Notes

SWORD OR SHIELD? SETTING LIMITS ON SLUSA'S EVER-GROWING REACH

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ABSTRACT

Concerned by the overwhelming presence of vexatious federal securities-fraud class actions, Congress passed the Private Securities Litigation Reform Act of 1995 to increase the procedural burden plaintiffs would face in filing these nonmeritorious suits. Instead of being deterred, plaintiffs simply brought their suits in state court. Congress responded with the Securities Litigation Uniform Standards Act of 1998 (SLUSA), making federal court the exclusive venue for securities-fraud class actions. However, Congress expressly saved from SLUSA's reach claims that were traditionally brought in state court under corporate law through the Delaware carve-out.

Though this exemption was meant to protect the historic dual federal-state securities-regulation regime, recent appellate court opinions have stretched SLUSA's reach too far, leaving plaintiffs incapable of bringing many traditional state-law claims essential to the proper policing of corporate law regardless of the forum. This Note addresses the implications of such a broad reading of SLUSA and advocates a two-pronged approach that will simultaneously effectuate SLUSA's purpose while still preserving these important state-law claims. By looking to the heart of a complaint, courts can best effectuate congressional intent both to limit problematic litigation practices and to preserve the important role federalism plays in the securities-law context.

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INTRODUCTION

Persuaded that securities class actions were needlessly pillorying corporations, Congress enacted the Private Securities Litigation Reform Act (PSLRA) in 1995.[1] The PSLRA was intended to minimize baseless securities-fraud claims and the vexatious litigation that accompanied them—legal entanglements many believed were harming the business world.[2] Shortly after the PSLRA's adoption, Congress was alerted to a troubling side effect of the new statute: instead of deterring plaintiffs' lawyers from filing meritless securities class actions all together, the PSLRA was simply shifting many of these suits from federal court into state court.[3] In response to this circumvention, Congress passed the Securities Litigation Uniform Standards Act of 1998 (SLUSA)[4] to make federal court the exclusive forum for securities-fraud class actions so that litigants could not avoid the intended effects of the PSLRA.[5]

Though Congress created SLUSA in response to a specific problem, courts have broadened its reach in problematic ways in the years since its enactment. Claims that never could have been brought in federal court are considered precluded by SLUSA,[6] and clearly fraudulent behavior—a Ponzi scheme, for example—is shielded from litigation in any forum.[7] Even more concerning is the lack of clarity among federal appellate courts regarding the scope of SLUSA's reach. Further exacerbating this problem, a 2011 Seventh Circuit decision effectively condones defendants' using the protections of SLUSA not as a shield from meritless litigation but as a sword against legitimate state-law claims.[8]

This Note clarifies the reach of SLUSA, particularly as it relates to traditional breach-of-fiduciary-duty claims in state court. Congressional intent and federalism concerns inform most of the

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1. Private Securities Litigation Reform Act of 1995, Pub. L. No. 104-67, 109 Stat. 737 (codified as amended in scattered sections of 15 and 18 U.S.C.).

2. *See infra* Part I.B.

3. H.R. REP. NO. 105-803, at 1–2 (1998) (Conf. Rep.).

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

5. *See infra* Part I.C.

6. *See infra* Part I.C.2.

7. *See infra* Part II.A.2.

8. Brown v. Calamos, 664 F.3d 123 (7th Cir. 2011). For a discussion of *Brown* and the existing circuit split, see *infra* Part II.

analysis, as they do in both the courts' opinions[9] and in the academic literature discussing SLUSA.[10] This Note concludes that the proper consideration of congressional intent and federalism is best facilitated by a two-pronged approach that focuses on the heart of the transaction in question.

The Note proceeds in four parts. Part I provides a brief history of the PSLRA and SLUSA, focusing primarily on the historical securities-fraud litigation practices that motivated the statutes. It also briefly outlines the traditional scope of state regulation concerning the behavior of directors and how that regulation does and does not overlap with the field of federal securities regulation. Part II addresses a circuit split that has developed in interpreting one of SLUSA's key provisions: the preclusion provision that prohibits certain state-law claims from proceeding as class actions in either state or federal court.[11] It reviews recent decisions from the Third, Fifth, Seventh, and Ninth Circuits, and focuses in particular on a 2011 decision out of the Seventh Circuit that goes one step further than any prior appellate decision interpreting the preclusion provision. The Seventh Circuit indicated that an entrenched type of state-law claim might be impossible to disentangle from claims that SLUSA precludes,[12] thus bringing a new wave of actions under SLUSA's reach.[13] Part III focuses on how the Seventh Circuit's decision violates principles of statutory interpretation and federalism. Finally, Part IV advances a two-part approach courts should take in analyzing whether a claim falls within SLUSA's preemptive reach. First, courts should consider whether the claim is of the type Congress was attempting to preempt. This will help maximize the remedial benefits of the statute without unnecessarily precluding meritorious claims. Second, courts should look at the heart of a complaint to make this determination. By looking beyond the plain words of a complaint, courts can satisfy Congress's preemptive goals without completely

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9. *See, e.g.*, Merrill Lynch, Pierce, Fenner & Smith Inc. v. Dabit, 547 U.S. 71, 81 (2006) (looking to congressional intent in interpreting the reach of SLUSA).

10. *See, e.g.*, Jennifer O'Hare, *Preemption Under the Securities Litigation Uniform Standards Act: If It Looks Like a Securities Fraud Claim and Acts Like a Securities Fraud Claim, Is It a Securities Fraud Claim?*, 56 ALA. L. REV. 325, 368 (2004) (emphasizing the role federalism should play in SLUSA's interpretation).

11. 15 U.S.C. §§ 78bb(f)(1)–(2) (2012).

12. *Brown*, 664 F.3d at 128–29.

13. *See infra* Part II.C.

eviscerating the important role that state law plays in the corporate context.

