been broadly criticized by commentators as well as the minority opinions on the Seventh Circuit, like the dissenting opinion in *Goldberg v. Bank of America*.[159] In *Goldberg*, a group of bank customers filed a putative class action asserting state-law breach of contract and fiduciary claims against their bank.[160] The customers all had custodial accounts with the bank, in which clients could invest in nationally traded securities.[161] At the end of each business day, the bank would invest the cash balances remaining in their clients' accounts into a mutual fund of the clients' choosing.[162] Immediately after the bank was acquired, new management eliminated a particular fee charged to clients to maintain the custodial accounts and informed the clients of this change.[163] However, none of the clients knew about this fee prior to the notification of elimination.[164]

The clients filed suit in state court, alleging that the bank had breached its investment contract because it did not mention this fee, as well as breached their fiduciary duty to the class of clients.[165] The bank removed the suit to federal court, pursuant to SLUSA, and the district court determined that the suit was barred by the statute.[166] The clients complained that the bank pocketed funds received from the mutual funds, which the clients invested in. The bank did not deposit those funds back into the custodial accounts. Essentially, the bank collected an extra fee, which was not on the contractual fee schedule and did not disclose that the clients were receiving returns. The Seventh Circuit quickly dispatched these arguments and found that these actions constituted a breach of fiduciary duty and breach of contract under state law. However, since the claims could also have been pursued under federal securities law, the court held that SLUSA preempted the lawsuit.[167] In a concurrence, Judge Flaum advocated that the plaintiffs' claims were preempted by SLUSA after examining the complaint under the Sixth Circuit's literalist approach.[168] Judge Flaum opined that the bank clients' complaint might have survived the preemption provision if it focused squarely on reducing the returns of clients instead of alleging a lack of disclosure on the part of bank management.[169]

In response, Judge Hamilton passionately dissented, arguing

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159. *See, e.g., Goldberg*, 846 F.3d at 922-25 (Hamilton, J., dissenting).
160. *Id.* at 915 (majority opinion).
161. *Id.*
162. *Id.*
163. *Id.*
164. *Id.*
165. *Id.*
166. *Id.*
167. *Id.* at 916.
168. *Id.* at 919-20 (Flaum, J., concurring).
169. *Id.*

that the dismissal should be reversed because the complaint did not allege "any form of fraud or negligent misrepresentation."[170] The dissent agreed with the intermediate approach of the Ninth Circuit, and stated that the bank and the majority opinion performed "some sort of reverse alchemy" and "transform[ed] this simple claim for breach of contract into one of 'omission of a material fact.'"[171] Judge Hamilton declared that while SLUSA serves a worthy purpose, courts should deny expanding its preemptive reach to state law breach of fiduciary duty and contract claims. Judge Hamilton opined that such a decision would give defendants broad latitude to execute some "extraordinary feats of legal jiu-jitsu to avoid liability for wrongdoing."[172] The three opinions from the three-judge panel in *Goldberg*, make it clear that the Seventh Circuit is strongly divided on how far SLUSA's preemptive provision reaches.

The Seventh Circuit's recent decision in *Goldberg* departs substantially from the plain text of SLUSA and its legislative history while promoting an arbitrary standard on class action plaintiffs in this securities litigation. Following the majority's line of reasoning, ordinary class action breach of contract claims levied against brokerages would be barred. Insurance providers and investment banks may be shielded from liability in the Seventh Circuit, even when they conceal vital information about the performance of clients' investments, charge hidden fees, or develop investment strategies for personal benefit at the expense of the client.

IV. TWO BIRDS, ONE STONE: A LEGISLATIVE SOLUTION

Congressional hyperactivity created these ambiguities. Congress could kill two birds with one stone by revising SLUSA's preemption provision.[173] The first bird is the wide, disparate treatment of consumer investors in the different circuits across the nation. The second bird is flightless, the result of congressional gridlock and partisanship on fiscal issues. However, Congress has the capacity to nudge the second bird from its perch and let it fly, based on the authority to act just as it did in the 1990s with the passage of both the PSLRA and SLUSA. 15 U.S.C. § 77(f)(2) provides the definition of a "covered class action."[174] Some included subsections clarify how many persons count towards the "50 person" limit and provide an exception for derivative actions brought by

