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Navigating the Securities Litigation Uniform Standards Act of 1998 (SLUSA)

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A Practice Note examining the Securities Litigation Uniform Standards Act of 1998 (SLUSA), a federal law enacted by Congress to prohibit certain private securities class action claims based on state law. This Note defines covered securities and covered class actions, examines SLUSA's applicability to claims based on state law and allegations that could form the basis of a federal securities fraud claim, and identifies the limits to SLUSA's application. It also highlights procedural and strategic issues that parties should be aware of when litigating securities class actions that implicate SLUSA, including issues related to the removal and dismissal of preempted actions, and remand motions.

The Securities Litigation Uniform Standards Act of 1998 (SLUSA) has its origins in the Private Securities Litigation Reform Act of 1995 (PSLRA), which imposed stricter limitations on plaintiffs pursuing federal securities litigation (109 Stat. 737). Following the PSLRA, plaintiffs increasingly filed securities actions asserting state law claims in state courts (see S. Rep. No. 105-182, at 3-4 (1998); H. Rep. No. 105-640, at 10 (1998)).

Congress responded by enacting SLUSA, which generally precludes private plaintiffs from filing certain class action lawsuits based on state law. This means that it bars state law claims of alleged misrepresentations or omissions of material facts in connection with the purchase or sale of a "covered security" (15 U.S.C. § 78bb(f)(1); *Goldberg v. Bank of Am., N.A.*, 846 F.3d 913, 916 (7th Cir. 2017)).

If a plaintiff files a SLUSA-barred lawsuit in state court, SLUSA enables a defendant to remove the lawsuit to federal court so that the federal court can dismiss the lawsuit as preempted by SLUSA (15 U.S.C. § 78bb(f)(2)). SLUSA's removal provision thereby ensures that federal courts have the opportunity to determine whether a state action is precluded by SLUSA (*Madden v. Cowen & Co.*, 576 F.3d 957, 964-65 (9th Cir. 2009)).

In 2018, the Supreme Court limited SLUSA's preclusive effect and federal courts' exclusive jurisdiction over federal securities cases by holding that SLUSA does not impact plaintiffs' ability to file class actions that exclusively assert claims under the Securities Act of 1933 (Securities Act) in state court, or allow defendants to remove such actions to federal court (*Cyan, Inc. v. Beaver Cty. Emps. Ret. Fund*, 138 S. Ct. 1061, 1078 (2018)). As a result, plaintiffs can pursue class action claims under the Securities Act in state courts.

This Note provides an overview of how SLUSA impacts securities litigation, including:

- The types of securities class actions subject to its mandate.
- Defendants' ability to remove actions to federal court if at least one claim satisfies SLUSA's applicability requirements.
- Federal courts' authority to determine whether SLUSA bars specific claims and either:
  - dismiss state law claims that are preempted by SLUSA; or
  - remand actions if SLUSA does not preempt the state law claims.

For more on the key PSLRA provisions governing securities fraud class actions, see Practice Note, Securities Litigation Involving the Private Securities Litigation Reform Act (PSLRA). For detailed guidance on how a defendant may remove a lawsuit from state to federal court, see Practice Note, Removal: How to Remove a Case to Federal Court and Removal Checklist.

SLUSA's Applicability

SLUSA bars "covered" class action claims based on state law if they allege that the defendant misrepresented or omitted a material fact or used a manipulative or deceptive device "in connection with the purchase or sale of a covered security" (15 U.S.C. § 78bb(f)(1); 15 U.S.C. § 77p(b)). Like the PSLRA, SLUSA does not itself create any causes of action. Instead, SLUSA ensures the applicability of federal law and procedure to securities fraud class actions.

Subject to certain limitations (see Limits to SLUSA's Applicability), SLUSA applies to cases involving "covered securities" if:

- A single lawsuit or a group of lawsuits meets SLUSA's definition of a covered class action (see Covered Class Actions).
- The plaintiffs assert claims under state law (see Claim Based on State Law).
- Those claims allege that the defendant engaged in specified misconduct (see Allegation of Specified Misconduct).
- The alleged misconduct was made "in connection with the purchase or sale" of a "covered security" (see In Connection with the Purchase or Sale of a Covered Security).

(See Covered Security; *Rayner v. E*TRADE Fin. Corp.*, 899 F.3d 117, 119-20 (2d Cir. 2018) (citing 15 U.S.C. § 78bb(f)(1)); see also *Freeman Invs., L.P. v. Pac. Life Ins. Co.*, 704 F.3d 1110, 1114 (9th Cir. 2013).)

For more on commencing securities class actions, see Commencing a Federal Securities Class Action Toolkit. For more on defending claims under the federal securities laws, see Securities Act: Federal Private Lawsuit Defense Toolkit and Exchange Act: Section 10(b) Defense Toolkit.

Covered Security

Definition

SLUSA generally applies if the class action brought under state law "concerns a transaction involving covered securities" (*Scala v. Citicorp. Inc.*, 2011 WL 900297, at *4-5 (N.D. Cal. Mar. 15, 2011)). SLUSA defines the term "covered security" consistent with the definition of a "covered security" in the Securities Act (15 U.S.C. §§ 78bb(f)(5)(E) and 77p(f)(3)). This includes all securities that are:

- Authorized to be "traded nationally and listed on a regulated national exchange," including securities listed or authorized to be listed on NYSE, NASDAQ, and other national exchanges when the alleged misconduct occurred (*Merrill Lynch, Pierce, Fenner & Smith Inc. v. Dabit*, 547 U.S. 71, 83 (2006); *Madden*, 576 F.3d at 967-69).
- Issued by an investment company that is registered or that has filed a registration statement under the Investment Company Act of 1940 (15 U.S.C. § 77p(f)(3); *Lander v. Hartford Life & Annuity Ins. Co.*, 251 F.3d 101, 109 (2d Cir. 2001)).
- In the form of a debt instrument registered under the Securities Act that is equally senior or more senior to a security issued by the same company on a national exchange (15 U.S.C. § 77p(f)(3)). An instrument has seniority if it has priority over another class of securities when the company distributes assets or pays dividends (see *In re Metro. Sec. Litig.*, 532 F. Supp. 2d 1260, 1298-99 (E.D. Wash. 2007) (quoting 15 U.S.C. § 77(r)(d)(4))).