I. A BACKGROUND OF THE PSLRA, SLUSA, AND THE DELAWARE CARVE-OUT

To fully understand the problems that arise from an overly broad application of SLUSA, it is important to understand its history. Unlike most statutes, SLUSA was created to solve a particular problem Congress itself had created. This makes its background and purpose particularly relevant for any analysis of its reach. Accordingly, this Part will briefly trace the history leading to its enactment, starting with an overview of federal securities-fraud litigation and the issues that led to the PSLRA. Next, this Part examines the key Supreme Court cases that interpret SLUSA before concluding with an overview of the Delaware carve-out and its purpose.

A. Securities-Fraud Litigation Under Section 10(b)

In 1933 and 1934 Congress passed substantial legislation federalizing the regulation of nationally traded securities in the wake of the Great Depression.[14] Before the Depression, securities markets and their participants were only lightly regulated, if at all, by the states through statutes known as blue sky laws.[15] The Securities Act of 1933 (1933 Act)[16] and the Securities Exchange Act of 1934 (1934 Act)[17] together provide specific protections for investors in nationally traded securities. In particular, Section 10(b) of the 1934 Act provides that "[i]t shall be unlawful for any person . . . [t]o use or employ . . . any manipulative or deceptive device or contrivance in contravention of [Securities and Exchange Commission (SEC) rules]."[18] The SEC promulgated Rule 10b–5 in 1948 to further explain the reach of Section 10(b).[19] In the years that followed the advent of Section 10(b)

14. *See* Ernst & Ernst v. Hochfelder, 425 U.S. 185, 194 (1976) ("Federal regulation of transactions in securities emerged as part of the aftermath of the market crash in 1929.").

15. Jonathan R. Macey & Geoffrey P. Miller, *Origin of the Blue Sky Laws*, 70 TEX. L. REV. 347, 348 (1991).

16. Securities Act of 1933, 15 U.S.C. §§ 77a–77aa (2012).

17. Securities Exchange Act of 1934, 15 U.S.C. §§ 78a–78pp (2012).

18. 15 U.S.C. § 78j.

19. 13 Fed. Reg. 8177, 8183 (Dec. 15, 1948) (codified as amended at 17 C.F.R. § 240.10b–5 (2013)).

and Rule 10b–5, the Court played a large role in defining the scope of both.[20] Despite the Supreme Court's attempts to minimize the potential for plaintiffs to file vexatious suits,[21] the number of suits—in particular meritless strike suits[22]—brought under this implied right of action continued to be alarming.[23]

B. The Enactment of the PSLRA and the Subsequent Migration of Actions to State Court

In 1995, the number of suits that forced even the most clean-handed defendants into settlements hit a tipping point, and Congress enacted the PSLRA to take further action to constrain the types of suits that could find their way into federal court. Congress was primarily concerned with three troublesome practices: (1) vexatious strike suits that led to expensive settlements oftentimes unrelated to the merits of the suit,[24] (2) imbalanced discovery costs,[25] and (3) the

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20. An implied right of action for violations of Rule 10b–5 has been consistently upheld by the Supreme Court. *E.g.*, Blue Chip Stamps v. Manor Drug Stores, 421 U.S. 723, 730 (1975). The Court has on several occasions defined the scope of both Section 10(b) and Rule 10b–5. *See* SEC v. Zandford, 535 U.S. 813, 825 & n.4 (2002) (extending the reach of Section 10(b) to include fraudulent schemes that merely "coincide" with the purchase or sale of securities, but clarifying that "our analysis does not transform every breach of fiduciary duty into a federal securities violation"); Santa Fe Indus., Inc. v. Green, 430 U.S. 462, 479 (1977) (reiterating that although Section 10(b) regulates disclosure, "'[c]orporations are creatures of state law'" and thus absent clear congressional intent, courts should not construe Section 10(b) in a way such that "the federal securities laws would overlap and quite possibly interfere with state corporate law" (quoting Cort v. Ash, 422 U.S. 66, 84 (1975))); *Blue Chip Stamps*, 421 U.S. at 730 (indicating that only purchasers and sellers may bring claims under Section 10(b)).

21. *See, e.g.*, *Blue Chip Stamps*, 421 U.S. at 743 ("The *Birnbaum* rule . . . separates in a readily demonstrable manner the group of plaintiffs who actually purchased or actually sold, and whose version of the facts is therefore more likely to be believed by the trier of fact, from the vastly larger world of potential plaintiffs who might successfully allege a claim but could seldom succeed in proving it."). The *Birnbaum* rule states that only "actual purchasers and sellers of securities" may bring claims under Section 10(b) and Rule 10b–5. *Id.* at 730.

22. Strike suits are defined as "suit[s] (esp[ecially] . . . derivative action[s]), often based on no valid claim, brought either for nuisance value or as leverage to obtain a favorable or inflated settlement." BLACK'S LAW DICTIONARY 1572 (9th ed. 2009). Strike suits "often follow sharp declines in a company's stock price due to a missed earnings projection or other unfavorable news[] [and] generally allege that some fraud or misstatement by the company caused the stock price to plummet." Larry Bumgardner, *Class Action Shareholder Suits Face Legal Setbacks*, GRAZIADIO BUS. REV. (2006), http://gbr.pepperdine.edu/2010/08/class-action-shareholder-suits-face-legal-setbacks.

23. H.R. REP. No. 104-369, at 31 (1995) (Conf. Rep.), *reprinted in* 1995 U.S.C.C.A.N. 730, 730 (noting that Congress saw "significant evidence of abuse in private securities lawsuits").

