Broader is Better: How Courts Should Determine Whether or Not an Allegation of Fraud Falls under the Preemption Provision of the Securities Litigation Uniform Standards Act

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NOTES

BROADER IS BETTER: HOW COURTS SHOULD DETERMINE WHETHER OR NOT AN ALLEGATION OF FRAUD FALLS UNDER THE PREEMPTION PROVISION OF THE SECURITIES LITIGATION UNIFORM STANDARDS ACT

JENNIFER ROSE ROESKE

INTRODUCTION

In the Securities Litigation Uniform Standards Act of 1998 ("SLUSA"),1 Congress preempted actions "in any State or Federal court by any private party alleging—an untrue statement or omission of a material fact in connection with the purchase or sale of a covered security."2 SLUSA was a reaction to plaintiffs’ strategic response to the Private Securities Litigation Reform Act of 1995 ("PSLRA" or "Reform Act"), which was enacted to combat perceived abuses of the anti-fraud provisions of the federal

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1 Associate Managing Editor, St. John's Law Review, J.D., 2014, St. John's University School of Law; B.A., Government, 2011, Georgetown University. The author would like to thank Professor Michael Perino for his help in creating this Note, as well as the author's family for all of their support over the past three years.

To avoid the PSLRA, litigants would file securities class action lawsuits in state rather than in federal court. Congress feared that the avoidance of the federal forum would undercut the PSLRA's effectiveness, and thus enacted SLUSA. Congress intended SLUSA to create uniform national standards for securities class actions involving national capital markets.

SLUSA clearly preempts traditional state securities fraud class actions. For example, if a publicly traded company makes fraudulent statements in a press release regarding its revenues, that action would be preempted under SLUSA. However, what if the complaint includes a disclaimer stating its allegations are not based on fraud, but on a state-law claim such as a breach of fiduciary duty or a violation of state unfair competition laws? Or what if the language of the complaint does not allege a misrepresentation or omission, but a misrepresentation or omission is implicated in a breach of contract claim? For example, if a trust beneficiary sues the bank that formerly administered the trust on behalf of all trust beneficiaries, alleging the bank breached its fiduciary and contractual duties to the class by failing to inform trust beneficiaries that their trust accounts would be invested in proprietary mutual funds, is that action preempted by SLUSA? The courts have struggled to interpret the misrepresentation language of SLUSA's preemption provision.

This Note argues that the correct approach for interpreting the scope of SLUSA's preemption language is the "literalist" approach taken by the Sixth Circuit. Part I of this Note lays out the legal framework of the Reform Act of 1995, Congress's intent

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5 See id. § 2(3).
6 See id. § 2(5).
7 For a discussion on what constitutes a "covered security," see infra notes 53–54 and accompanying text.
8 Segal v. Fifth Third Bank, N.A., 581 F.3d 305, 312 (6th Cir. 2009); see also Atkinson v. Morgan Asset Mgmt., Inc. 658 F.3d 549, 552 (6th Cir. 2011); Rowinski v. Salomon Smith Barney Inc., 398 F.3d 294, 296 (3d Cir. 2005).
9 See Rowinski, 398 F.3d at 297.
10 See Segal, 581 F.3d at 308–10. According to the Sixth Circuit, this action is preempted. Id. at 310.
in enacting the legislation, and the unintended consequences that flowed from the PSLRA's heightened pleading requirements. Part I also discusses SLUSA, what led to its passage, and its preemption language. Additionally, it looks at the Supreme Court's interpretation of preemption statutes generally, as well as the Supreme Court's broad interpretation of SLUSA in Merrill Lynch, Pierce, Fenner & Smith Inc. v. Dabit.\footnote{547 U.S. 71 (2006).}

Part II examines the three distinct approaches that exist in the Third, Ninth, and Sixth Circuits for defining what is and what is not within the scope of SLUSA's preemption language. One approach is the Third Circuit approach, which tries to distinguish between essential and extraneous allegations in a complaint.\footnote{See generally LaSala v. Bordier et Cie, 519 F.3d 121 (3d Cir. 2008).} If the allegation of fraud is essential to the claim, the suit is necessarily preempted and dismissed.\footnote{See id. at 141. Whether the dismissal should be without prejudice was left as an open question. Id. at 129 n.6.} But if the allegation of fraud is merely "an extraneous detail,"\footnote{See id. at 141.} the action may proceed in state court.\footnote{See id.}

The Ninth Circuit takes a second approach, which preempts an action if it alleges in language or substance a misrepresentation or omission of a material fact, but subsequently allows the suit to be dismissed without prejudice.\footnote{See Stoody-Broser v. Bank of Am., N.A., 442 F. App’x 247, 248 (9th Cir. 2011).} This approach permits a plaintiff to file an amended complaint that removes the fraud allegation and therefore is not preempted under SLUSA.\footnote{See id. at 248–49.}

A third approach, referred to throughout this Note as the Sixth Circuit literalist approach, reads the language of SLUSA broadly.\footnote{See Atkinson v. Morgan Asset Mgmt., Inc., 658 F.3d 549, 555–56 (6th Cir. 2011); see also Segal v. Fifth Third Bank, N.A., 581 F.3d 305, 312 (6th Cir. 2009).} The Fifth and Eighth Circuits have also used this
approach in earlier cases.\textsuperscript{19} Under this analysis, if a complaint can be interpreted as alleging fraud, it is preempted under SLUSA and subject to dismissal with prejudice.\textsuperscript{20}

Finally, Part III criticizes the Third and Ninth Circuit approaches and argues that the literalist approach is the correct standard for analyzing SLUSA's preemption language. While the distinction of whether or not the misrepresentation or omission is a necessary element of an alleged cause of action seems like a defensible bright-line rule, the Third Circuit approach is problematic.\textsuperscript{21} Lower courts have struggled to apply the standard consistently, and in some cases the distinction between essential and extraneous claims has proved ephemeral.\textsuperscript{22}

On the other hand, the Ninth Circuit approach gives plaintiffs the ability to amend their complaint so they can cure what originally triggered SLUSA preemption.\textsuperscript{23} While this approach seems fair, it is difficult, if not impossible, to apply.\textsuperscript{24} Although the language alleging a misrepresentation or omission may no longer appear, it is difficult for a court to determine whether or not the plaintiff has eliminated the allegation in substance from the complaint.\textsuperscript{25} Further, this approach has caused confusion within the Ninth Circuit, which is illustrative of the problems it presents.\textsuperscript{26}

The Sixth Circuit approach is consistent with Congress's intent in enacting SLUSA and with the Supreme Court's interpretation of SLUSA in \textit{Dabit}. It will also lead to consistency

\textsuperscript{19} While this approach was dubbed the "Sixth Circuit Approach" by Judge Posner in \textit{Brown v. Calamos}, 664 F.3d 123, 127 (7th Cir. 2011), it was used before in the Fifth and Eighth Circuits. See \textit{Miller v. Nationwide Life Ins. Co.}, 391 F.3d 698, 702 (5th Cir. 2004) ("The issue of preemption thus hinges on the content of the allegations—not on the label affixed to the cause of action. . . . [t] is plain that Miller has alleged both untrue statements and omissions of material fact in his state law breach of contract claim."); \textit{Dudek v. Prudential Sec., Inc.}, 295 F.3d 875, 879–80 (8th Cir. 2002) ("Although plaintiffs deleted the allegations of fraud, misrepresentation, and non-disclosure that permeated their New York complaint, the fact allegations in the two complaints are otherwise essentially the same, . . . both complaints allege that defendants misstated or omitted material facts in connection with the purchase and sale of the tax-deferred annuities.").

\textsuperscript{20} \textit{See Atkinson}, 658 F.3d at 554; \textit{Segal}, 581 F.3d at 311.

\textsuperscript{21} \textit{See infra} Part III.A.

\textsuperscript{22} \textit{See infra} Part III.A.

\textsuperscript{23} \textit{See infra} Part III.B.

\textsuperscript{24} \textit{See infra} Part III.B.

\textsuperscript{25} \textit{See infra} Part III.B.