The relevant investment product must meet the definition of a covered security at the time the alleged misconduct occurred (see *Madden*, 576 F.3d at 967-68).

Debt securities that are exempt from registration under the Securities Act, such as investments in private placement securities or debentures, are not covered securities (15 U.S.C. §§ 78bb(f)(5)(E) and 77p(f)(3)). Similarly, certificates of deposit issued by federally insured banks (bank CDs) are generally not covered securities under SLUSA even if the bank represents to investors that it intends to use the proceeds from the bank CDs' sales to invest in liquid investments, including stocks, on the bank's behalf and not on behalf of the CD-purchasers (*Chadbourne & Parke LLP v. Troice*, 571 U.S. 377, 396-97 (2014)).

Applicability

Courts have generally held that SLUSA precludes claims involving investments in:

- Mutual funds primarily comprised of covered securities (see, for example, *Kenneth Rothschild Tr. v. Morgan Stanley Dean Witter*, 199 F. Supp. 2d 993, 999-1000 (C.D. Cal. 2002)).
- Investments in American Depositary Receipts (ADRs) and American Depositary Shares (ADSs) that are traded on national exchanges (see *Merryman v. J.P. Morgan Chase Bank, N.A.*, 2016 WL 5477776, at *5-6 n.7, n.10 (S.D.N.Y. Sept. 29, 2016)).
- Reverse convertible notes (RCNs) and high-yield subordinate notes that are senior to an issuer's nationally traded stock (see *Luis v. RBC Capital Mkts., LLC*, 2016 WL 6022909, at *6-7 (D. Minn. Oct. 13, 2016) (applying SLUSA to RCNs); *BT Sec. Corp. v. W.R. Asset Mgmt. Co., LLC*, 891 So. 2d 310, 314-15 (Ala. 2004) (applying SLUSA to high-yield subordinate notes)).

Courts have also found that SLUSA may preclude claims involving variable annuities. Variable annuities are a hybrid between an insurance product and an investment security, because the beneficiary bears the risk of the underlying securities in which the annuitant is invested. In determining whether an annuity qualifies as a covered security, a court will look at whether the beneficiary bears the risk of the investment in the underlying securities (*see Mineo Corp. v. Rowe*, 2009 WL 10689420, at *12 (E.D.N.C. Sept. 16, 2009) (citing *SEC v. Variable Annuity Life Ins. Co. of Am.*, 359 U.S. 65 (1959)).

If the annuity is registered as a variable annuity with the SEC and the beneficiary bears the risk of the underlying securities in which the annuitant is invested, courts are likely to find that the variable annuity is a covered security (see, for example, *Lander*, 251 F.3d at 105, 108-09 (2d Cir. 2001); *Herndon v. Equitable Variable Life Ins. Co.*, 325 F.3d 1252, 1254 (11th Cir. 2003)). If, however, the insurer bears the risk of the investment in the underlying securities courts are likely to find that the annuity is a "pure" insurance product and not a covered security (*Ring v. AXA Fin., Inc.*, 483 F.3d 95, 100-01 (2d Cir. 2007)).

Courts may likewise preclude claims related to investments in feeder funds in which the investors intend to indirectly invest in covered securities. Feeder funds are a device used by hedge funds to pool money contributed by investors into a larger "master" fund, thereby allowing investors to benefit from economies of scale. If a fund represents to its investors that their investments would be used to purchase covered securities, courts have generally determined that these investments are covered by SLUSA even if the feeder fund never purchased the securities (see, for example, *In re Kingate Mgmt. Ltd. Litig.*, 784 F.3d 128, 141-42 (2d Cir. 2015); *Schnorr v. Schubert*, 2005 WL 2019878, at *5-6 (W.D. Okla. Aug. 18, 2005)).

Some courts may look at whether the plaintiff-investor invested in the feeder fund primarily to invest in covered securities and whether the misrepresentation occurred in connection with the covered securities component of the investment (see, for example, *Hidalgo-Velez v. San Juan Asset Mgmt., Inc.*, 758 F.3d 98, 108 (1st Cir. 2014) (holding that SLUSA did not apply to investments in a fund representing that at least 75% of its assets would be invested in uncovered securities and the alleged misrepresentation occurred in connection with those uncovered securities)).

Courts have recognized two situations where SLUSA may not apply to investments that contain both a covered and an uncovered securities component. Specifically, SLUSA may not apply if:

- The alleged misconduct solely concerns an uncovered component that is separable from the covered security component, including, for example, if the uncovered component is a standalone product that can be optionally purchased in combination with a covered security (see, for example, *Ring*, 483 F.3d at 99-101 (holding that SLUSA did not apply to misrepresentations made in connection with a Children's Term Rider that was optionally purchased in combination with a variable annuity)).
- The investor primarily intended to invest in uncovered securities so that any investment in covered securities is merely incidental to the investor's primary purpose. In making this determination, courts consider:
  - the investment product's composition to determine whether the investment is primarily an investment in uncovered securities (see *Hidalgo-Velez*, 758 F.3d at 107-08; see also *Q3 Invs. Recovery Vehicle, LLC v. Tran*, 2020 WL 2832499, at *3-4 (M.D. Fl. June 1, 2020)); and
  - the alleged misrepresentations to determine whether they were "mainly false promises to purchase uncovered securities" and "too attenuated" from the investment's covered securities component (*Hidalgo-Velez*, 758 F.3d at 108; see also *Baldwin v. Merrill Lynch*, 2019 WL 4046542, at *5 (D. Me. Aug. 27, 2019)).