24. *Id.* These concerns mirror those emphasized by the Court in *Blue Chip Stamps*: "But to the extent that it permits a plaintiff with a largely groundless claim to simply take up the time of

chilling effect that litigation had on the disclosure of forward-looking statements.[26] To remedy these respective problems, Congress enacted the PSLRA, which includes the following provisions: (1) heightened pleading requirements mandating that plaintiffs plead with particularity facts leading to a strong presumption of fraudulent behavior, (2) an automatic stay of discovery pending any motions to dismiss, and (3) a safe harbor for forward-looking statements.[27]

In the years that immediately followed the enactment of the PSLRA, an unintended consequence arose: instead of encouraging the plaintiffs' bar to more carefully consider the filing of securities-fraud class actions, these suits migrated to state court where the PSLRA's heightened pleading standards and discovery stays did not reach.[28] The evidence presented to Congress indicated that this was a new phenomenon; state class actions involving nationally traded securities, though available, had previously been uncommon.[29] In response to this migration, Congress enacted SLUSA.[30]

C. SLUSA Cut Off the State-Court Loophole

1. *SLUSA's Purpose.* SLUSA was intended to prevent an end run around the PSLRA's reforms and to ensure "national standards for securities class action lawsuits involving nationally traded

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a number of other people . . . rather than a reasonably founded hope that the process will reveal relevant evidence, it is a social cost rather than a benefit." *Blue Chip Stamps*, 421 U.S. at 741.

25. *See* H.R. REP. No. 104-369, at 31, *reprinted in* 1995 U.S.C.C.A.N. at 730 ("[T]he abuse of the discovery process to impose costs so burdensome that it is often economical for the victimized party to settle . . . .").

26. Michael A. Perino, *Fraud and Federalism: Preempting Private State Securities Fraud Causes of Action*, 50 STAN. L. REV. 273, 290 (1998).

27. 15 U.S.C. §§ 77z–1, 78u–4 (2012); Perino, *supra* note 26, at 293. Other requirements include restrictions on who can qualify as a lead plaintiff and mandatory review of potential Rule 11 sanctions. 15 U.S.C. §§ 77z–1, 78u–4.

28. Merrill Lynch, Pierce, Fenner & Smith Inc. v. Dabit, 547 U.S. 71, 82 (2006); *see also* H.R. REP. NO. 105-640, at 10 (1998); S. REP. NO. 105-182, at 3–4 (1998).

29. *See Dabit*, 547 U.S. at 82 (noting that prior to the PLRSA, "state-court litigation of class actions involving nationally traded securities had previously been rare"). For example, one study cited by Congress showed that about 26 percent of litigation activity had moved from federal to state court, largely as a result of a "substitution effect." Joseph A. Grundfest & Michael A. Perino, *Securities Litigation Reform: The First Year's Experience* (Stanford Law Sch., John M. Olin Program in Law and Econ., Working Paper No. 140, Feb. 1997). However, in a later paper Professor Perino noted that none of the three primary studies cited by Congress had "compile[d] any statistically significant data to support this inference." Perino, *supra* note 26, at 299.

30. H.R. REP. NO. 105-803, at 1–2 (1998) (Conf. Rep.).

securities."[31] SLUSA's key provision precludes certain claims from being heard in either state or federal court.[32] In particular, state-law claims that allege fraud or "misrepresentation . . . in connection with the purchase or sale of a security" are subject to removal and dismissal.[33] SLUSA also contains express exemptions from its preclusionary reach to mirror Delaware's law on fiduciary duty of disclosure as written at the time of SLUSA's enactment.[34]

SLUSA, according to its proponents, was designed explicitly to cure what Congress perceived as a large failing of the PSLRA.[35] In enacting SLUSA, Congress was not attempting to eliminate all remedies in state court, particularly not those remedies that were available in state court before either the PSLRA or SLUSA.[36] SLUSA also did not create any new substantive rights, but rather set forth a new jurisdictional rule about where certain types of cases could be heard.[37] The language of SLUSA in many ways parallels that of Section 10(b): both include the phrase "in connection with"; both ban "manipulative or deceptive device[s]"; and both center around claims alleging fraud, misrepresentations, or omission.[38] As might be

31. *Id.* at 2. The findings that prompted the enactment of SLUSA were not undisputed. *See* H.R. Rep. No. 105-640, at 45 ("Data compiled by unbiased sources shows that the number of state securities class actions has declined during the last year to pre-Reform Act levels."). In fact, opponents of the statute felt it was premature. *Id.*

32. 15 U.S.C. §§ 78bb(f)(1)–(2). This portion of SLUSA was originally referred to as a preemption provision, but the Court later deemed it to be a preclusion provision. *See* Kircher v. Putnam Funds Trust, 547 U.S. 633, 636 n.1 (2006) ("The preclusion provision is often called a preemption provision; the Act, however, does not itself displace state law with federal law but makes some state-law claims nonactionable through the class-action device in federal as well as state court."). However, because it is highly unlikely that individual plaintiffs will be able to bring claims in the context of breaches of fiduciary duty, the provision functions as a preemption. For further discussion of the implications of this provision, see *infra* notes 237–38 and accompanying text.

33. *Id.*

34. Jennifer O'Hare, *Director Communications and the Uneasy Relationship Between the Fiduciary Duty of Disclosure and the Anti-Fraud Provisions of the Federal Securities Laws*, 70 U. CIN. L. REV. 475, 477 (2002).

35. H.R. REP. NO. 105-640, at 10; *see* H.R. REP. NO. 105-803, at 1–2 (noting that SLUSA was enacted to "prevent certain State private securities class action lawsuits alleging fraud from being used to frustrate the objectives of the Private Securities Litigation Reform Act").

36. *See* Securities Litigation Uniform Standards Act of 1998, Pub. L. No. 105-353, § 2(5), 112 Stat. 3227, 3227 (finding that that the need for uniform national standards for securities-fraud lawsuits must be accomplished "while preserving the appropriate enforcement powers of State securities regulators").

37. *See* H.R. REP. NO. 105-640, at 11 ("The solution to this problem is to make Federal court the exclusive venue for securities fraud class action litigation.").