\textsuperscript{26} \textit{See infra} Part III.B.
among the circuits. Congress enacted SLUSA to promote uniform national standards.\textsuperscript{27} It was concerned with the flood of litigation from federal to state courts and the increasing prevalence of strike suits in state courts.\textsuperscript{28} The Sixth Circuit does not read anything into the statutory language; it takes it at face value. When a plaintiff alleges a misrepresentation or omission, the action is dismissed with prejudice, consistent with Congress’s intent to achieve uniformity and consistency. In \textit{Dabit}, the Supreme Court held that the language of SLUSA should be read broadly to ensure the effectiveness of the PSLRA.\textsuperscript{29} The Sixth Circuit approach reads the language of SLUSA broadly, in line with the Court’s interpretation of SLUSA.\textsuperscript{30} Most importantly, the literalist approach provides a standard that will create uniformity among the circuits. The Sixth Circuit’s approach is straightforward and simple; the court looks to see if there is an allegation of misrepresentation or omission in the language or substance of the complaint.

I. THE LEGAL FRAMEWORK

A. The Legislation

1. The Private Securities Litigation Reform Act of 1995

   The PSLRA was enacted to combat perceived abuses of the anti-fraud provisions of the federal securities laws.\textsuperscript{31} Congress, as well as the business community, was concerned with the prevalence of strike suits—lawsuits brought for their settlement value as opposed to their merits.\textsuperscript{32} The PSLRA’s procedural


\textsuperscript{30} See Atkinson v. Morgan Asset Mgmt., Inc., 658 F.3d 549, 555 (6th Cir. 2011); Segal v. Fifth Third Bank, N.A., 581 F.3d 305, 309 (6th Cir. 2009).


\textsuperscript{32} O’Hare, supra note 31, at 334–35; see also Blue Chip Stamps v. Manor Drug Stores, 421 U.S. 723, 749–50 (1975) (limiting the private right of action under Rule 10b-5 to plaintiffs who were either purchasers or sellers of securities). Generally, in
reforms were intended to make it more difficult for plaintiffs to bring federal securities fraud actions in an attempt to eliminate the problem of strike suits in federal court.\textsuperscript{33}

Many unintended consequences flowed from the passage of the PSLRA.\textsuperscript{34} Traditionally, plaintiffs preferred federal private rights of action over state claims, particularly in class action litigation involving publicly traded companies.\textsuperscript{35} But to avoid the procedural requirements of the Reform Act, plaintiffs filed their claims under state law in state court.\textsuperscript{36} Evidence suggests that after the Reform Act, there was a significant shift in litigation from federal to state courts, especially in California.\textsuperscript{37} While there was debate over the actual size and scope of the shift, Congress was persuaded by the evidence, which prompted hearings in 1997 and 1998 that led to the passage of SLUSA.\textsuperscript{38}

strike suits plaintiffs would allege that a company issued a misleading press release or other public document, which caused investors to purchase or sell their securities at lower prices. O'Hare, \textit{supra} note 31, at 334-35. Plaintiffs would sue the issuer, the issuer's management, as well as the issuer's accounting firm, law firm, and bank. \textit{Id.} at 335. Defendants would often settle even non-meritorious claims to avoid the high costs and bad publicity that accompanied these types of claims. \textit{Id.}

\textsuperscript{33} \textit{See} Michael A. Perino, \textit{Securities Litigation Under the PSLRA} 11-3 (2012); \textit{see also} O'Hare, \textit{supra} note 31, at 335. The procedural reforms in the PSLRA included a heightened pleading standard and an automatic stay of discovery upon the filing of a motion to dismiss. \textit{Id.} It also included a lead plaintiff provision, a proportionate liability provision, and a provision requiring courts to inquire at the conclusion of each suit whether counsel had complied with Rule 11. \textit{Id.} at 335-36.


\textsuperscript{35} \textit{Perino, supra} note 33, at 11-4 ("[P]laintiffs filed most of these cases in federal court for one simple reason: federal courts have exclusive jurisdiction over Rule 10b-5 actions." (footnote omitted)); \textit{see also} Thomas Lee Hazen, \textit{Allocation of Jurisdiction Between the State and Federal Courts for Private Remedies Under the Federal Securities Law}, 60 N.C. L. REV. 707, 713 (1982). For further analysis of why plaintiffs preferred federal court, see \textit{Perino, supra} note 33, 11-4, 11-5.

\textsuperscript{36} O'Hare, \textit{supra} note 31, at 337.

\textsuperscript{37} \textit{See} SEC REPORT, \textit{supra} note 34, at 67-68; Perino, \textit{supra} note 31, at 299; Grundfest & Perino, \textit{supra} note 34. Additionally, plaintiffs, after the Reform Act, began pursuing a dual-track litigation strategy to evade the Reform Act's discovery stay. \textit{See Perino, supra} note 33, at 11-9; \textit{see also} O'Hare, \textit{supra} note 31, at 337.

\textsuperscript{38} \textit{See Perino, supra} note 33, at 11-10.
2. The Securities Litigation Uniform Standards Act

Proponents of SLUSA argued that the legislation was essential to the effectiveness of the Reform Act, while opponents insisted Congress should await results before considering a preemption proposal because it was too soon to tell the legislation's true effect. The argument in favor of SLUSA ultimately prevailed, and the President signed the bill into law on November 3, 1998.

The SLUSA preemption provision provides:

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.

If SLUSA applies, it allows the defendant to remove the claim to federal court where it must be dismissed. Congress inserted this provision to ensure that federal courts would interpret the scope of preemption under SLUSA. When an action does not fall within SLUSA it must be remanded to state court.

The legislative history of SLUSA demonstrates that Congress was primarily concerned with protecting issuers from strike suits. Congress recognized the need for uniform federal securities laws in order to limit the exposure of publicly traded companies after an initial public offering. Congress found that

43 PERINO, supra note 33, at 11-14 to -15; O'Hare, supra note 31, at 342.
44 See H.R. REP. NO. 105-640, at 16 (stating the purpose of removal is to "prevent a State court from inadvertently, improperly, or otherwise maintaining jurisdiction over an action that is preempted [under SLUSA]").
47 The Conference Report stated:
the PSLRA caused a shift in securities class action lawsuits from federal to state court.\textsuperscript{48} The shift operated against the PSLRA's purpose, thereby inhibiting its effectiveness.\textsuperscript{49} SLUSA was enacted because of the strong federal interest in the regulation of securities in order to protect investors and promote strong markets.\textsuperscript{50} To prevent this shift in litigation from frustrating the purpose of the PSLRA, Congress found it was appropriate to enact national standards for securities class action lawsuits.\textsuperscript{51} While Congress left intact concurrent state-federal jurisdiction, this was not an issue Congress was concerned about when it enacted SLUSA. Congress's main aim was to prevent the circumvention of the PSLRA, not to readdress the jurisdiction over these claims.\textsuperscript{52}

SLUSA is not all-encompassing. SLUSA does not apply to all fraud claims involving securities brought under state law. It is limited to "covered securities," which are generally nationally traded securities.\textsuperscript{53} The definition of "covered securities" in SLUSA is modeled after the National Securities Markets Improvement Act of 1996, which preempted many state-law offering rules for securities that Congress determined were "inherently national in nature."\textsuperscript{54} Additionally, only "covered

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\textsuperscript{48} See supra notes 46–51 and accompanying text.

\textsuperscript{49} See id. § 2(3).

\textsuperscript{50} See id. § 2(4).

\textsuperscript{51} Id. § 2(5).

\textsuperscript{52} See supra notes 46–51 and accompanying text.


\textsuperscript{54} H.R. REP. NO. 104-864, at 43 (1996) (Conf. Rep.); see also PERINO, supra note 33, at 11-37. SLUSA provides:

The term “covered security” means a security that satisfies the standards for a covered security specified in paragraph (1) or (2) of section 77r(b) of this title at the time during which it is alleged that the misrepresentation, omission, or manipulative or deceptive conduct occurred, except that such
class actions” are preempted, which include three different types of actions: (1) actions brought on behalf of more than fifty persons; (2) actions brought on a representative basis; and (3) a group of joined or consolidated actions. Even if a class action falls into one of these three “covered class action” categories, it is only covered under SLUSA if the plaintiff seeks damages on behalf of the class. Finally, the preemption provision is subject to a number of exceptions and exclusions, which include the “Delaware carve-out,” as well as derivative actions brought by shareholders on behalf of a corporation.