Covered Class Actions

SLUSA does not preempt every securities fraud class action brought under state law (*Dabit*, 547 U.S. at 87). Instead, SLUSA applies to single lawsuits and groups of lawsuits seeking damages that meet certain criteria.

For information on the Class Actions Fairness Act of 2005 (CAFA) and its relationship to the PSLRA and SLUSA, see Box, SLUSA and the Class Action Fairness Act of 2005.

Single Lawsuits

The term "single lawsuit" within SLUSA's definition of a covered class action means a single filed action falling into one of two categories (15 U.S.C. § 78bb(f)(5)(B)(i); see also *In re WorldCom, Inc. Sec. Litig.*, 308 F. Supp. 2d 236, 244-45 (S.D.N.Y. 2004)).

First, SLUSA applies to a single lawsuit seeking damages on behalf of more than 50 individuals or prospective class members. This means that SLUSA applies to single lawsuits seeking damages for at least 51 people even if the plaintiffs did not style their claim as a class action lawsuit. In determining whether there are at least 51 plaintiffs:

- Single entities, such as corporations, investment companies, pension plans, and partnerships, count as one person (15 U.S.C. § 78bb(f)(5)(D)).
- Each member of an entity that was primarily established to pursue a cause of action, such as a trust created to pursue claims on behalf of its beneficiaries, counts towards the 51 person threshold (see *Cape Ann Inv'rs LLC v. Lepone*, 296 F. Supp. 2d 4, 10 (D. Mass. 2003); see also *Smith v. Arthur Andersen LLP*, 421 F.3d 989, 1007-08 (9th Cir. 2005)).

Second, SLUSA also applies to single actions in which a named plaintiff purports to represent the interests of a group of prospective plaintiffs. Therefore, SLUSA applies to putative class actions under FRCP 23, even if the representative plaintiff alleges that the putative class has 50 or fewer proposed class members (*Nielen-Thomas v. Concorde Inv. Servs., LLC*, 914 F.3d 524, 530-32 (7th Cir. 2019)).

Both types of single lawsuits contain a predominance requirement that is satisfied where "the central component" of each plaintiff's or prospective class member's claim "relies on the same core factual issues" (*Marchak v. JPMorgan Chase & Co.*, 84 F. Supp. 3d 197, 207-08 (E.D.N.Y. 2015)). Reliance is removed from the question of predominance for single lawsuits brought by more than 50 people, but not from the predominance analysis for class representative actions (15 U.S.C. § 78bb(f)(5)(B)(i); *Nielen-Thomas*, 914 F.3d at 530 n.7).

Group of Lawsuits

A group of lawsuits collectively is a covered class action under SLUSA if the lawsuits:

- Are filed in or pending in the same court and seek damages on behalf of more than 50 persons collectively.
- Involve common questions of law or fact, even if common issues do not predominate.
- Are joined, consolidated, or otherwise proceed as a single action for any purpose.

(15 U.S.C. § 78bb(f)(5)(B)(ii); *Instituto de Prevision Militar v. Merrill Lynch, Pierce, Fenner & Smith, Inc.*, 546 F.3d 1340, 1346-47 (11th Cir. 2008).)

In deciding whether a group of lawsuits are joined, consolidated, or proceed as a single action, courts may consider whether:

- The allegations are substantially identical.
- The same counsel represent the plaintiffs.
- A Multi-District Litigation (MDL) panel referred the lawsuits to a single court.
- The plaintiffs made joint court filings.
- The lawsuits are subject to joint procedural treatment in a single court.

(*Anwar v. Fairfield Greenwich Ltd.*, 118 F. Supp. 3d 591, 609 (S.D.N.Y. 2015), reconsidered in part on other grounds, 151 F. Supp. 3d 390 (S.D.N.Y. 2015) (collecting cases).)

Although some of these factors are consistent with formal joinder or consolidation, the inclusion of the phrase "otherwise proceed as a single action for any purpose" means that the actions do not need to be formally joined or consolidated for SLUSA to apply (15 U.S.C. § 78bb(f)(5)(B)(ii)). For example, courts have found that cases proceed "as a single action for any purpose" based on both:

- Coordination exclusively for discovery or other pretrial purposes (see *Instituto de Prevision Militar*, 546 F.3d at 1347; *In re WorldCom, Inc. Sec. Litig.*, 308 F. Supp. 2d at 246).
- Informal coordination due to a court determination that the plaintiffs are acting in unison, such as by making joint or identical filings (see *In re Enron Corp. Sec., Derivative & ERISA Litig.*, 535 F.3d 325, 339-40 (5th Cir. 2008)).

In contrast, courts may decline to find that a group of actions are proceeding as a single action when the filings are distinguishable and the actions proceed independently (see, for example, *Rice v. Regions Bank*, 2010 WL 11614152, at *6-7 (N.D. Ala. Mar. 8, 2010) (cases did not proceed as a single action for any purpose where the state court denied a motion to consolidate the separately filed actions and the plaintiffs' complaints were "far from identical")).