38. *Compare* 15 U.S.C. §§ 78bb(f)(1)–(2), *with id*. § 78j.

expected, the Supreme Court has taken note of these similarities in interpreting SLUSA.[39]

2. *The Court's Broad Interpretation of SLUSA's Reach.* Though SLUSA was meant to address a particular problem, Congress drafted the statute using broad language, leading to some interpretive difficulties in the lower courts. In *Merrill Lynch, Pierce, Fenner & Smith Inc. v. Dabit*,[40] the Supreme Court addressed one issue that had divided the lower courts: whether SLUSA preempted claims by securities *holders* that could not have previously been brought in federal court under the *Blue Chip Stamps* rule.[41] Dabit, a former Merrill Lynch broker, brought claims for breach of fiduciary duty and breach of the covenant of good faith and fair dealing on behalf of himself and other brokers, alleging that Merrill Lynch's actions had caused them both to hold on to overvalued securities and to lose clients who believed they had been given bad advice.[42]

Merrill Lynch's motion to dismiss was granted, the district court finding that the claims fell "'squarely within SLUSA's ambit.'"[43] On appeal, the Second Circuit reversed, holding that even though the "in connection with" language must be read broadly, the standing requirements of *Blue Chip Stamps* were also imported into SLUSA's interpretive scheme, and therefore the holding claims were not covered by SLUSA.[44] A few months later in *Kircher v. Putnam Funds Trust*,[45] the Seventh Circuit held the opposite, opining that SLUSA preempted even those claims for which there is no federal remedy.[46]

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39. *See* Merrill Lynch, Pierce, Fenner & Smith Inc. v. Dabit, 547 U.S. 71, 86 (2006) (construing SLUSA in light of § 10(b) and Rule 10b–5 based on the presumption that "'identical words used in different parts of the same statute . . . have the same meaning'" (quoting IBP, Inc. v. Alvarez, 546 U.S. 21, 34 (2005))).

40. Merrill Lynch, Pierce, Fenner & Smith Inc. v. Dabit, 547 U.S. 71 (2006).

41. *Id.* at 84–85. In *Blue Chip Stamps*, the Court held that only purchasers or sellers had standing to sue. Blue Chip Stamps v. Manor Drug Stores, 421 U.S. 723, 730 (1975).

42. *Dabit*, 547 U.S. at 75–76.

43. *Id.* at 76 (quoting *In re* Merrill Lynch & Co., No. 02MDL1484(MP), 2003 WL 1872820, at *1 (S.D.N.Y. Apr. 10, 2003)).

44. Dabit v. Merrill Lych, Pierce, Fenner & Smith, Inc., 395 F.3d 25, 51 (2d Cir. 2005), *vacated*, 547 U.S. 71.

45. Kircher v. Putnam Funds Trust, 403 F.3d 478 (7th Cir. 2005), *vacated*, 547 U.S. 633 (2006).

46. *See id.* at 484 ("[P]laintiffs' effort to define non-purchaser-non-seller classes is designed to evade PSLRA in order to litigate a securities class action in state court in the hope that a local judge or jury may produce an idiosyncratic award. It is the very sort of maneuver that SLUSA is designed to prevent.").

In resolving this split, the Supreme Court agreed with the Seventh Circuit's decision in *Kircher* and heavily emphasized policy concerns in its reasoning. First, the Court examined the *Blue Chip Stamps* decision and determined that the Court there had relied on policy concerns to set the purchaser-seller limitation rather than purporting to interpret the language of the statute.[47] According to the Court, this reliance on policy would have been clear to Congress when it drafted SLUSA.[48] Furthermore, the Court reasoned, it would be contrary to Congress's purpose in enacting SLUSA if holder claims such as Dabit's were not precluded because the alleged misconduct was clearly securities fraud, regardless of which plaintiff was bringing the claim.[49] Ultimately, the unanimous Court held that SLUSA was to be interpreted broadly to effect its stated purpose,[50] but it also acknowledged the importance of exemptions such as the Delaware carve-out.[51]

D. State Fiduciary-Duty Claims and the Delaware Carve-Out

So far this Note has described the evolution of certain federal securities laws. However, federal securities law inevitably overlaps with state corporate law. This overlap has become problematic in the context of interpreting SLUSA, in part because courts are allowing SLUSA to influence otherwise distinct areas of corporate law that it was not intended to touch. This Section first establishes that Congress did not intend for such an erosion. It then offers a brief description of the different fiduciary duties owed under Delaware law and highlights that their scope is far beyond, and oftentimes distinct from, that of federal securities laws. This distinction is important to understand when interpreting SLUSA's reach.

Before Congress passed the PSLRA, the possibility for concurrent state and federal securities-fraud litigation was always

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47. *Dabit*, 547 U.S. at 84.

48. *Id.*

49. *See id.* at 86 ("As the *Blue Chip Stamps* Court observed, class actions brought by holders pose a special risk of vexatious litigation. It would be odd, to say the least, if SLUSA exempted that particularly troublesome subset of class actions from its pre-emptive sweep." (citation omitted)).

50. *See id.* ("A narrow reading of the statute would undercut the effectiveness of the 1995 Reform Act and thus run contrary to SLUSA's stated purpose . . . .").

51. *See id.* at 87 ("The statute carefully exempts from its operation certain class actions based on the law of the State in which the issuer of the covered security is incorporated . . . .").

present.[52] However, the use of state securities law to bring claims was often less desirable for class-plaintiffs than federal law due to, among other things, the absence of the availability of the fraud-on-the-market theory under most state doctrines.[53] Accordingly, when Congress enacted the PSLRA, it did not consider preemption of state corporate law.[54] The statute was premised simply on a hope that the new procedural hurdles would discourage nonmeritorious suits.

Only when the unexpected consequence of a migration to state courts was realized did Congress shift its focus to preempting state-law claims.[55] However, even then, preemption was in the field of securities regulation, not in the field of corporate law.[56] Though the distinction between the two is not perfectly demarcated, a common description is that federal securities law regulates disclosure, whereas state law regulates the internal affairs of a corporation.[57] And, historically, the force of the latter frequently occurs through state-law litigation that enforces the fiduciary obligations of corporate officers, directors, and controlling stockholders.[58] Because corporations are themselves creatures of state law, it has long been common practice

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52. *See* Perino, *supra* note 26, at 281 (noting that the 1933 Act and the 1934 Act "both contain explicit savings clauses that preserve state authority over securities matters").