170. *Id.* at 920 (Hamilton, J., dissenting).
171. *Id.* at 921.
172. *Id.*
173. *See* discussion and sources *supra* notes 9-20.
174. 15 U.S.C. § 77(f)(2)(A-C).

groups of shareholders.[175]

By restricting the definition of what a covered class action is, it allows federal courts to strike down claims which look, sound, and operate like the type of securities fraud claims which are prone to abuse. Simply put, stock drop suits are easily distinguishable from the type of claim wrongly prohibited under SLUSA's current preemption provision. With just a handful of words, Congress could eradicate the circuit split on this issue. In short, a uniform bright line must be accepted to provide consistent, workable outcomes. Whether it is the stricter, literalist approach or the intermediate, majority approach, securities-holders of all kinds would exponentially benefit from clarity in this area of the law.

The conflicting decisions stemming from the federal circuit courts expose the need for Congress to take action to make this area of securities law clear. SLUSA was devised to prevent the rising filings of typical "strike suits" and stock price drop cases[176] and its preemptive provision should not be used to slowly suffocate a plaintiff's rights to private causes of action for wrongdoings not made in the intended context. While "strike suits" were a concern because they sapped the value of public companies,[177] they bear little to no similarity with the claims discussed above. A class action claim based on state law breach of fiduciary duty that alleges that a broker or insurance provider is investing imprudently solely to collect higher fees is be a prime example. Further, such actions would directly violate contractual and fiduciary obligations to investors.[178] Current events demonstrate the tendencies of brokerage firms, large corporations, and big banks to perform "legal jiu-jitsu" to avoid liability.[179]

The combination of the rise of retail investing, the aftermath of the COVID-19 pandemic, and the new age of democratization of financial markets have drawn a lot of attention to the securities markets.[180] During the COVID-19 pandemic, involvement in retail investment skyrocketed, in substantial part due to investment apps like Robinhood and WeBull.[181] As a result, we might see further effort to utilize both the PSLRA and SLUSA to broadly restrict class action lawsuits based on state law claims of unjust enrichment, breach of fiduciary duty, breach of contract, and unfair practice—as

175. *Id.*

176. H.R. Rep. No. 105-640, 105th Cong., 2d Sess. 9 (1998).

177. *Id.*

178. *Cf.* Velikonja, *supra* note 6.

179. *See Goldberg*, 846 F.3d at 921.

180. Over the course of the past few years, retail investing has become incredibly accessible to the general public. *See* Kyle Tang, *The Surge of Retail Investing in 2020*, MEDIUM (Dec. 4, 2020), medium.com/international-junior-economist/the-surge-of-retail-investing-in-2020-ac74790e30f3 [perma.cc/ECC4-G67Z].

181. *Id.*

they were used in the cases above.[182] Allowing SLUSA to reach so far would vitiate an emerging contention prevalent in the burgeoning retail investment community, which is the democratization of securities markets. Depending upon the circuit, such pushes for democratization are snuffed out by a broad interpretation of SLUSA's preemption provision and create increased protections for financial institutions.

Securities litigation filings are in constant flux.[183] As a part of future legislation, Congress could and should make it abundantly clear that SLUSA's preemptive reach does not include state law breach of contract and breach of fiduciary duty claims. Such legislation should codify the intermediate approach to class actions brought under state law. The Supreme Court has addressed several elements of SLUSA preemption related to specific language in the provision but not the full scope of its application to class actions based in state law.[184] If Congress crafts new securities class action reform in the reactionary, far-reaching vein of days past,[185] it would take a hardline approach to seek a reduction in the yearly filings to reduce pressures on courts and financial institutions.

However, doing so could be disastrous. That would force retail investors in the instances elaborated above to either (1) proceed as a class for suit under Section 10(b) in federal courts, or (2) sue individually for breach of contract and fiduciary duty in state courts. The first option would be a poor fit for these claims to truly be heard because the power of collective action has proven a mightier tool to regulate actions of fiduciaries, and the second option would likely not provide relief to shareholders or retail investor plaintiffs because their individual suits would be kicked to private arbitration.[186] Arbitration clauses are included in most agreements

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182. *See* cases and discussion *infra* part III.