Opt-Outs from Class Action Lawsuits

Courts may treat a group of at least 51 plaintiffs who have opted out of a class action settlement and have claims pending in the same court as proceeding as a single lawsuit under SLUSA (see, for example, *Hound Partners Offshore Fund, LP v. Valeant Pharm. Int'l, Inc.*, 2018 WL 4401731, at *3-4 (D.N.J. Sept. 14, 2018); *Amorosa v. Ernst & Young LLP*, 672 F. Supp. 2d 493, 516-18 (S.D.N.Y. 2009), aff'd sub nom. *Amorosa v. AOL Time Warner Inc.*, 409 F. App'x 412 (2d Cir. 2011)).

An opt-out lawsuit may also proceed as a single action with the class action lawsuit if the opt-out lawsuits are managed in coordination with the class action lawsuit and the lawsuits are interrelated (see, for example, *Highfields Capital I, LP v. SeaWorld Entm't, Inc.*, 365 F. Supp. 3d 1050, 1060-62 (S.D. Cal. 2019); *Kuwait Inv. Office v. Am. Int'l Grp., Inc.*, 128 F. Supp. 3d 792, 812-13 (S.D.N.Y. 2015)).

The US Court of Appeals for the Third Circuit, however, has held that even though opt-out plaintiffs' lawsuits are inevitably related to a class action lawsuit, a group of class action opt-out lawsuits does not proceed as a single action with the class action lawsuit if the opt-out lawsuits are not prosecuted at the same time as the class action lawsuit (*N. Sound Capital LLC v. Merck & Co.*, 938 F.3d 482, 489-90, 492-94 (3d Cir. 2019)).

Seeking Damages

SLUSA only applies to actions in which the plaintiffs seek damages, which includes actions for disgorgement and restitution (see *Feitelberg v. Merrill Lynch & Co., Inc.*, 234 F. Supp. 2d 1043, 1048 (N.D. Cal. 2002), aff'd, 353 F.3d 765 (9th Cir. 2003)). SLUSA does not apply if the plaintiffs seek only declaratory or injunctive relief (see, for example, *Wald v. C.M. Life Ins. Co.*, 2001 WL 256179, at *5-6 (N.D. Tex. Mar. 8, 2001)).

To prevent plaintiffs from avoiding SLUSA by omitting monetary relief in their complaints, only to later add claims for monetary damages, courts look beyond the relief sought in the operative complaints to determine whether the plaintiffs selectively omitted monetary relief to avoid SLUSA (see *Gibson v. PS Grp. Holdings, Inc.*, 2000 WL 777818, at *3-4 (S.D. Cal. Mar. 8, 2000); see also *Anderson v. Merrill Lynch, Pierce, Fenner & Smith, Inc.*, 2007 WL 9734031, at *2-3 (D.N.M. Apr. 4, 2007), aff'd, 521 F.3d 1278 (10th Cir. 2008) (holding that plaintiffs could not circumvent SLUSA by seeking an equitable bill of discovery "as a predicate to future amendments seeking additional recovery")).

Claim Based on State Law

SLUSA precludes plaintiffs from bringing claims under state statutory or common law that they could have pursued under the anti-falsity provisions of the federal securities law (see *Goldberg v. Bank of Am., N.A.*, 846 F.3d 913, 916 (7th Cir. 2017)).

Courts disregard the labels given to plaintiffs' state law claims, and dismiss the claims if they meet SLUSA's applicability requirements (see, for example, *Hanson v. Morgan Stanley Smith Barney, LLC*, 762 F. Supp. 2d 1201, 1205-06 (C.D. Cal. 2011)). For example, courts have determined that allegations of fraud in connection with a transaction involving a covered security may arise in claims for:

- Breach of contract (see *Miller v. Nationwide Life Ins. Co.*, 391 F.3d 698 (5th Cir. 2004)).
- Breach of fiduciary duty (see *Lewis v. Scottrade, Inc.*, 879 F.3d 850 (8th Cir. 2018)).
- Unfair competition (see *Hanson*, 762 F. Supp. 2d at 1201).
- Negligent misrepresentation (see *Romano v. Kazacos*, 609 F.3d 512 (2d Cir. 2010)).
- Negligent breach of state common law duties (see *In re Mut. Funds Inv. Litig.*, 437 F. Supp. 2d 439 (D. Md. 2006), aff'd, 309 F. App'x 722 (4th Cir. 2009)).

So long as the state or common law claim, as alleged by plaintiffs, amounts to an allegation of fraud in connection with a transaction involving a covered security, courts will hold that SLUSA preempts the claim.

Allegation of Specified Misconduct

SLUSA applies to allegations that involve either:

- A misrepresentation or omission of a material fact (for more information on these claims, see Practice Note, Exchange Act: Section 10(b) Elements and Defenses).
- The use of a manipulative or deceptive device or scheme in connection with the purchase or sale of a covered security (see Practice Note, Exchange Act: Section 10(b) Scheme Liability and Market Manipulation).

(15 U.S.C. § 78bb(f)(1).)

Courts generally look beyond the face of the pleadings to consider whether the complaint alleges facts that form the basis of a federal securities fraud claim (see, for example, *Romano v. Kazacos*, 609 F.3d 512, 519-21 (2d Cir. 2010); *Segal v. Fifth Third Bank, N.A.*, 581 F.3d 305, 310 (6th Cir. 2009)).