53. *Id.* at 284. In federal court under the fraud-on-the-market theory, plaintiffs need not show that each class member relied upon an alleged misrepresentation. Rather, plaintiffs are entitled to a presumption of reliance when the statements at issue are public. Stoneridge Inv. Partners, LLC v. Scientific-Atlanta, Inc., 552 U.S. 148, 159 (2008). At the time of publication the Supreme Court was set to address the viability of the fraud-on-the-market theory. Halliburton Co. v. Erica P. John Fund, Inc., 718 F.3d 423 (5th Cir. 2013), *cert. granted*, 82 U.S.L.W. 3298 (U.S. Nov. 15, 2013) (No. 13-317).

54. *See* Perino, *supra* note 26, at 287 ("Congress seems to have viewed litigation reform as a federal problem that required a federal solution. The legislative history contains only scattered references to state court, most of which are unrelated to the possibility of a shift in litigation strategy."). For a summary of the argument that the PSLRA did actually preempt some state law of its own force, however, see *id.* at 318 n.188.

55. *See* O'Hare, *supra* note 34, at 489 ("To achieve the goals of [SLUSA], Congress decided to preempt a large number of actions brought in state court.").

56. *See id.* at 502–03 (explaining the evolution of the Delaware carve-out as a preservation of state corporate law, in particular the duty of disclosure).

57. *See* Santa Fe Indus., Inc. v. Green, 430 U.S. 462, 478–79 (1977) (noting that the purpose of the 1934 Act was to promote disclosure and thus declining to extend the 1934 Act's reach to internal affairs of the corporation); *see also* Renee M. Jones, *Does Federalism Matter? Its Perplexing Role in the Corporate Governance Debate*, 41 WAKE FOREST L. REV. 879, 884 (2006) (critiquing this "artificial boundary").

58. *See* Jones, *supra* note 57, at 882 ("A background assumption that grounds much of corporate law scholarship is the notion that a separate sphere of state sovereignty exists in corporate law."); *id.* at 882–88 (providing a critical analysis of the distinctions that limit the expansion of federal power into state corporate law).

to allow states to police the behavior of officers and directors, particularly as it relates to the internal affairs of the corporation and to relationships between directors, officers, and shareholders.[59]

In light of this practice, the preemption conversations were not about sweeping reform in the fields of securities and corporate law, but rather about fixing a specific problem that Congress had accidentally created: the migration of traditionally federal claims to state court.[60] Thus, even though SLUSA was designed to prevent the filing of certain securities-fraud actions in state court, the statute contains two express exemptions that effectuate a congressional intent to preserve the areas of securities law traditionally left to the states. The first exemption prevents preemption of exclusively derivative actions brought by shareholders on behalf of a corporation.[61] The second exemption, which has two prongs, has come to be known as the "Delaware carve-out." The carve-out allows certain types of class actions to remain in state court.[62] It was modeled after the then-existing Delaware law surrounding the duty of disclosure,[63] which extended only to situations in which shareholder action was requested, such as mergers, amendments to the articles of incorporation, and periodic elections of directors.[64] The carve-out saves from SLUSA's scope misconduct that occurs within the context of specific transactions that often will involve covered securities; however, due to the internal, corporate nature of the excluded transactions, state law will still produce the uniform result that SLUSA aims to achieve.

When directors are requesting shareholder action, the fiduciary duty of disclosure mandates full and fair disclosure of all information

59. *Santa Fe*, 430 U.S. at 479.

60. *See* 143 CONG. REC. S10,477 (daily ed. Oct. 7, 1997) (statement of Sen. Chris Dodd) ("The legislation that we are introducing today, if enacted, will allow Congress to address this State litigation problem before it gets completely out of control. It will do so in a very targeted and narrow way, essentially preempting only those class actions that have recently migrated to State court . . . .").

61. 15 U.S.C. § 78bb(f)(5)(C) (2012).

62. *Id.* § 78bb(f)(3).

63. O'Hare, *supra* note 34, at 476.

64. Malone v. Brincat, 722 A.2d 5, 11 (Del. 1998). Though the *Malone* court extended this duty to other contexts, the scope of the carve-out remains unchanged despite some calls to expand it to reflect the new state of the law in Delaware. *See* O'Hare, *supra* note 34, at 477 ("Prior to [*Malone*], the Delaware carve-out was coextensive with the Delaware law of fiduciary duty of disclosure.").

within the board's control.[65] Though a breach of this duty may also rise to the level of a Section 10(b) action and does involve disclosure (an area typically regulated by federal law), a cause of action for breach of this disclosure obligation has long been available in state courts.[66] Such an action involves an element similar to scienter,[67] and most of the analysis centers around whether there has been a material omission or misstatement.[68] However, at least in Delaware, an action for breach of the duty of disclosure does not include elements of reliance, causation, or economic loss, as is required for a Section 10(b) action.[69] By continuing to allow these actions in Delaware (or other states with similar laws), the experience and efficiency of the state courts in handling these types of actions is maintained,[70] and presumably the reforms of the PSLRA are not evaded due to the longstanding nature of this type of action in state law.[71]

This duty of disclosure in Delaware derives from a combination of the broader fiduciary duties of loyalty and care.[72] These duties are identical for both officers and directors.[73] Generally, the duty of loyalty "requires an undivided and unselfish loyalty to the corporation and demands that there be no conflict between duty and self-interest."[74] The duty of care requires attentiveness to the corporation's affairs, reasonably informed and deliberated

65. *Malone*, 722 A.2d at 12.