183. *Compare* Jefferson E. Bell, et al., *2020 Mid-Year Securities Litigation Update,* HARV. L. SCHOOL FORUM ON CORP. GOVERNANCE (Sept. 1, 2020), corpgov.law.harvard.edu/2020/09/01/2020-mid-year-securities-litigation-update/ (projecting potential increases in filings for 2021); *with* Amanda Maine*, Securities Docket Panelists Weigh in on Enforcement Implications of Covid-19 Pandemic*, 772 Corp. Governance Guide, 2020 WL 3274118, *with* CORNERSTONE RESEARCH, SECURITIES CLASS ACTION FILINGS: 2021 YEAR IN REVIEW 4 (2021) (indicating that 2021 filings declined 35% from 2020).

184. *See generally Dabit*, 547 U.S. at 71 (examining whether SLUSA preempted "holder" class action suits based in state law in which the breach stems from the defendant's use of persuasion and misleading evidence to convince stockholders to hold on their stocks).

185. *See* Selden, *supra* note 3, at 58 (describing Congress's "far-reaching procedural reforms to constrain private securities litigation" as a flawed approach to regulating securities markets).

186. *See* U.S. Sec. & Exch. Comm'n, *Inv. Bull.: Broker-Dealer/Customer Arbitration*, INV. ALERTS & BULL. (Dec. 20, 2016), www.sec.gov/oiea/investor-alerts-bulletins/ib_arbitration.html [perma.cc/D3QP-2TX5].

and these clauses apply to disputes between individual customers and the brokerage firms.[187] In arbitration proceedings, plaintiffs have limited tools of discovery and the arbitrators are not required to follow any legal precedent.[188] A contract calling for arbitration can set up any strictures on the scope and methods of discovery.[189] As a result, depositions have not come standard within discovery in arbitration. Plaintiffs in these forums face lessened chances to recover damages.

Congress could make tweaks to further plaintiff protections by refocusing on corporate fraud events, as they did with the Sarbanes-Oxley Act to course correct after numerous financial collapses from corporate accounting scandals.[190] But, such inactions would harm the thousands of plaintiffs negatively impacted by SLUSA's overly broad reach until that course correction would come. While the Supreme Court could take up the issue of SLUSA's preemptive scope—as suggested by Judge Hamilton's dissent in *Goldberg*[191]—it would best be served if it is incorporated as a part of legislation to address problem areas.[192] It is foreseeable that the nation's high court might not wish to step into the field of fraud and federalism once more, despite pleas from some jurists.[193]

Other theorists have suggested that each state should enact their own versions of the PSLRA.[194] The legislation would prevent state courts from becoming havens for "strike suits" and clearly delineate protections to preserve state law breach of contract and breach of fiduciary suits because they share few similarities to the cases which drew the ire of both Congress and the Supreme Court over the past few decades.[195] Unfortunately, coordinating all of these individual bills across all fifty states would be extremely

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187. *See id.*

188. *Id.*

189. Janice L. Sperow, *Discovery in Arbitration: Agreement, Plans, and Fairness*, A.B.A. (Apr. 10, 2019), www.americanbar.org/groups/litigation/committees/alternative-dispute-resolution/practice/2019/discovery-in-arbitration-agreement-plans-and-fairness/ [perma.cc/64SX-JT6F].

190. *See* Selden, *supra* note 3, 81-84.

191. Goldberg v. Bank of Am., 846 F.3d 913, 925 (7th Cir. 2017) (J. Hamilton, dissenting) "Only the Supreme Court can settle this three- or four-way circuit split." *Id.*

192. *See* Sarah A. Fedner & Gregory A. Markel, *Two Areas for Reform in Securities Litigation*, D&O DIARY (June 9, 2020), www.dandodiary.com/2020/06/articles/securities-litigation/guest-post-two-areas-for-reform-in-securities-litigation/ [perma/cc/6L7J-EBZU].

193. *Goldberg*, 846 F.3d at 925.