Courts often look to federal securities fraud cases, such as Rule 10b-5 cases, when deciding if the allegations under state law effectively assert a claim based on a material misrepresentation or omission (see, for example, *Brink v. Raymond James & Assocs., Inc.*, 892 F.3d 1142, 1147-48 (11th Cir. 2018) (interpreting the term "material" within SLUSA's preemption provision consistent with "materiality" under Section 10(b) of the Exchange Act and Rule 10b-5); see also Practice Note, Exchange Act: Section 10(b) Defenses Against Materiality Claims).

Most courts have held that a complaint does not need to allege scienter or reliance for SLUSA to apply, however, even though these are key elements of a securities fraud claim (see *Anderson v. Merrill Lynch Pierce Fenner & Smith, Inc.*, 521 F.3d 1278, 1285-87 (10th Cir. 2008) (collecting cases holding that allegations of scienter and reliance are not required for SLUSA to apply, but noting that a few courts disagree)). For more on these elements of a securities fraud claim, see Practice Note, Exchange Act: Section 10(b) Elements and Defenses.

In Connection with the Purchase or Sale of a Covered Security

SLUSA applies if the alleged misconduct occurred "in connection with the purchase or sale of a covered security" (15 U.S.C. § 78bb(f)(1)). In *Merrill Lynch, Pierce, Fenner & Smith Inc.* v. *Dabit*, the Supreme Court held that SLUSA's "in connection with" requirement is broad and applies so long as the alleged misconduct "coincide[s] with a securities transaction" (547 U.S. 71, 85 (2006) (internal quotations omitted)). In light of this broad interpretation, the Supreme Court determined that SLUSA also applies to claims brought by plaintiffs who allege that they held onto covered securities, in addition to plaintiffs who allege that they bought or sold covered securities, due to the alleged misrepresentation (*Dabit*, 547 U.S. at 84, 86-7).

The Supreme Court further clarified the meaning of SLUSA's "in connection with" requirement in *Chadbourne & Parke LLP* v. *Troice*. In *Troice*, the Supreme Court held that SLUSA applies if there is a "material connection" between the alleged misconduct and a transaction in a covered security. That connection exists if the alleged misconduct made a significant difference to the plaintiff's decision to engage in a covered securities transaction. The Supreme Court held that this standard is not met when the case involves a transaction either:

- By investor-plaintiffs in an uncovered security, where the defendant represents that the proceeds from the sale of uncovered securities will be used to purchase covered securities that the defendant will wholly own.
- Incidental to the alleged misrepresentation, rather than constituting a relevant part of the fraud, including, for example, when:
  - a plaintiff sells a covered security to finance the purchase of an uncovered security; and
  - the uncovered security is the subject of the fraudulent scheme.

(*Troice*, 571 U.S. at 377, 387-88, 396-97.)

Courts have recognized that SLUSA's "in connection with" standard remains broad and that the Supreme Court established an outer limit in *Troice* (see, for example, *Zola v. TD Ameritrade, Inc.*, 889 F.3d 920, 925-26 (8th Cir. 2018) (pointing out that in *Troice*, the Supreme Court expressly declined to modify *Dabit*); *In re Herald*, 753 F.3d 110, 113 (2d Cir. 2014) (stating that "*Troice* clarifies the scope of SLUSA by delineating an outer limit")).

For example, after *Troice*, the US Court of Appeals for the Seventh Circuit has held that the alleged misconduct does not need to be specific to the "price, quality, or suitability" of a covered security (*Goldberg v. Bank of Am., N.A.*, 846 F.3d 913, 916 (7th Cir. 2017) (holding that SLUSA applied to claims that a defendant allegedly retained fees that it should have deposited in its customers' custodial accounts)). Courts have also held that *Troice* does not impact SLUSA's application to investments in otherwise uncovered investment products, if the alleged misconduct relates to investors' expectation that they were indirectly investing in covered securities (see, for example, *Kingate Mgmt.*, 784 F.3d at 141-42).

Limits to SLUSA's Applicability

SLUSA exempts certain actions that may otherwise qualify as preempted covered class actions. Specifically, SLUSA preserves:

- Actions to enforce a contractual agreement between issuers and indenture trustees.
- Certain class actions brought under the law of the state in which the issuer of the covered security is incorporated (commonly referred to as the Delaware Carve-Out) (see Delaware Carve-Out for Certain Actions Brought Under State Law).
- Actions brought by a state or state pension plan and state securities agency enforcement proceedings (see Actions Brought by States).
- Derivative claims brought by shareholders on behalf of a corporation (see Exclusively Derivative Actions).

(*Dabit*, 547 U.S. at 87 (citing 15 U.S.C. §§ 78bb(f)(3)-(4), (f)(5)(C)).)

Because of SLUSA's limitation to claims brought under state law, courts have also recognized certain additional limitations on SLUSA's applicability. SLUSA does not apply to claims brought under the Securities Act (see Actions Brought Under the Securities Act of 1933). A few courts have also held that SLUSA does not apply to claims brought under foreign laws (see Actions Brought Under Foreign Laws).

Delaware Carve-Out for Certain Actions Brought Under State Law

SLUSA preserves two types of claims based on "the statutory or common law of the State in which the issuer is incorporated" (15 U.S.C. § 78bb(f)(3)(A)). These limitations on SLUSA preemption are commonly referred to as the Delaware carve-out because of the large number of corporations incorporated in Delaware (see *Campbell v. Am. Int'l Grp., Inc.*, 760 F.3d 62, 65 (D.C. Cir. 2014)). If an action is subject to either of the two Delaware carve-out scenarios, SLUSA does not preempt the action (see *Madden*, 576 F.3d at 975).