B. The Supreme Court’s Interpretation

1. Preemption Statutes

In Merrill Lynch, Pierce, Fenner & Smith Inc. v. Dabit, the Supreme Court turned to the settled framework it laid out in earlier cases such as Medtronic, Inc. v. Lohr for interpreting preemption statutes. Medtronic involved the ability of Lora Lohr, who was injured due to the failure of her pacemaker, to recover damages under Florida common law from Medtronic, Inc., the manufacturer of the device. The statute involved was the Medical Device Amendments of 1976 (“MDA”), and Medtronic argued that the statute preempted state common law negligence actions against the manufacturers of an allegedly defective medical device. While the statute expressly preempted certain state causes of action, the Court had to determine the scope of the actions covered by the MDA. Ultimately, the Court held

term shall not include any debt security that is exempt from registration under this subchapter pursuant to rules issued by the Commission under section 77d(2) of this title.

15 U.S.C. § 77p(f)(3); see also id. § 78bb(f)(5)(E). For additional information on what constitutes a “covered security,” see PERINO, supra note 33, at 11-37 to -39; O’Hare, supra note 31, at 339 n.84.


56 See id.

57 O’Hare, supra note 31, at 341. Under the “Delaware carve-out,” certain actions are preserved for violations of the fiduciary duty of disclosure under state law. Id.


60 Dabit, 547 U.S. at 87.

61 Medtronic, 518 U.S. at 474.

62 Id.

63 Id. at 484.
that Lora Lohr’s action was not preempted by the MDA. Relevant to this discussion is the analytical framework the Court used to analyze the MDA’s preemption language.

The Court began its analysis by stating that the interpretation of the scope of a preemption statute starts with the statutory text, but that this evaluation “does not occur in a contextual vacuum.” The interpretation is informed by two presumptions about the nature of preemption. The first presumption is that Congress “does not cavalierly pre-empt state-law causes of action.” The analysis starts with the assumption that the police powers of the states are not to be superseded unless Congress had a clear and manifest purpose. The Court concluded that this presumption is relevant and applicable to questions concerning the scope of preemption statutes.

The second presumption in the Court’s analysis is guided by the notion that “[t]he purpose of Congress is the ultimate touchstone of pre-emption analysis.” Consequently, the scope of a preemption statute must be interpreted and understood with “a fair understanding of congressional purpose.” Congressional purpose is primarily derived from the statutory preemption language as well as the “statutory framework” surrounding it. Also relevant is the “structure and purpose of the statute as a whole,” through not only the statutory text, but also the court’s reasoned understanding of Congress’s intention for the statute and its surrounding regulatory scheme to affect “business, consumers, and the law.”

64 Id. at 487.
65 Id. at 484–85 (citing Gade v. Nat’l Solid Wastes Mgmt. Ass’n, 505 U.S. 88, 111 (1992) (Kennedy, J. concurring in part and concurring in judgment)).
66 Id. at 485.
67 Id.
68 Id.
69 Id. (citing Rice v. Santa Fe Elevator Corp., 331 U.S. 218, 230 (1947)). The Supreme Court has stated its task in preemption cases is to enforce the “clear and manifest purpose of Congress.” Rice, 331 U.S. at 230.
70 See Medtronic, 518 U.S. at 486.
72 Id. at 529 n.27 (emphasis added).
74 Id. at 98 (O’Connor, J., plurality opinion).
75 Medtronic, 518 U.S. at 486.
Medtronic illustrates the interpretive framework used by the Supreme Court in its analysis of preemption statutes. The Court employed this framework to analyze SLUSA and the scope of its preemption language in Dabit.\textsuperscript{76}


In Dabit, the Supreme Court held that SLUSA applied broadly to preempt state-law class action claims.\textsuperscript{77} There, the respondent, Shadi Dabit, a former Merrill Lynch broker, filed a class action on behalf of himself and all other former or current brokers, who, while employed at Merrill Lynch, purchased certain stocks—for themselves and their clients—between December 1, 1999, and December 31, 2000.\textsuperscript{78} Dabit claimed Merrill Lynch breached its fiduciary duty and covenant of good faith and fair dealing by disseminating misleading research and manipulating stock prices.\textsuperscript{79} Dabit asserted that the class was damaged by Merrill Lynch’s actions in two ways: (1) the misrepresentations and manipulative tactics caused them to hold onto overvalued securities, and (2) the brokers lost commission fees when their clients, who became aware that they made poor investments, took their business elsewhere.\textsuperscript{80}

The district court granted Merrill Lynch’s motion to dismiss on the ground that the action fell within SLUSA.\textsuperscript{81} The Court of Appeals for the Second Circuit reversed, concluding the claims did not allege fraud “in connection with the purchase or sale” of securities under SLUSA because the fraud was not alleged by a purchaser or seller of securities.\textsuperscript{82} Because the complaint alleged that the brokers were fraudulently induced to retain or delay selling their securities, it fell outside of SLUSA’s preemptive scope.\textsuperscript{83} The Supreme Court ultimately disagreed with the decision of the Second Circuit, and concluded holders of securities

\textsuperscript{77} Id. at 74.
\textsuperscript{78} Id. at 75.
\textsuperscript{79} Id.
\textsuperscript{80} Id. at 76.
\textsuperscript{82} Dabit, 547 U.S. at 77; see Dabit, 395 F.3d at 51.
\textsuperscript{83} Dabit, 547 U.S. at 77.
also fell within SLUSA’s scope. The Supreme Court employed the Medtronic framework and ultimately determined that SLUSA should be read broadly.

The Court in its analysis briefly recounted the events that led up to the adoption of SLUSA, highlighting the large federal interest in protecting the integrity and efficient operation of the market for nationally traded securities. The Court found that the presumption that Congress envisioned a broad interpretation of the statute follows not only from the plain meaning of the statute, but also from the concerns that “culminated in SLUSA’s enactment.” The Court stated that a narrow reading of SLUSA would undercut the effectiveness of the 1995 Reform Act, thus operating contrary to SLUSA’s stated purpose, which is to prevent strike suits from frustrating the objectives of the PSLRA. It also acknowledged the unintended consequences of the PSLRA that prompted the enactment of SLUSA. If the Court were to adopt the respondent’s construction, the prospect of parallel class action proceedings in state and federal court would be raised, which the Court said would conflict with Congress’s stated preference for national standards.

The Court reasoned that its conclusion was consistent with the presumption that Congress does not “cavalierly” preempt state-law causes of action. According to the Court, SLUSA does not preempt any state causes of action; it simply denies plaintiffs the right to use the class action device for certain claims. Further, the Court stated that the tailored exceptions to SLUSA preemption show that Congress did not act “cavalierly.” Finally, federal law has been the traditional vehicle for asserting

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84 "Id. at 77-78. The Second Circuit decision was vacated and remanded for further proceedings consistent with the Supreme Court's opinion. Id. at 89.
85 Id. at 87-88.
86 Id. at 81-82.
87 Id. at 81.
88 Id. at 86.
90 Id.
91 Id. at 86-87.
92 Id. at 87.
93 Id.
94 Id.
class action securities fraud claims. Therefore, this is not an area where a federal statute eliminated a historically entrenched state-law remedy.

The Supreme Court in *Dabit* asserted that a broad reading of the SLUSA language is proper. The Court reiterated that the purpose of SLUSA is to prevent strike suits and create national standards for securities class action lawsuits. The Court pointed to the plain meaning of SLUSA, Congress's intent in enacting SLUSA, as well as the presumptions employed by the Court to analyze preemption statutes to support its broad construction.

II. THE CIRCUIT COURT DIVISION

A. *The Three Approaches*

Since *Dabit*, several circuit courts have interpreted the scope of the SLUSA preemption language—"any private party alleging—a misrepresentation or omission of a material fact"—differently, causing a split of authority. Specifically, the Third, Ninth, and Sixth Circuits have developed three distinct approaches to whether an allegation of a misrepresentation or omission should be enough to preempt an action under SLUSA. The Supreme Court recently denied certiorari to a case raising this issue. Resolving this split is important because Congress enacted SLUSA to create uniform national standards in order to protect the effectiveness of the PSLRA, and different circuit court approaches undermine Congress's intent.