66. *See, e.g.*, Stroud v. Grace, 606 A.2d 75, 84 (Del. 1992) (explaining that this duty of disclosure has been a "mainstay of Delaware law for decades" (citing Cahall v. Lofland, 114 A. 224, 234 (Del. Ch. 1921))).

67. *See Malone*, 722 A.2d at 12 n.32 (noting that a good-faith, erroneous judgment of the scope or content of disclosure implicates the duty of care, not the duty of disclosure). Though the full scope of these duties is complex, situation specific, and beyond the province of this Note, it is important to highlight some elements of these claims to appreciate the difference between a claim for a breach of the duty of loyalty and a claim for securities fraud. For a more complete description of these duties, see generally 2 JAMES D. COX & THOMAS LEE HAZEN, THE LAW OF CORPORATIONS §§ 10:1–10:19, at 126–222 (3d ed. 2010).

68. *Malone*, 722 A.2d at 12.

69. *Id.*

70. *Cf.* O'Hare, *supra* note 34, at 502 ("[E]xperts were concerned that preempting fiduciary duty of disclosure claims would undercut important advantages offered by state courts, particularly in Delaware.").

71. *See id.* at 502–03 (noting the concern that "preempti[on] [of] fiduciary duty of disclosure claims would undercut important advantages offered by state courts, particularly in Delaware"). In fact, some experts argued that keeping these claims in state court would *help* corporations expeditiously complete their transactions. *Id.*

72. *Malone*, 722 A.2d at 11.

73. Gantler v. Stephens, 965 A.2d 695, 708–09 (Del. 2009).

74. Guth v. Loft, Inc., 5 A.2d 503, 510 (Del. 1939).

decisionmaking, and a substantive component that decisions have a rational basis.[75] Both duties encompass a far broader range of circumstances and behaviors than the duty of disclosure.

When bringing an action for breach of the duty of loyalty or care, a plaintiff first faces the burden of overcoming the business judgment rule.[76] To overcome this presumption, the plaintiff must show both that the challenged decision was not made in a "good faith pursuit of a legitimate corporate interest" and that the decision was not made with due care.[77] Alternatively, a cognizable claim for a breach of the duty of loyalty will be sufficient to overcome the business judgment presumption.[78] Classic breaches of the duty of loyalty include self-dealing transactions and usurping corporate opportunities.[79] For example, when a director has a substantial financial stake in the outcome of a transaction she cannot be considered disinterested or independent.[80] Not only does state law subject such self-dealing and disloyal transactions to rigorous scrutiny, but the burden of persuasion also falls on the self-interested director.[81]

It is important to note that although most actions against corporate officers and directors lie with the corporation and therefore must be brought derivatively,[82] it is also possible (albeit rare) for the action to lie directly with a shareholder and therefore not be covered by SLUSA's express exemption for derivative suits. In deciding whether a claim is derivative or direct, Delaware courts look to "the nature of the wrong and to whom the relief should go."[83] Oftentimes

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75. COX & HAZEN, *supra* note 67, § 10:3.

76. *Gantler*, 965 A.2d at 705–06. The business judgment rule provides officers or a board with "a strong presumption in its favor," *id.* at 706, and "'a court will not substitute its judgment for that of the board if the . . . decision can be attributed to any rational business purpose,'" *id.* (alteration in original) (quoting Unocal Corp. v. Mesa Petroleum Co., 493 A.2d 946, 954 (Del. 1985)) (quotation marks omitted).

77. *Id.* at 706, 708.

78. *Id.* at 708.

79. COX & HAZEN, *supra* note 67, § 10:11. For a more complete analysis of the duty of loyalty and breaches thereof, see generally Deborah A. DeMott, *Breach of Fiduciary Duty: On Justifiable Expectations of Loyalty and Their Consequences*, 48 ARIZ. L. REV. 925, 925–34 (2006).

80. Cede & Co. v. Technicolor, Inc., 634 A.2d 345, 362 (Del. 1993).

81. *See id.* at 361 ("If the [business judgment] rule is rebutted, the burden shifts to the defendant directors, the proponents of the challenged transaction, to prove to the trier of fact the 'entire fairness' of the transaction to the shareholder plaintiff.").

82. COX & HAZEN, *supra* note 67, § 10:18.

83. Tooley v. Donaldson, Lufkin & Jenrette, Inc., 845 A.2d 1031, 1039 (Del. 2004). Proceeding derivatively requires that the plaintiff also overcome a demand requirement, *see*

the distinction between whether an action is derivative or direct is complex[84] and whether the suit proceeds derivatively or directly, it is not a less onerous process for a plaintiff than the procedural hurdles imposed by the PSLRA. Regardless, this distinction is a matter of state law and not a question that SLUSA attempts to answer. Rather, the carve-out attempts to fill in the gaps left open by the derivative-action exception by exempting from SLUSA's scope actions that are based predominantly on interactions between a company and its existing shareholders rather than on communications directed toward the market such as press releases and quarterly reports.

This brief description of the different fiduciary duties owed under Delaware law highlights that their scope is far beyond, and oftentimes distinct from, that of the federal securities laws. Where the two spheres clearly overlap, Congress was swayed by arguments that claims in the overlapping area should *stay* in state court.[85] Combining this with SLUSA's stated goals seems to establish that most of these traditional state-law claims should remain unaffected by SLUSA's reach. In fact, one of the primary reasons Congress ultimately included the carve-out was to preserve the "body of well-developed case law" that had developed in Delaware regarding fiduciary-duty claims.[86] Unfortunately, this has not been the result. Lower courts have taken varying interpretive approaches, and a 2011 decision by the Seventh Circuit has risked the enforceability of an entirely new class of claims—in either state *or* federal court.

II. *BROWN* AND THE CIRCUIT SPLIT

Over the years, the circuits have developed conflicting approaches to interpreting SLUSA's preclusion provision and the Delaware carve-out. As discussed in this Part, the Seventh Circuit was not persuaded by any of the prevailing approaches and instead set

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Kamen v. Kemper Fin. Servs., Inc., 500 U.S. 90, 101 (1991) (discussing the "contours of the demand requirement" in a derivative action), and perhaps prevail over a special litigation committee, *see* Kahn v. Kohlberg Kravis Roberts & Co., 23 A.3d 831, 834–35, 841 (Del. 2011) (describing these procedural challenges).