The first carve-out applies to claims that involve the purchase or sale of securities by the issuer (or its affiliate) exclusively from or to existing holders of the issuer's equity securities (for example, when plaintiffs directly sell their shares to a defendant-issuer (or its affiliate) (see *In re Metlife Demutualization Litig.*, 2006 WL 2524196, at *5-6 (E.D.N.Y. Aug. 28, 2006))). This carve-out does not apply if the securities were offered on the open market to investors that were not previously equity shareholders (see, for example, *G.F. Thomas Invs., L.P. v. Cleco Corp.*, 317 F. Supp. 2d 673, 681-82 (W.D. La. 2004), aff'd, 123 F. App'x 155 (5th Cir. 2005); *Zoren v. Genesis Energy, L.P.*, 195 F. Supp. 2d 598, 604 (D. Del. 2002)).

The second carve-out applies to claims that involve any "recommendation, position, or other communication" about the issuer's sale of securities:

- Made by or on behalf of the issuer or its affiliate to holders of the issuer's equity securities.
- Concerning an equity holder's decision with respect to voting, responding to a tender or exchange offer, or exercising dissenters' or appraisal rights.

(15 U.S.C. § 78bb(f)(3)(A)(ii).)

This carve-out applies:

- Most often in the context of communications relating to mergers, acquisitions, or other extraordinary corporate transactions (such as proxy statements) (see, for example, *Alessi v. Beracha*, 244 F. Supp. 2d 354, 358-59 (D. Del. 2003) (holding that the second provision of the Delaware carve-out applied to allegations related to proposed stock buyout program); *Greaves v. McAuley*, 264 F. Supp. 2d 1078, 1083-84 (N.D. Ga. 2003) (holding that the second provision of the Delaware carve-out applied to allegations related to a proposed merger)).
- To communications related to ordinary shareholder voting (see, for example, *Huang v. Reyes*, 2008 WL 648519, at *5-6 (N.D. Cal. Mar. 6, 2008); *Indiana Elec. Workers Pension Tr. Fund v. Millard*, 2007 WL 2141697, at *8 (S.D.N.Y. July 25, 2007)).

Only plaintiffs who owned the defendant's equity securities when the alleged cause of action occurred can benefit from the two Delaware carve-out provisions (see *Golub v. Hilb, Rogal & Hobbs Co.*, 379 F. Supp. 2d 639, 643 n.3 (D. Del. 2005); *Sofonia v. Principal Life Ins. Co.*, 378 F. Supp. 2d 1124, 1133-34 (S.D. Iowa 2005), aff'd, 465 F.3d 873 (8th 2006)). In addition, both Delaware carve-out provisions apply only to claims recognized under the law of the state in which the defendant is incorporated. The Delaware carve-out therefore does not apply if:

- The plaintiff has not asserted a cause of action recognized under the law of the state in which the defendant is incorporated (see, for example, *Simon v. Stang*, 2010 WL 1460430, at *4 (N.D. Cal. Apr. 12, 2010) (holding that the Delaware carve-out does not apply to a claim against a Delaware corporation that referenced California law where the plaintiff did not establish that the claim was also recognized under Delaware law)).
- The defendant is a foreign corporation that is not incorporated under the laws of any state (see *In re Stillwater Capital Partners Inc. Litig.*, 853 F. Supp. 2d 441, 462 (S.D.N.Y. 2012); see also Actions Brought Under Foreign Laws).

Actions Brought by States

SLUSA preserves actions brought by states, state securities agencies, and state pension plans (15 U.S.C. § 78bb(f)(3)(B), (f)(4)). SLUSA defines a state pension plan as a "pension plan established and maintained by the government of a State" or by one of its subdivisions or agencies (15 U.S.C. § 78bb(f)(3)(B)(ii)).

These types of actions may proceed only when the state, a state subdivision, state enforcement agency, or state pension plan brings an action on its own behalf or "as a member of a class comprised solely of other States, political subdivisions, or State pension plans that are named plaintiffs and that have authorized participation, in such action." (15 U.S.C. § 78bb(f)(3)(B)(i); *Demings v. Nationwide Life Ins. Co.*, 593 F.3d 486, 491-93 (6th Cir. 2010); see also *In re Petrobras Sec. Litig.*, 169 F. Supp. 3d 547, 553-54 (S.D.N.Y. 2016)).

SLUSA preempts actions brought by an entity allegedly on behalf of the state or state pension plan, in addition to other investors (*Demings*, 593 F.3d at 493-95).

Exclusively Derivative Actions

SLUSA exempts exclusively derivative actions from the definition of covered class actions (15 U.S.C. § 78bb(f)(5)(C)). If a plaintiff brings an action solely on behalf of a corporation and seeks damages on behalf of the corporation (and not on behalf of a class or other investors), the action does not qualify as a covered class action under SLUSA (see, for example, *Sung ex rel. Lazard Ltd. v. Wasserstein*, 415 F. Supp. 2d 393, 408 (S.D.N.Y.

2006) (exception for derivative actions applied because all of the claims were brought derivatively and the relief was sought on behalf of the corporation)). However, if an action includes both a derivative claim and a claim that meets SLUSA's applicability requirements, the action is subject to SLUSA's removal and preemption provisions (see *Proctor v. Vishay Intertech. Inc*., 584 F.3d 1208, 1221-23 (9th Cir. 2009)).

Actions Brought Under Foreign Laws

A number of courts have held that SLUSA does not apply to claims brought under the laws of foreign countries. These courts have reasoned that SLUSA only preempts state law as defined under the Exchange Act, which defines state as "any State of the United States" (*LaSala,* 519 F.3d at 138-39 (3d Cir. 2008); see also *In re BP p.l.c. Sec. Litig.*, 109 F. Supp. 3d 946, 958-60 (S.D. Tex. 2014)).