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95 Id. at 88.
96 Id.
97 Id. at 86–87.
98 Id.
99 Id.
102 Brown v. Calamos, 132 S. Ct. 2774 (2012) (mem.), denying cert. to 664 F.3d 123 (7th Cir. 2011); see also Brown, 664 F.3d at 127.
103 See supra notes 46–51 and accompanying text.
1. The Third Circuit “Essential” Versus “Extraneous” Approach

The Third Circuit first addressed the scope of SLUSA’s misrepresentation language in Rowinski v. Salomon Smith Barney Inc." The plaintiff filed a class action in Pennsylvania state court alleging that Salomon Smith Barney, one of the largest investment banks and stock brokerage firms in the world at the time, disseminated “biased investment research” that breached the parties’ services contract, unjustly enriched the firm, and violated state consumer protection law. Salomon Smith Barney removed the action to federal court and the district court later granted its motion to dismiss based on SLUSA preemption. The district court reasoned that the plaintiff was unable to escape the obvious connection between the misrepresentations alleged in the analyst reports and the purchase and sale of securities. While the plaintiff carefully avoided alleging that his stock purchase decisions were affected, the district court found the plaintiff would not be concerned with the accuracy of the reports unless he relied on them. Therefore, the lower court held that the complaint, despite its language referring to state law, alleged a “misrepresentation or omission of a material fact” and was therefore preempted by SLUSA.

The Third Circuit affirmed the judgment of the district court. The court concluded that “[t]he misrepresentation issue is straightforward.” The plaintiff alleged that Salomon Smith Barney provided biased investment research and analysis to its customers, artificially inflated the ratings and analysis of its investment banking clients, and was fined for providing materially misleading reports. The plaintiff argued that the factual allegations of misrepresentation in the complaint were

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104 398 F.3d 294, 299–300 (3d Cir. 2005).
105 Id. at 296.
107 Id. at *3.
108 Id.
109 Id. at *2–4. The claims were dismissed without prejudice because the court found the plaintiff may have been able to assert claims under federal securities laws. Id. at *4 & n.6.
110 Rowinski, 398 F.3d at 305.
111 Id. at 299.
112 Id. at 299–300.
irrelevant to the SLUSA inquiry because misrepresentation was not an essential legal element of the claim. However, the court disagreed and reasoned that, “preemption does not turn on whether allegations are characterized as facts or as essential legal elements of a claim, but rather on whether the SLUSA prerequisites are ‘alleged’ in one form or another.” An approach where only essential legal elements of a state claim triggered preemption would be inconsistent with the plain meaning of the statute and would allow artful pleading to undermine SLUSA’s goal of uniformity. The court concluded that SLUSA preempted the action because the allegations of a material misrepresentation served as the factual predicate of the state-law claim. Because SLUSA preempted “actions” and not “claims,” the statute suggests that if any of the claims alleged were preempted, the entire action must be dismissed; here, the court affirmed the district court’s dismissal of the action without prejudice.

A few years later, the Third Circuit, in *LaSala v. Bordier et Cie*, altered its approach. In *LaSala*, the defendants Bordier et Cie and Dominick Company (collectively, the “Banks”) were alleged to have assisted AremisSoft, a software enterprise, in executing a “pump-and-dump” scheme. The plaintiffs, who were trustees, asserted four claims: two counts of aiding and abetting a breach of fiduciary duty and two counts of violating Swiss money-laundering laws. The Banks filed a motion to

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113 Id. at 300.
114 Id.
115 Id. (“The Congress finds that . . . it is appropriate to enact national standards for securities class action lawsuits involving nationally traded securities[.]” (alterations in original) (quoting 15 U.S.C. § 78a note (2012) (Congressional Findings of 1998 Amendment)).
116 Id.
117 Id. at 305 & n.12 (noting that the district court dismissed the plaintiff’s claims without prejudice).
118 519 F.3d 121 (3d Cir. 2008).
119 Id. at 126. Once the scheme was discovered, the purchasers of the stock filed a federal class action securities suit requesting rescission of their stock-purchase contracts. *Id.* AremisSoft petitioned for Chapter 11 Bankruptcy while this suit was pending. *Id.* To settle the suit, the purchasers were assigned all causes of action owned by AremisSoft. *Id.* The plan for reorganization provided for the creation of a state-law trust (the “Trust”) to take title to and prosecute the assigned claims. *Id.* at 127. Joseph LaSala and Fred Ziedman were trustees of the Trust. *Id.*
120 Id. There was one count of each allegation brought against both Bordier and Dominick. *Id.*
dismiss, arguing the lawsuit was preempted by SLUSA.\textsuperscript{121} The plaintiff sought to hold the defendant liable for aiding and abetting the misrepresentations and omissions made by third parties.\textsuperscript{122} The district court looked to the Eighth Circuit for guidance, which had previously held that SLUSA preemption applied to the aiding and abetting claims against a defendant when a plaintiff implicitly alleged misrepresentations or omissions in connection with the purchase of securities.\textsuperscript{123} Based on 	extit{Dabit}, the Eighth Circuit's guidance, and the plain meaning of SLUSA, the district court granted the motion to dismiss, determining that all of the claims involved substantive allegations of misrepresentations and were therefore preempted by SLUSA.\textsuperscript{124}

The Third Circuit vacated the district court's dismissal of the complaint and remanded the case for further proceedings consistent with its opinion.\textsuperscript{125} The court's relevant analysis concerned the violations of Swiss money-laundering laws.\textsuperscript{126} The Banks argued that the state-law claims were preempted under SLUSA, and because the Swiss law claims re-alleged and incorporated the allegations supporting the state-law claims, they too must be preempted.\textsuperscript{127}

The Third Circuit stated that the Banks were misinterpreting its analysis in \textit{Rowinski},\textsuperscript{128} which held that a claim is preempted by SLUSA "when an allegation of a misrepresentation in connection with a securities trade is a 'factual predicate' of the claim, even if misrepresentation is not a legal element of the claim."\textsuperscript{129} In \textit{Rowinski}, the court had reasoned that when a plaintiff's necessary fact was a

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\item \textsuperscript{121} Id.
\item \textsuperscript{122} LaSala v. Bordier et Cie, 452 F. Supp. 2d 575, 578 (D.N.J. 2006), \textit{vacated}, 519 F.3d 121 (3d Cir. 2008).
\item \textsuperscript{123} Id. at 587.
\item \textsuperscript{124} See id. at 588; LaSala, 519 F.3d at 129. The court did not specify whether or not the dismissal was with or without prejudice. See generally LaSala, 452 F. Supp. 2d 575.
\item \textsuperscript{125} LaSala, 519 F.3d at 143. The case on remand was settled. LaSala v. Bordier et Cie, No. 3:05-cv-04520 (D.N.J. Oct. 30, 2008).
\item \textsuperscript{126} LaSala, 519 F.3d at 140–42.
\item \textsuperscript{127} Id. at 140–41. The state-law claims in this case were remanded, but the analysis was based on the "in connection with" language, not the misrepresentation language, of SLUSA. Id. at 141, 143.
\item \textsuperscript{128} Id. at 141.
\item \textsuperscript{129} Id. (citing \textit{Rowinski} v. Salomon Smith Barney Inc., 398 F.3d 294, 300 (3d Cir. 2005)).
\end{enumerate}
\end{footnotesize}
misrepresentation, it could not avoid SLUSA by altering its legal theory.130 In LaSala, the court reframed its Rowinski analysis, reasoning that the “misrepresentation” part of SLUSA is met when an allegation of misrepresentation in connection with a securities trade operates as a factual predicate.131 A factual predicate must give rise to liability; it cannot be an “extraneous detail.”132 The distinction matters because complaints are often filled with more information than necessary.133 The court concluded that the inclusion of extraneous allegations does not require that the complaint be dismissed under SLUSA.134 In LaSala, the allegations of misrepresentation in the Swiss law claims appeared to be extraneous.135 Whether a preempted action should be dismissed without prejudice remained an open question for the court.136

2. The Ninth Circuit “Intermediate” Approach

The Ninth Circuit addressed the scope of SLUSA’s preemption language involving misrepresentations in Stoody-Broser v. Bank of America, N.A.137 In Stoody-Broser, trust beneficiary and plaintiff Ellen Stoody-Broser filed a class action complaint against Bank of America (“BOA”), the trustee.138 The complaint alleged “omissions of material fact and deceptive practices” in connection with BOA’s investment in proprietary mutual funds; for example, the beneficiaries of the trust had no knowledge of BOA’s investments until after they were made.139 The district court dismissed the complaint under SLUSA.140 The district court found that while the allegations in the complaint

130 Id.; see also Rowinski, 398 F.3d at 299–300.
131 LaSala, 519 F.3d at 141.
132 Id.
133 Id.
134 Id.
135 Id.
136 Id. at 129 n.6.
137 442 F. App’x 247, 248 (9th Cir. 2011).
139 Stoody-Broser, 442 F. App’x at 248. The complaint alleged that the trust beneficiaries had no advance knowledge of BOA’s investments until after they were made, that BOA failed to document its transactions and to make documentation available, and that omissions allowed BOA to “reap millions as a part of an unlawful ‘scheme.’” Id.
140 Stoody-Broser, 2009 WL 2707393, at *5.
involved violations of fiduciary obligations, the essence of the complaint was that the defendants misrepresented and omitted material facts relating to the investment.\textsuperscript{141} Therefore, because the gravamen of the complaint set forth "a scheme premised on the inherent misrepresentations and omissions made by the trustee," SLUSA preempted it.\textsuperscript{142}

The Ninth Circuit affirmed the district court's dismissal, but remanded the case with instructions to grant Stoody-Broser leave to amend her complaint.\textsuperscript{143} The court recognized its prior holding in \textit{Proctor v. Vishay Intertechnology Inc.}\textsuperscript{144} that a misrepresentation does not have to be a specific element of a claim to fall within SLUSA's preclusion provision.\textsuperscript{145} As a result, it agreed with the district court that the complaint was precluded under SLUSA in its current form.