84. *See* COX & HAZEN, *supra* note 67, § 15:3 ("Courts frequently have great difficulty in classifying a plaintiff's claim as individual or derivative.").

85. *See* O'Hare, *supra* note 34, at 503 ("To avoid losing the benefits offered by state courts, . . . experts urged Congress to preserve claims based on a breach of fiduciary duty of disclosure. Ultimately, Congress was swayed by these arguments.").

86. *Id.* at 502.

forth its own sweeping approach in *Brown v. Calamos*[87] that eviscerates the very basis for the Delaware carve-out's existence. This Part will first explore the intended function of the carve-out and describe some existing limits on SLUSA. It will then examine the circuit split that has developed regarding the scope of the preclusion provision.

A. The Delaware Carve-Out and Other Limits on SLUSA's Reach

This Note so far has focused on what Congress *did* intend SLUSA to cover. To fully understand the implications of *Brown*, it is important to understand what Congress did *not* intend SLUSA to cover. This Section looks to the Delaware carve-out to establish a basis for determining more broadly what types of claims were not meant to be, and should not be, affected by SLUSA. The existence of the carve-out demonstrates an unambiguous intent to keep certain types of claims *out* of SLUSA's reach and is therefore a good source for determining what should fall *within* its reach. This Section concludes with an analysis of a 2012 Fifth Circuit decision that considers a different question under SLUSA but presents important arguments regarding the implications of an overbroad approach.

1. *The Carve-Out at Work.* The Delaware carve-out is an express exemption from SLUSA's preemptive sweep. Given that congressional intent carries great authority when construing an open-ended statute such as SLUSA, it is fundamental to analyzing the types of claims that Congress meant to shield from SLUSA's grasp. Apart from the carve-out, SLUSA does not preempt any derivative actions.[88] While most duty-of-loyalty suits will proceed derivatively, this is not always the case, and it is a question with which federal courts may be especially unfamiliar, particularly as compared to state courts in Delaware.[89]

The first prong of the carve-out saves transactions occurring exclusively between the issuer and its existing stockholders.[90] Because one of Congress's primary objectives with SLUSA was to create a uniform set of "national standards for nationally traded securities,"[91]

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87. Brown v. Calamos, 664 F.3d 123 (7th Cir. 2011).
88. *See* 15 U.S.C. § 78bb(f)(5)(C) (2012).
89. *See supra* notes 82–86 and accompanying text.
90. 15 U.S.C. § 78bb(f)(3)(A)(ii)(I).
91. S. REP. NO. 105-182, at 8 (1998).

it is logical that nonmarket transactions would be exempt.[92] Furthermore, a corporation can expect that any action for breach of fiduciary duty would be brought under the laws of the state of incorporation, which underscores the rationality of the scope of this part of the carve-out. The Senate Banking Committee expressly stated that it was "not the intent of the Committee . . . to interfere with state law regarding the duties and performance of an issuer's directors or officers in connection with a purchase or sale of securities by the issuer . . . from current shareholders."[93] This first prong should thus protect claims alleging, for example, that a director or officer caused the corporation to improperly redeem outstanding Class A shares to the detriment of Class B shareholders, even though a strikingly similar fact pattern in *Brown* was not evaluated under this prong.[94]

The second prong of the carve-out preserves duty-of-disclosure claims that are related to certain corporate transactions requiring shareholder approval.[95] To fit within this prong, three specific elements must be met:

> A covered class action may be maintained under SLUSA if it involves: (1) any recommendation, position, or other communication with respect to the sale of any issuer; (2) that is made by or on behalf of the issuer or an affiliate of the issuer to holders of equity securities of the issuer; and (3) concerns decisions of such equity holders with respect to voting their securities, acting in response to a tender or exchange offer, or exercising dissenters' or appraisal rights.[96]

92. *Cf.* G.F. Thomas Invs., L.P. v. Cleco Corp., 317 F. Supp. 2d 673, 682 (W.D. La. 2004) ("[P]art I of the Delaware carve-out provisions of SLUSA provides that only when shares of stock are purchased or sold to a limited market (that of the corporation's current shareholders) will the Delaware carve-out provision apply. When the stock is offered to the open market, SLUSA governs the prospective class action." (citing Zoren v. Genesis Energy, L.P., 195 F. Supp. 2d 598, 603 (D. Del. 2002); Burekovitch v. Hertz, No. 01-CV-1277, 2001 WL 984942, at *6 (E.D.N.Y. July 24, 2001))).

93. S. REP. NO. 105-182, at 6.

94. Though plaintiffs noted in a footnote in their motion for remand that this prong of the carve-out should apply, Plaintiff's Memorandum in Support of Motion for Remand at 6 n.1, Brown v. Calamos, 777 F. Supp. 2d 1128 (N.D. Ill. 2011) (No. 10-cv-6558), 2010 WL 5632736, defendants dismissed this argument without analysis in their notice of removal, Notice of Removal of Action Under 28 U.S.C. § 1441 and 1446 Pursuant to Securities Litigation Uniform Standards Act ¶ 6(b)(i), *Brown*, 777 F. Supp. 2d 1128 (No. 10-cv-6558), 2010 WL 4236606, and neither the district court nor the Seventh Circuit addressed the issue.

95. 15 U.S.C. § 78bb(f)(3)(A)(ii)(II).