194. *See, e.g.*, Virginia F. Milstead, *Why We Need a State-Level Private Securities Litigation Reform Act*, A.B.A. LITIG. (Dec. 10, 2019), www.americanbar.org/groups/litigation/committees/class-actions/articles/2019/fall2019-why-we-need-state-level-private-securities-litigation-reform-act/ [perma.cc/FP6G-JW9N].

195. *See Blue Chip Stamps*, 421 U.S. at 741.

difficult.

It is true that there are economic impacts resulting from allowing discovery in frivolous "strike suits" devised to extort large settlements from defendants with deep pockets.[196] However, the claims described in the cases above are not devised for that purpose. Further, the economic impacts which result from the perpetration of corporate fraud and breaches of duties owed to clients are far more immediate than those phantom pains devised by opponents of securities suits proceeding via the class action vehicle.[197] Given the technology sector's prominent role in the state level and federal level securities reforms in the 1990s,[198] it is important to note that modern brokerage and financial services companies, like Robinhood, could seek to stretch SLUSA's preemptive reach to reduce litigation expenses from future class actions in a similar way.

V. CONCLUSION

The ambiguity between the circuits on the extent of SLUSA's preemptive power creates inconveniences for firms while unduly burdening investors and the plaintiff's bar. Investors have become vilified over time—perhaps unfairly—to breed the broad-reaching behemoth of a procedural hurdle that is the PSLRA and SLUSA. While one might conclude that SLUSA should be read as broadly as possible,[199] it should not extinguish the private cause of action entirely. The irony behind Congress' passage of SLUSA in 1998 is far more evident now because these procedural restrictions seriously threatened "mom and pop investors" and state courts' ability to decide what types of cases involving securities to hear.[200] This directly clashes with the metered goals of reducing federal government overreach and protection of retail investors. Additionally, Congress has consistently expressed that the States should retain some measure of control over adjudicating some securities disputes.[201]

Securities reform is one of the many junctures Congress faces,[202] but legislation restricting SLUSA's ever expanding reach

196. *See* H.R. Rep. No. 105-640, 105th Cong. 2d Sess. 9 (1998).

197. *See* Velikonja, *supra* note 6.

198. *See* Painter, *supra* note 2, at 4-5, 36-38.

199. Merrill Lynch, Pierce, Fenner & Smith Inc. v. Dabit, 547 U.S. 71, 86.

200. *See* H.R. Rep. No. 105-640 (dissenting views of Rep. Ron Klink).

201. *See id.*

202. *See* Lisa Lerer & Astead W. Herndon, *When Ted Cruz and A.O.C. Agree: Yes, the Politics of GameStop Are Confusing*, N.Y. TIMES (Feb. 4, 2021), www.nytimes.com/2021/01/31/us/politics/gamestop-robinhood-democrats-republicans.html [perma.cc/66RZ-4ZNR] (explaining the conflict between congressional Republicans and Democrats since the January 6th, 2021 Capitol

could present an opportunity for bi-partisan collaboration in a turbulent political era. Future regulation might come down the pipeline considering the public attention on events like the GameStop Squeeze of early 2021.[203] However, that will not solve these unique problems posed by the expansive interpretation of SLUSA's preemption provision. The historical background of securities litigation legislation taken in tandem with current events could provide securities defense advocates and high technology firms the opportunity to rear their heads like they did in the 1990s. For these reasons, Congress should make a concerted effort to enact securities class action litigation reform to prevent the courts from sweeping state law breach of contract and fiduciary duty into the category of claims deemed as abusive. These claims do not frustrate the cornerstones of our economic system because these suits serve the vital function of preventing greed and mismanagement of client funds.

riots, although they agree on taking action to investigate or regulate following the Robinhood-Gamestop squeeze situation); *see also* @AOC, TWITTER (Jan. 28, 2021, 11:46 AM), twitter.com/AOC/status/1354848253729234944 [perma.cc/FQF8-CUTZ] (twitter beef between Ted Cruz and Alexandria Ocasio-Cortez).

203. Yun Li, *GameStop Breaks Below $50 a Share as Short Squeeze Comes to an End*, CNBC (Feb. 9, 2021 11:32 AM), www.cnbc.com/2021/02/09/gamestop-breaks-below-50-a-share-as-short-squeeze-comes-to-an-end.html [perma.cc/E3AZ-88KN].