However, the court noted that "[d]ismissal without leave to amend is improper unless it is clear ... that the complaint could not be saved by any amendment."\textsuperscript{146} While acknowledging the danger of artful pleading, the court believed the complaint could allege a violation of BOA's fiduciary duty to trust beneficiaries without alleging a misrepresentation, omission, or fraudulent practice.\textsuperscript{147} Consequently, the court remanded the case to give Stoody-Broser an opportunity to plead such a complaint.\textsuperscript{148}

On remand, the district court denied the defendant's motion to dismiss.\textsuperscript{149} The court found that the amended complaint removed all fraud claims and therefore "cured" all preemption issues.\textsuperscript{150} The court emphasized that the plaintiff changed both the language and the substance of the claims.\textsuperscript{151} While "the original complaint alleged that Plaintiff[s] ... were misled about the investment of their trust assets, the amended complaint alleges merely that Defendants fail[ed] to act with due care

\textsuperscript{141} Id. at *3.
\textsuperscript{142} Id. at *4.
\textsuperscript{143} \textit{Stoody-Broser}, 442 F. App'x at 248–49.
\textsuperscript{144} 584 F.3d 1208 (9th Cir. 2009).
\textsuperscript{145} \textit{Stoody-Broser}, 442 F. App'x at 248 (citing \textit{Proctor}, 584 F.3d at 1222 n.13).
\textsuperscript{146} Id. (quoting Gompper v. VISX, Inc., 298 F.3d 893, 898 (9th Cir. 2002)).
\textsuperscript{147} Id. at 249.
\textsuperscript{148} Id.
\textsuperscript{150} Id. at *4.
\textsuperscript{151} Id.
under their fiduciary obligations to do so.\textsuperscript{152} The court held that the claims were no longer preempted under SLUSA because they were no longer predicated upon a misrepresentation.\textsuperscript{153}

In August 2012, the district court granted the defendant’s motion to certify immediate appeal on the denial of the defendant’s motion to dismiss.\textsuperscript{154} The court noted the “substantial” disagreement in several circuit courts, including the Ninth Circuit, regarding whether a plaintiff can amend a set of facts to state a non-preempted claim.\textsuperscript{155} The Ninth Circuit did not accept the interlocutory appeal.\textsuperscript{156}

3. The Sixth Circuit “Literalist” Approach\textsuperscript{157}

The Sixth Circuit first addressed the scope of SLUSA’s misrepresentation language in \textit{Segal v. Fifth Third Bank, N.A.}\textsuperscript{158} Segal was a beneficiary of a trust previously administered by Fifth Third Bank.\textsuperscript{159} He sued the bank on behalf of himself and all of the beneficiaries of the trust.\textsuperscript{160} The complaint asserted state-law claims that Fifth Third breached its fiduciary duty and contractual duty to the class.\textsuperscript{161} One specific allegation was that the bank promised trust beneficiaries individualized management but breached the agreement by providing “standardized and largely automated management.”\textsuperscript{162} Fifth Third filed a motion to dismiss, which the district court granted for failure to state a claim under SLUSA.\textsuperscript{163} The district court found that the plaintiffs’ action was premised upon the allegation that Fifth Third misrepresented or failed to disclose material facts, or engaged in a manipulative or deceptive course of conduct when Fifth Third invested the plaintiffs’ fiduciary funds.\textsuperscript{164} The

\begin{thebibliography}{99}
\bibitem{152} Id.
\bibitem{153} Id.
\bibitem{155} Id. at *4.
\bibitem{156} Stoody-Broser v. Bank of Am., No. 12-80159 (9th Cir. Nov. 1, 2012).
\bibitem{157} While this is called the Sixth Circuit Approach, support for it can be found in other circuits in earlier cases. See infra notes 188–200 and accompanying text.
\bibitem{158} 581 F.3d 305 (6th Cir. 2009).
\bibitem{159} Id. at 308.
\bibitem{160} Id.
\bibitem{161} Id.
\bibitem{162} Id. The management was often by low-level or inexperienced employees. Id.
\bibitem{163} Id.
\end{thebibliography}
fact that the plaintiffs avoided using the words “misrepresentation” or “omission” did not matter because the court looked to the substance of the allegations.\footnote{Id.}

The Sixth Circuit began its analysis with the Supreme Court’s broad interpretation of the SLUSA language in \textit{Dabit}.\footnote{Segal, 581 F.3d at 309.} The Sixth Circuit noted the Supreme Court’s view that a narrow reading of SLUSA would be inconsistent with ordinary principles of statutory construction and would undercut the effectiveness of the PSLRA.\footnote{Id.} The court found that Segal’s complaint contained misrepresentations, material omissions, and manipulation.\footnote{The complaint alleged that Fifth Third did not inform trust beneficiaries that their trust accounts would be invested in proprietary mutual funds and the Bank knowingly overcharged its clients, among other things. \textit{See id.} at 309–10.} But Segal included a disclaimer in the amended complaint that stated that “[n]one of the causes of action stated herein are based upon any misrepresentation or failure to disclose material facts to plaintiff[s].”\footnote{Id. at 310 (quoting Amended Complaint ¶ 2, Segal, 581 F.3d 305).} The court stated it must look to the substance of the complaint’s allegations in applying SLUSA; a plaintiff cannot avoid its application through artful pleading that removes the covered words from the complaint while leaving the covered concepts.\footnote{Id. at 310–11.} SLUSA does not ask whether the complaint makes material or dependent allegations of misrepresentation, it asks “whether the complaint includes these types of allegations, pure and simple.”\footnote{Id. at 311.}

The plaintiff tried to point to the Third Circuit’s reasoning in \textit{LaSala}, arguing that the inclusion of extraneous allegations does not require that the complaint be dismissed under SLUSA.\footnote{Id. at 311–12.} However, the Sixth Circuit dismissed the language of the Third Circuit as dicta, emphasizing that the language of SLUSA does not state “material,” “dependent,” or “extraneous” allegations.\footnote{Id. at 312.} Moreover, the court stressed that a broad interpretation of SLUSA leaves no room for this “extraneous” analysis, which
would be difficult to implement. In SLUSA, Congress left open many ways for claimants like Segal to vindicate their rights. As a result, the court concluded that the district court was correct in granting the motion to dismiss because Segal’s claim was barred by SLUSA.

The Sixth Circuit again applied the literalist approach in Atkinson v. Morgan Asset Management, Inc. In Atkinson, the plaintiffs held shares in three mutual funds that sustained losses between 2007 and 2008. The plaintiffs filed a class action suit in state court against the funds’ advisors, officers, directors, distributor, auditor, and affiliated trust company (collectively, “Defendants”), attributing their losses to fraud. The complaint alleged thirteen state-law claims for breach of contract, violations of the Maryland Securities Act, breach of fiduciary duty, negligence, and negligent misrepresentation. The essence of the plaintiffs’ argument was that the Defendants took unjustified risks in allocating the funds’ assets and concealed the risks from shareholders. Defendants removed the state action to federal court under SLUSA. Plaintiffs moved for remand, but the district court denied the plaintiffs’ motion for remand and dismissed the action under SLUSA with prejudice. The district court found that the plaintiffs’ claims alleged facts dependent on findings of deceit, fraud, misrepresentation, or omissions of a material fact.