Not all courts have recognized this limitation on SLUSA's applicability. For example, while one court in the Southern District of New York held that the "plain language of SLUSA does not bar foreign law claims" (*Petrobras*, 169 F. Supp. 3d at 551-52), another court noted that the "Second Circuit has not ruled on SLUSA's application to foreign law claims" (*In re Kingate Mgmt. Ltd. Litig.*, 2016 WL 5339538, at *18 n.23 (S.D.N.Y. Sept. 21, 2016), aff'd, 746 F. App'x 40 (2d Cir. 2018)).

Actions Brought Under the Securities Act of 1933

The Securities Act of 1933 (Securities Act) is the principal federal statute governing securities offerings. Section 11 of the Securities Act permits private plaintiffs to bring actions against corporate issuers and their underwriters for investment losses caused by material misstatements or omissions in securities offerings. Section 12 of the Securities Act imposes liability for violations of the Securities Act's registration requirements. Section 15 of the Securities Act also extends liability to "controlling persons," such as directors and officers, who signed the registration statement associated with the securities offering.

In contrast, the Securities Exchange Act of 1934 (Exchange Act) is the principal federal statute governing securities trading. Courts have interpreted Section 10(b) of the Exchange Act and Securities and Exchange Commission (SEC) Rule 10b-5 to imply a private right of action for plaintiffs to redress investment losses caused by their reliance on material misrepresentations or omissions made in connection with the purchase or sale of a security (17 C.F.R. § 240.10b-5). Additionally, Section 20(a) of the Exchange Act allows for control person claims.

Unlike the Exchange Act, the Securities Act contains an anti-removal provision which provides that except "as provided in section 77p(c) of this title," meaning SLUSA, "no case arising under this subchapter and brought in any State court of competent jurisdiction shall be removed to any court of the United States" (15 U.S.C. § 77v(a)). Therefore, before *Cyan*, certain federal courts held that SLUSA abrogated state court jurisdiction over "covered class actions" asserting claims under the Securities Act, notwithstanding the Securities Act's anti-removal provision (see, for example, *Knox v. Agria Corp.*, 613 F. Supp. 2d 419, 422-25 (S.D.N.Y. 2009)).

In *Cyan, Inc. v. Beaver County Employees Retirement Fund* the Supreme Court held that SLUSA's amendments to the Securities Act do not deprive state courts of jurisdiction over covered class actions that assert only Securities Act claims (*Cyan*, 138 S. Ct. at 1069-71). State courts therefore have concurrent jurisdiction over class actions asserting only Securities Act claims and defendants cannot remove Securities Act claims from state court.

The Supreme Court's decision in *Cyan* did not impact Exchange Act claims, which must be brought in federal court. However, *Cyan* enables plaintiffs to bring class action claims under the Securities Act in state courts, thereby potentially avoiding some of the PSLRA's more stringent provisions. This may result in parallel state and federal securities litigation.

For information on how *Cyan* impacted the applicability of the Class Action Fairness Act of 2005 to securities fraud class actions, see Box, SLUSA and the Class Action Fairness Act of 2005.

For more information on the Supreme Court's holding in *Cyan* and its impact, see Article, Expert Q&A: Securities Act Claims and SLUSA After Cyan.

Procedural Considerations

SLUSA's core provisions enable defendants to remove qualifying covered class actions from state court to federal court so that preempted state law claims can be dismissed (15 U.S.C. § 78bb(f)(1)-(2)).

Counsel navigating SLUSA must understand its procedural requirements regarding:

- Removal of covered class actions (see Removal of Covered Class Actions Brought Under State Law).

- Dismissal of preempted claims (see Dismissal of Preempted Claims).
- Remand for actions that the court determines are not subject to SLUSA preemption (see Remand Motions and Appeals of Remand Orders).

Removal of Covered Class Actions Brought Under State Law

SLUSA's removal provision ensures that "federal courts will have the opportunity to determine whether a state action is precluded" (*Madden*, 576 F.3d at 964-65). A defendant must serve a notice of removal under SLUSA within 30 days (28 U.S.C. § 1446; see *Haag v. Webster*, 434 F. Supp. 2d 732, 733-34 (W.D. Mo. 2006); see also *Montoya v. New York State United Teachers*, 754 F. Supp. 2d 466, 470 (E.D.N.Y. 2010)).

The 30-day removal period starts from the time that the defendant is first served with a complaint, amended complaint, motion, order, or other document suggesting that the action is removable under SLUSA (see *Proctor*, 584 F.3d at 1223-24). If the original complaint does not allege facts forming a basis for removal under SLUSA, the time for a defendant to remove the action to federal court runs from a future filing alleging such a basis. However, when at least one claim in the complaint satisfies SLUSA, the defendant must remove the action within 30 days of service of that complaint (see *Burns v. Prudential Sec., Inc.*, 450 F. Supp. 2d 808, 811-13 (N.D. Ohio 2006); see also *Proctor*, 584 F.3d at 1221-24).

The Seventh Circuit has also held that SLUSA preemption is an affirmative defense that a defendant may forfeit (see *Dixon v. ATI Ladish LLC*, 667 F.3d 891, 894 (7th Cir. 2012)). Therefore, defendants, particularly those defending actions within the Seventh Circuit, should raise SLUSA preclusion as soon as practicable to avoid a potential waiver.

Dismissal of Preempted Claims

Once the defendant removes the case, the federal court must dismiss the state law claims if it holds that SLUSA preempts them (see *Kircher v. Putnam Funds Tr.*, 547 U.S. 633, 644 (2006)). However, federal appellate courts disagree on the impact of dismissal under SLUSA's preemption provision.