The Sixth Circuit affirmed the district court’s decision to dismiss the complaint. The court found that the complaint alleged the Defendants failed to “provide truthful and complete

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174 Id. The court also states that it presumes this is the reason why Rowinski rejected this suggestion. Id.
175 Id. For example, Segal could have filed the same complaint on behalf of himself and up to forty-eight other individuals and avoided SLUSA preclusion. Id. Segal could have also filed a class action in accordance with PSLRA. Id.
176 Id.
177 658 F.3d 549 (6th Cir. 2011).
178 Id. at 551–52.
179 Id. at 552.
180 Id.
181 Id.
182 Id.
183 Id.
185 Atkinson, 658 F.3d at 557.
The plaintiffs contended that SLUSA only bars claims that require fraud as a necessary element. However, the court found this contention to be inconsistent with the law of the Sixth Circuit, which reviews the substance of a complaint’s allegations, not allowing claimants to avoid the application of SLUSA through “artful pleading.” The court concluded, “[a]pplying Segal, SLUSA precludes [p]laintiffs’ claims because they include allegations of misrepresentations and omissions, ‘pure and simple.’” The court reiterated that SLUSA cannot be tricked, and that the plaintiffs could have avoided SLUSA preclusion by filing a class action with less than fifty members.

This approach has also been applied in the Fifth and Eighth Circuits. In Dudek v. Prudential Securities, Inc., investors brought a state court class action against their insurer “alleging improper marketing of tax-deferred annuities to accounts that already enjoyed tax-deferred status.” Plaintiffs alleged the annuities were improper investments because the tax-deferred accounts did not need the tax benefits, so the extra costs and fees were a waste of the investors’ money. The defendants removed the case, and the district court dismissed the action with prejudice. The court found that the securities were covered by SLUSA because the plaintiffs’ claims were in substance based upon “material misrepresentations and non-disclosures in the purchase or sale of a covered security.”

Both the district court and the Eighth Circuit in Dudek found that the gravamen of the complaint involved an “untrue statement or substantive omission of a material fact.” Moreover, the original complaint filed included allegations of fraud and deceit. The Eighth Circuit found that although the

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166 Id. at 554.
167 Id. at 555.
168 Id.
169 Id. (quoting Segal v. Fifth Third Bank, N.A., 581 F.3d 305, 311 (6th Cir. 2009)).
170 Id. at 556.
171 295 F.3d 875 (8th Cir. 2002).
172 Id. at 877.
173 Id.
174 Id. at 877–78.
175 Id. at 878.
176 Id. at 879.
177 Id.
plaintiffs deleted the allegations of fraud and deceit, "both complaints allege[d] that defendants misstated or omitted material facts in connection with the purchase and sale of the tax-deferred annuities." Therefore, the Eighth Circuit held the complaint was preempted by SLUSA and affirmed the district court decision.\footnote{198}{Id. at 879–80.}

In \textit{Miller v. Nationwide Life Insurance Co.},\footnote{199}{Id. at 880.} Miller filed a class action against Nationwide alleging breach of contract under Louisiana law, arguing that "in its initial offerings Nationwide had represented there would be no fees charged."\footnote{200}{391 F.3d 698 (5th Cir. 2004).} The district court dismissed the contract claim under SLUSA.\footnote{201}{Id. at 699.} Miller's complaint alleged untrue statements and omissions, and described actions by Nationwide as materially false and misleading.\footnote{202}{Id.} The Fifth Circuit reasoned that preemption hinges on the content of the allegations, not on the label given to the cause of action, in this case a breach of contract claim.\footnote{203}{Id. at 699, 702.} Consequently, the Fifth Circuit concluded it was plain that Miller alleged untrue statements and omissions of material fact, so it dismissed the action, affirming the district court's decision.\footnote{204}{Id. at 702.}

Therefore, while this approach has been labeled the Sixth Circuit "literalist" approach, the Sixth Circuit is not the only circuit that has utilized this approach.

\section*{III. THE CORRECT STANDARD: THE SIXTH CIRCUIT "LITERALIST" APPROACH}

In practice, the Third and Ninth Circuit approaches have led to inconsistent and difficult-to-apply standards that clash with Congress's intent and the Supreme Court's interpretation of SLUSA. Conversely, the Sixth Circuit approach is consistent with the language and congressional intent behind SLUSA. It is also consistent with both the Supreme Court's interpretation of preemption statutes generally, as well as the Court's interpretation of SLUSA in \textit{Dabit}. Finally, the literalist
approach will lead to consistency among the circuits, which was Congress's ultimate goal in enacting SLUSA, making it the correct approach.

A. Criticism of the Third Circuit Approach

The Third Circuit's *LaSala* approach has proven to be problematic and at odds with the court's earlier approach in *Rowinski*, the language and intent behind SLUSA, and the Supreme Court's interpretation of SLUSA. Further, this approach has yielded inconsistent results in the lower courts and has at times proven irrelevant to SLUSA preemption analysis. In *Rowinski*, the Third Circuit noted that an approach "under which only essential legal elements of a state law claim trigger preemption, is inconsistent with the plain meaning of the statute."\(^{206}\) The court in *Rowinski* concluded that it must look at whether a misrepresentation or omission was alleged, not whether it was a fact or essential legal element of the claim.\(^{207}\)

The Third Circuit moved away from its *Rowinski* analysis in *LaSala*, drawing a distinction between essential and extraneous elements of a claim.\(^{208}\) The court in *LaSala* concluded that the misrepresentation or omission must be a factual predicate of the claim which gives rise to liability in order for the action to be preempted by SLUSA.\(^{209}\)

SLUSA preempts any covered class action by "any private party alleging—a misrepresentation or omission of a material fact."\(^{210}\) According to the Supreme Court, the analysis of the


\(^{207}\) Id. Despite the Third Circuit's subsequent *LaSala* opinion, a district court in the Third Circuit recently applied the *Rowinski* analysis with only a brief mention of *LaSala* or the distinction between essential and extraneous claims. See generally Wilson v. Wells Fargo Advisers, LLC, No. 11-511-SLR-SRF, 2012 U.S. Dist. LEXIS 151851 (D. Del. Oct. 22, 2012). This illustrates the uncertainty that exists within the lower courts of the Third Circuit regarding which approach should be applied. While the *Rowinski* approach is similar to the literalist approach, it is distinguishable because the court requires dismissal without prejudice. See *Rowinski*, 398 F.3d at 305 & n.12. But cf. Atkinson v. Morgan Asset Mgmt., Inc., 658 F.3d 549, 553 n.1, 556–57 (6th Cir. 2011) (affirming district court's dismissal of claims with prejudice); Segal v. Fifth Third Bank, N.A., 581 F.3d 305, 312 (6th Cir. 2009) (same). This dismissal without prejudice presents the same issues that the Ninth Circuit approach presents. See infra Part III.B.

\(^{208}\) *LaSala* v. Bordier et Cie, 519 F.3d 121, 141 (3d Cir. 2008).

\(^{209}\) Id.

statute must begin with the text and its plain meaning. In \textit{LaSala}, the court noted that a misrepresentation must be a factual predicate; it must be a fact that gives rise to liability, not an extraneous detail. But looking at the text of the statute, the Third Circuit’s analysis in \textit{LaSala} was inconsistent with the plain meaning of SLUSA. SLUSA does not draw a distinction between types of allegations. The text states that a class action must be preempted if it involves “any private party alleging—a misrepresentation or omission of a material fact.” Therefore, reading in a requirement that the allegation must be essential to the claim is inconsistent with the statute.

While it could be argued that the text of SLUSA is inherently ambiguous, the next step in the proper analysis of preemption statutes is to examine congressional intent. Congress intended to promote uniform national standards for securities class action litigation involving national capital markets. These uniform rules were necessary to protect issuers from exposure to the jurisdictions of fifty different states. SLUSA was prompted by the perceived flood of litigants from federal to state courts to avoid the heightened requirements of the PSLRA. Congress wanted to curb the prevalence of strike suits through SLUSA. Under a system that draws distinctions between essential and extraneous elements of a claim, it would be nearly impossible to achieve the uniformity that Congress envisioned in enacting SLUSA. This approach gives courts enormous discretion, therefore making it difficult for courts to produce consistent results, which operates against Congress’s intent to establish uniform national standards.


\footnote{212} \textit{LaSala}, 519 F.3d at 141.


\footnote{216} Id. at 14–16.


\footnote{218} O’Hare, \textit{supra} note 31, at 334–35.
Although the approach of distinguishing between an essential claim necessary for liability and an extraneous one seems like a defensible bright-line rule, it has not been applied consistently in practice. This inconsistency is illustrated by In re Charles Schwab Corporation Securities Litigation and Simon v. Stang, two district court cases in the Northern District of California that applied LaSala. In Schwab, the plaintiffs alleged that the defendants Charles Schwab Corporation and several affiliated entities and individuals violated federal securities laws and state laws by misrepresenting the risk profile and assets of Schwab's YieldPlus Fund and by improperly changing the fund's investment policies. When the court reached its SLUSA analysis, it used the LaSala approach and focused on the gravamen of the complaint. Because the plaintiffs agreed that Schwab properly disclosed the change in its policy, none of the claims were predicated on a misrepresentation and therefore they were not preempted by SLUSA. The allegations that Schwab misrepresented the nature of the fund as an "ultra-short bond fund" and misrepresented the fund's portfolio duration were extraneous to the complaint despite their incorporation by reference into the state-law claims.

In Simon, the court attempted to distinguish Schwab. In Simon, the plaintiffs alleged that they were wrongfully denied a cumulative vote on a merger. The court noted that the defendants' misrepresentations in Schwab were one means of effectuating the scheme, whereas the change in policy was the other. Here, the court concluded the cases were similar because the defendants used multiple means to effectuate the wrongful merger, including misstatements and denying a vote to the common shareholders. However, the claim incorporated by reference several allegations of misrepresentations in connection with voting rights. Therefore, the claim was precluded under

221 Id. at 551.
222 Id.
223 Id.
224 Simon, 2010 WL 1460430, at *5.
225 Id. at *7.
226 Id.
227 Id.
SLUSA because the complaint expressly alleged misrepresentations and omissions in connection with the violation.\textsuperscript{228}

These decisions directly conflict with one another. In \textit{Schwab}, because the misrepresentations were incorporated by reference in the claim, the court found they were extraneous and therefore the claim was not precluded.\textsuperscript{229} In \textit{Simon}, the court concluded that because the allegations of misrepresentations were incorporated by reference in the complaint the claim was preempted, even though the plaintiffs had a valid claim without the alleged misrepresentation.\textsuperscript{230} This inconsistency and confusion is one reason why the \textit{LaSala} approach is problematic.

\textit{Brown v. Calamos}\textsuperscript{231} illustrates another difficulty in applying the \textit{LaSala} standard. In \textit{Brown}, shareholders in an investment company filed a putative class action in state court alleging that company officials breached their fiduciary duties and were unjustly enriched by causing the company to redeem certain preferred shares in a manner that unfairly benefitted preferred shareholders.\textsuperscript{232} Judge Posner found that the allegation of fraud would be difficult and maybe impossible to disentangle from the charge of a breach of the duty of loyalty that the defendants owed their investors.\textsuperscript{233} Because the fraud was pervasive, there was no utility in distinguishing essential from extraneous elements of the claim.\textsuperscript{234} \textit{Brown} highlights that the \textit{LaSala} approach may sometimes be irrelevant to a court's preemption analysis.\textsuperscript{235}

Further, the Third Circuit's approach is inconsistent with the Supreme Court's interpretation of SLUSA in \textit{Dabit}. There, the Supreme Court underwent the above analysis and concluded that SLUSA requires a broad interpretation in accordance with

\textsuperscript{228} Id.
\textsuperscript{229} In re Charles Schwab Corp. Sec. Litig., 257 F.R.D. 534, 551 (N.D. Cal. 2009).
\textsuperscript{230} Simon, 2010 WL 1460430, at *7.
\textsuperscript{231} 664 F.3d 123 (7th Cir. 2011).
\textsuperscript{233} Calamos, 664 F.3d at 129.
\textsuperscript{234} See id. at 128–29.
\textsuperscript{235} See id.; see also Jorling v. Anthem, Inc., 836 F. Supp. 2d 821, 835 (S.D. Ind. 2011) (“As was the case in Brown, it would be impossible to ‘disentangle’ the securities fraud issue from the state law claims involving fiduciary failure and breach of contract.”).
statutory principles and congressional intent. It noted that a narrow interpretation would both undercut the effectiveness of the PSLRA as well as contradict SLUSA's stated purpose to achieve uniformity. In LaSala, the court narrowed its interpretation of SLUSA preemption by requiring that the misrepresentation be a factual predicate that gives rise to liability. The Third Circuit in LaSala distinguished essential from extraneous elements of a claim, a specific inquiry that is at odds with the Supreme Court's broad interpretation of SLUSA. Not only did the Third Circuit interpret SLUSA narrowly, it also read language and meaning into the statute. Moreover, this approach makes it impossible to achieve uniform national standards, which was the intent of Congress in enacting SLUSA.

Therefore, the Third Circuit's attempt in LaSala to narrow the interpretation of the SLUSA preemption language is inconsistent with both the language and the Supreme Court's interpretation of SLUSA. The approach is also problematic because it is difficult for courts to apply consistently, and sometimes may even be irrelevant to a court's analysis.

B. Criticism of the Ninth Circuit Approach

A number of issues flow from the Ninth Circuit's intermediate approach. This approach enables plaintiffs to avoid SLUSA by changing the language of their complaint, ignoring the possibility that the fraud could later be reintroduced into the "cured" action. It also allows for an inefficient use of judicial resources, and is inconsistent with the plain meaning and congressional intent behind SLUSA.

Looking at the substance of the approach, after recognizing the complaint in Stoody-Broser was preempted under SLUSA, the Ninth Circuit tried to remedy the preemption issue by allowing the plaintiff to amend the preempted complaint. The gravamen of Stoody-Broser's original complaint involved a

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237 Id. at 86.
238 LaSala v. Bordier et Cie, 519 F.3d 121, 141 (3d Cir. 2008).
239 Id.
misrepresentation claim, yet the district court on remand found SLUSA preemption no longer applied. The court is supposed to look beyond the allegations to the substance of a complaint to avoid artful pleading. Instead, the Ninth Circuit's approach enabled a plaintiff like Stoody-Broser to change the language of her claim in order to avoid SLUSA preemption.

Additionally, as Judge Posner determined in Brown v. Calamos, the fraud element might enter into the litigation long after the amended complaint is filed. The plaintiff, or its lawyer, saw the allegation as adding substance to the original complaint; otherwise they would not have included it. Therefore, while the new pleadings may no longer contain allegations of fraud, there will be a temptation to reintroduce the fraud allegations once the case is remanded to state court. To allow removal of a complex commercial case after the pleadings stage would unreasonably increase the length and cost of litigation. Following the Ninth Circuit approach would lead to inefficiency because once the gravamen of the complaint involves misrepresentation, it must be preempted under SLUSA.

The judicial inefficiency that follows from this approach is illustrated by the subsequent history of Stoody-Broser. This matter has now been heard by the district court, appealed to the Ninth Circuit, remanded back to the district court, appealed back to the Ninth Circuit where the appeal was not accepted, and is now back in the district court. This demonstrates the large waste of judicial resources that can result from this approach. While giving a plaintiff a chance to amend its complaint seems fair, the reality is that it is difficult for courts to determine whether or not an amended complaint has been "cured."

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244 Brown v. Calamos, 664 F.3d 123, 127 (7th Cir. 2011).
245 Id. at 128.
246 Id.
247 Id. at 127.
248 See supra Part II.A.2.
249 See supra Part II.A.2.
Additionally, dismissals of claims with prejudice serves as a deterrent to strike suits. Congress was motivated to enact SLUSA in part because of the perception that plaintiffs were avoiding the heightened requirements of the PSLRA by bringing their claims in state court. SLUSA only applies in very specific and limited situations, and the plaintiff or plaintiff's attorney needs to take responsibility for the allegations it includes in the complaint. For example, a plaintiff could entirely avoid SLUSA by filing a complaint on behalf of forty-nine individuals. By dismissing claims with prejudice, it deters plaintiffs' lawyers from bringing strike suits in state court and forces plaintiffs and their attorneys to be more careful about what they include in their complaint.