The Ninth Circuit, relying in part on statements made by the Second and Third Circuits, has held that dismissals under SLUSA are jurisdictional and therefore federal courts should not dismiss these claims with prejudice (see *Hampton v. Pac. Inv. Mgmt. Co. LLC*, 869 F.3d 844, 847 (9th Cir. 2017)). In contrast, the Seventh Circuit has held that a suit barred by SLUSA should be dismissed with prejudice, reasoning that if a pleading amounts to allegations of securities fraud, allowing that plaintiff to reassert the claims in state court through an amended complaint thwarts "SLUSA's goal of preventing state-court end runs around" the PSLRA (*Brown v. Calamos*, 664 F.3d 123, 127-28, 131 (7th Cir. 2011)).

In addition, plaintiffs often assert many claims within their complaints, some of which may implicate SLUSA and others that may not. A few courts have held that SLUSA precludes actions, not specific claims, and therefore the entire action must be dismissed if SLUSA preempts a claim (see, for example, *Siepel v. Bank of Am., N.A.*, 239 F.R.D. 558, 570-72, 570 n.11 (E.D. Mo. 2006), aff'd, 526 F.3d 1122 (8th Cir. 2008); *Schnorr*, 2005 WL 2019878, at *7). Other courts have rejected this approach and have held that SLUSA only requires federal courts to dismiss the preempted claims but the other claims may proceed in state court upon remand, unless an alternative basis for federal court jurisdiction exists (see, for example, *Kingate Mgmt.*, 784 F.3d at 153-54; *In re Lord Abbett Mut. Funds Fee Litig.*, 553 F.3d 248, 255-56 (3d Cir. 2009); *Proctor*, 584 F.3d at 1227-28).

For a collection of resources on motions to dismiss federal securities class actions, see Securities Litigation: Motion to Dismiss Toolkit.

Remand Motions and Appeals of Remand Orders

A federal court must remand an action to the state court where it originated if SLUSA does not preclude the plaintiffs' state law claims (*Kircher v. Putnam Funds Tr.*, 547 U.S. 633, 644 (2006)).

Federal courts generally look at whether the operative complaint at the time of removal contains claims that are precluded by SLUSA (see, for example, *Brockway v. Evergreen Int'l. Tr.*, 496 F. App'x 357, 361 (4th Cir. 2012)).

However, some courts may consider an amended complaint, filed after the defendant removed the action to federal court, if the amended complaint clarifies that the possibly precluded claims do not actually implicate SLUSA's removal and preemption provisions (see *Schuster v. Garden*, 319 F. Supp. 2d 1159, 1164-65 (S.D. Cal. 2003); see also *Superior Partners v. Chang*, 471 F. Supp. 2d 750, 755-56 (S.D. Tex. 2007)). Courts apply this limited exception to avoid preempting otherwise viable state law claims, if the court believes that the plaintiffs have inadvertently pled a cause of action in a manner that implicated SLUSA (see *Schuster*, 319 F. Supp. 2d at 1164-65; see also *Simon v. Stang*, 2010 WL 1460430, at *4 (N.D. Cal. Apr. 12, 2010)). Courts will not apply this exception if they believe that the plaintiff "is attempting to forum shop or to circumvent SLUSA" (*Superior Partners*, 471 F. Supp. 2d at 756; see also *Schuster*, 319 F. Supp. 2d at 1164).

Defendants cannot appeal orders remanding actions to state court because federal appellate courts lack the power to review orders remanding cases that were removed under SLUSA. State courts may instead reject the federal district court's conclusion that SLUSA does not preclude a claim and dismiss the claim (*Kircher*, 547 U.S. at 646-47 (stating that collateral estoppel "should be no bar" to state courts' revisiting "the preclusion issue" on remand)).

SLUSA and the Class Action Fairness Act of 2005

After Congress enacted the PSLRA and SLUSA, it enacted the Class Action Fairness Act of 2005 (CAFA) (28 U.S.C. §§ 1332(d), 1453, and 1711-15). CAFA relaxes the complete diversity rule—no plaintiff can be from the same state as any defendant—and expands the federal courts' jurisdiction over class action cases to ensure "[f]ederal court consideration of interstate cases of national importance" (*Standard Fire Ins. Co. v. Knowles*, 568 U.S. 588, 595 (2013) (quoting § 2(b)(2), 119 Stat. 5)). CAFA provides that federal courts have diversity jurisdiction over actions that meet CAFA's applicability requirements if at least one plaintiff is from a different state as one defendant (28 U.S.C. § 1332(d)(2)). A defendant may rely on CAFA to remove a qualifying class action to federal court.

However, CAFA's expansion of federal court diversity jurisdiction does not apply to claims involving covered securities (28 U.S.C. § 1332(d)(9)(A); see also *Estate of Pew v. Cardarelli*, 527 F.3d 25, 30 (2d Cir. 2008)). Courts have reasoned that CAFA does not apply to cases involving covered securities because federal courts had alternative sources of jurisdiction over class action claims involving covered securities, including SLUSA (see *Estate of Pew*, 527 F.3d at 30). But the Supreme Court's recent decision in *Cyan*, in combination with CAFA's limitation for claims involving covered securities, prevents defendants from removing Securities Act class action claims to federal court under these procedural mechanisms (*Cyan*, 138 S. Ct. at 1069-71; Actions Brought Under the Securities Act of 1933).

For more information on CAFA, see Practice Note, Class Action Fairness Act of 2005 (CAFA): Overview.