Further, like the Third Circuit's approach in LaSala, the Ninth Circuit's approach is inconsistent with the plain meaning of the statute and congressional intent. The language of the statute does not indicate that plaintiffs are to be given a second shot at pleading their complaints. It plainly states that if a complaint involves an allegation of fraud, the suit is preempted. Moreover, allowing plaintiffs to take a second bite of the apple runs against congressional intent in enacting SLUSA. Congress wanted to prevent issuers from exposure to the jurisdictions of all fifty states and to stop the flood of litigation from state to federal court. The Ninth Circuit's approach would lead to issuers being exposed to many different state jurisdictions because it allows plaintiffs to simply take the language of fraud out of their complaints and proceed at the state level. While the suit could theoretically be removed a second time, it would be a gross waste of limited judicial resources.

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251 See Segal v. Fifth Third Bank, N.A., 581 F.3d 305, 312 (6th Cir. 2009). However, this contention should not be carried out to the extent where a plaintiff is punished for hiring a bad lawyer. Taken to its logical extreme, it could admittedly lead to unfair results for claimants.

252 Atkinson v. Morgan Asset Mgmt., Inc., 658 F.3d 549, 556 (6th Cir. 2011).

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

approach is at odds with the statutory language and purpose of SLUSA. Therefore, the Ninth Circuit's interpretation of the SLUSA preemption language cannot be correct.

C. The "Literalist" Approach Is the Correct Standard

1. The Literalist Approach Is Consistent with the Language of SLUSA and Congressional Intent

Unlike the Third and Ninth Circuit approaches, the literalist approach is consistent with the language of SLUSA as well as Congress's intent in enacting the statute. It is also consistent with the Supreme Court's ruling in *Dabit*, and the approaches of the Fifth and Eighth Circuits in earlier cases.255

The language of SLUSA is broad. It does not distinguish essential from extraneous claims, and it does not give plaintiffs the ability to avoid preemption by amending their complaints.256 According to the language, when there is a misrepresentation or omission of a material fact alleged in a complaint, it is preempted.257 The Sixth Circuit's approach does not read anything into the language; it takes it at face value. While some may argue the language is vague, the literalist approach is further supported by congressional intent.

Congress intended that SLUSA be interpreted broadly to reach all procedural devices that may be used to try to circumvent the Reform Act.258 Congress wanted to eliminate strike suits, which had become a problem since the passage of the PSLRA.259 The Sixth Circuit approach is consistent with those intentions. When a plaintiff inserts a fraud allegation in a complaint, or the complaint clearly implicates issues of fraud, the action is dismissed, "pure and simple."260 This approach does not read additional requirements into the statutory text, and therefore is consistent with both the language and purpose of SLUSA.

255 See *Segal*, 581 F.3d at 312.
256 See *supra* Part III.A-B.
259 O'Hare, *supra* note 31, at 334–35.
260 *Segal*, 581 F.3d at 311.
2. The Literalist Approach Is Consistent with the Supreme Court’s Interpretation of Preemption Statutes and of SLUSA in *Merrill Lynch, Pierce, Fenner & Smith Inc. v. Dabit*

The literalist approach properly applies Supreme Court precedent. It is consistent with the statutory text, which is where the Supreme Court begins its analysis.\(^{261}\) This approach is also supported by the Court’s two presumptions about preemption.\(^{262}\) In drafting SLUSA, Congress did not “cavalierly” preempt state law; the statute only applies to “covered securit[ies]” in specially defined class action suits.\(^{263}\) Congress also legislated a number of exceptions to SLUSA, further illustrating that it had a clear and manifest purpose consistent with the Supreme Court’s first presumption that Congress does not act “cavalierly.”\(^{264}\)

The Sixth Circuit approach promotes and enables uniformity within the circuits, in harmony with congressional purpose in enacting SLUSA.\(^{265}\) The literalist approach is the least discretionary approach; a court makes its decision based on the existence of a fraud allegation.\(^{266}\) This approach does not distinguish between essential and extraneous allegations or allow for plaintiffs to amend their original preempted complaints.\(^{267}\) It looks at the text and substance of the complaint,

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\(^{261}\) *See* Gade v. Nat’l Solid Wastes Mgmt. Ass’n, 505 U.S. 88, 111 (1992) (Kennedy, J., concurring in part and concurring in judgment); *see supra* Part III.C.1.


\(^{263}\) *See supra* Part I.B.2 (explaining that the Supreme Court concluded that Congress did not act cavalierly in enacting SLUSA); *Merrill Lynch, Pierce, Fenner & Smith Inc. v. Dabit*, 547 U.S. 71, 83 (2006) (discussing the definition of “covered securit[ies]”).

\(^{264}\) *See Medtronic*, 518 U.S. at 485 (citing *Rice v. Santa Fe Elevator Corp.*, 331 U.S. 218, 230 (1947)).


\(^{266}\) *See generally* Segal v. Fifth Third Bank, N.A., 581 F.3d 305 (6th Cir. 2009).

\(^{267}\) *See supra* Part III.A.
and if there is fraud it preempts the suit, satisfying the Supreme Court's second presumption that the touchstone of the analysis of preemption statutes is Congress's intent.\textsuperscript{268}

This approach is also in line with the Supreme Court's reading of SLUSA in \textit{Dabit}. SLUSA was enacted due to the unintended consequences that flowed from the requirements of the PSLRA.\textsuperscript{269} The Court concluded that ordinary principles of statutory construction and the purposes for enacting SLUSA supported a broad reading of the statute.\textsuperscript{270} The Sixth Circuit's approach follows the interpretation of the Supreme Court. It keeps in mind the reasons for enacting SLUSA, what Congress was trying to prevent, and reads the text of the statute in a way which is not only consistent with the Supreme Court's view but also would enable all courts to reach the same outcome.

3. The Literalist Approach Will Lead to Consistency Among the Circuits

In SLUSA, Congress stated, "[I]n order to prevent certain State private securities class action lawsuits alleging fraud from being used to frustrate the objectives of the [PSLRA], it is appropriate to enact national standards for securities class action lawsuits involving nationally traded securities . . . ."\textsuperscript{271} Congress saw the shift of litigation from federal to state court, and saw it as curbing the effectiveness of the 1995 Reform Act.\textsuperscript{272} Due to the strong federal interest in the regulation of securities to protect investors and promote strong markets, Congress enacted SLUSA.\textsuperscript{273}

The policies underlying this statute are consistency and uniformity. Congress wanted litigants to face the same standards throughout the country; it did not want issuers to be exposed to the jurisdictions of all fifty states.\textsuperscript{274} The literalist


\textsuperscript{270} Id. at 85–87.


\textsuperscript{272} See id. § 2(2)–(3).

\textsuperscript{273} See id. § 2(4).

approach is in line with the policies underlying SLUSA. The Sixth Circuit’s interpretation of SLUSA enables consistency throughout the nation by looking to see whether there is an allegation of fraud in the language and substance of the complaint, “pure and simple.” This approach is straightforward; it does not leave room for guesswork. Congress laid out specific standards for SLUSA preemption, and that specificity coupled with its intention to create uniform national standards supports the Sixth Circuit’s clear and easily applicable approach. While it would be impossible to find an approach that completely eliminates a court’s discretion, the Sixth Circuit minimizes judicial discretion by having clear guidelines for when a class action brought under state law is preempted.

CONCLUSION

The Sixth Circuit’s literalist approach, which has also been applied in other jurisdictions, furthers Congress’s purpose in enacting SLUSA. SLUSA was meant to create uniform national standards for securities class action lawsuits. Since its enactment, courts have interpreted the misrepresentation language of SLUSA’s preemption statute differently. The Supreme Court has held that SLUSA should be interpreted broadly so that it does not undercut the 1995 Reform Act’s effectiveness. The Sixth Circuit approach does this by employing a standard that enables uniformity throughout the nation. Its standard is broad and requires courts to preempt lawsuits that allege fraud in the language or substance of the complaint. Because this approach involves minimal judicial discretion, it would enable courts to come out with the same result in most cases, thereby supporting Congress’s intent in enacting SLUSA. In order to achieve uniformity, the SLUSA misrepresentation language must be interpreted broadly, consistent with the Supreme Court’s interpretation of SLUSA and Congress’s goal of uniform national standards for securities class action lawsuits. In turn, this will have a positive effect on both individuals and the securities markets by protecting investors and promoting strong and efficient markets.

275 Segal v. Fifth Third Bank, N.A., 581 F.3d 305, 311 (6th Cir. 2009).
276 See supra notes 191–205 and accompanying text.