96. Alessi v. Beracha, 244 F. Supp. 2d 354, 358 (D. Del. 2003).

Once these elements are met, the second prong saves claims regarding, for example, material misrepresentations in proxies.[97]

Generally, the applicability of the second prong should be straightforward (the suit is derivative, or not; the purchase or sale involved only current shareholders, or not; there was a request for shareholder action, or not). However, as explained in the remainder of this Part, not all questions under SLUSA are straightforward, and the types of claims Congress attempted to preclude from its reach are made clear when one looks to the carve-out. Accordingly, while courts cannot and should not force claims under the umbrella of the carve-out if they do not fit, the clear efforts of Congress to save certain types of claims from preemption—particularly those claims involving misconduct surrounding transactions between the corporation and its existing shareholders—are particularly relevant when making determinations about SLUSA's scope. Unfortunately, not all circuits take this into consideration, though the Fifth Circuit did consider some other limits on SLUSA's reach in its 2012 decision in *Roland v. Green*.[98]

2. Roland v. Green *and Limits on SLUSA*. Though *Roland* was predominantly concerned with establishing a standard for the Fifth Circuit to interpret the "in connection with" language of SLUSA,[99] its reasoning about SLUSA's intended scope is persuasive. *Roland* concerned "an alleged multi-billion dollar Ponzi scheme perpetrated by R. Allen Stanford" and his corporate entities, and three consolidated cases stemming therefrom.[100] The essence of the complaints was that plaintiffs had been sold certificates of deposit (CDs) that promised a high rate of return, and the defendants had represented that the CDs were backed by secure, liquid investments.[101] The district court initially determined that the CDs were not "covered securities" within the meaning of SLUSA but continued its SLUSA analysis anyway.[102] The court concluded that it

97. *See* Derdiger v. Tallman, 75 F. Supp. 2d 322, 325 (D. Del. 1999) (remanding a case where the defendant allegedly "misrepresented material facts in proxy statements" under the second prong of the carve-out).

98. Roland v. Green, 675 F.3d 503 (5th Cir. 2012), *cert. granted in part sub nom.* Chadbourne & Parke LLP v. Troice, 81 U.S.L.W. 3408 (U.S. Jan. 18, 2013) (No. 12-79).

99. *See supra* note 33 and accompanying text.

100. *Roland*, 675 F.3d at 506.

101. *Id.* at 508.

102. *Id.* at 510 (quotation marks omitted).

must interpret the statute broadly and found that preclusion was warranted because the plaintiffs had been induced to believe that their CDs were backed by securities.[103] The court therefore denied plaintiffs' motion to remand and, in separate orders, dismissed two other companion cases based on its findings.[104]

The Fifth Circuit was not persuaded by this analysis and reversed,[105] relying in large part on policy concerns.[106] The court surveyed the approaches taken by the Second, Sixth, Seventh, Eighth, Ninth, and Eleventh Circuits concerning the question of when a fraud or misrepresentation "coincide[s]" with a covered transaction.[107] The court specifically inquired into how courts faced with similar Ponzi schemes interpreted SLUSA, noting three distinct approaches.[108] It also noted the tension in the Supreme Court's command that "in connection with" should be interpreted broadly, yet not so broadly as to convert every common-law fraud that involves nationally traded securities into a Section 10(b) violation.[109] The court determined that it needed to balance the tension between the need to take the "connection" requirement seriously with policy and legislative intent considerations, "all of which militate against an overbroad

103. *Id.* The court went on to support its finding by noting that the scheme targeted retirees who were encouraged to roll over their retirement funds. *Id.* Because at least one plaintiff sold SLUSA-covered securities and used the proceeds to purchase the CDs, the court held that this was an independent ground to support SLUSA preclusion. *Id.* at 511.

104. *Id.*

105. *Id.* at 524.

106. *See id.* at 517 ("Given the Supreme Court's express reliance on 'policy considerations' in its determination of the scope of the 'in connection with' language in Section 10(b), we find it useful to consider such arguments in our formulation of the standard." (citations omitted) (citing Merrill Lynch, Pierce, Fenner & Smith Inc. v. Dabit, 547 U.S. 71, 81 (2006); Blue Chip Stamps v. Manor Drug Stores, 421 U.S. 723, 737 (1975))).

107. *Id.* at 512–14. The court found that only the Second, Ninth, and Eleventh Circuits had truly attempted to define this scope, rather than merely stating "what connection above and beyond 'coincide' is sufficient." *Id.* at 512–13. The "coincide" test has its basis in *SEC v. Zandford*. *See id.* at 512; *supra* note 20.

108. *Roland*, 675 F.3d at 514–15 ("From our reading of these uncovered securities cases, we glean three approaches: (1) focus the analysis on whether the financial product purchased was a covered security (the 'product approach'); (2) focus on the 'separation' between the investment in the financial product and the subsequent transactions (real or purported) in covered securities (the 'separation approach'); and (3) focus on the 'purpose(s)' of the investment (the 'purposes approach').").

109. *Id.* at 512 (citing SEC v. Zandford, 535 U.S. 813, 819–20 (2002)). The court was also attentive to the ongoing importance of state-law regulation. *See id.* at 518 ("Notably, state common law breach of fiduciary duty actions provide an important remedy not available under federal law.").

formulation."[110] The court found that the test adopted by the Ninth Circuit best struck this balance. Under that test, SLUSA applies when a fraud is "more than tangentially related" to the purchase or sale of covered securities.[111] Ultimately, the court reversed and embraced this approach, citing favorably to an amicus brief filed by Members of Congress that supported a more tailored reading of the statute than the one adopted by the district court.[112]

Although this decision does not address the exact issue in *Brown* and its progeny, it nonetheless highlights important limiting principles that should be considered when interpreting SLUSA. First, SLUSA was intended to ensure predictable, uniform national standards for nationally traded securities, particularly in the case of market transactions that cut across state lines.[113] That said, it was also designed to preserve the right of individuals to bring suit under state law, especially with respect to claims regarding internal corporate matters.[114] Second, it is not enough to interpret SLUSA broadly; a broad interpretation must still effectuate the statute's purpose. This cannot mean that SLUSA should be interpreted so broadly as to convert it from a shield against frivolous, disjointed litigation into a sword that eviscerates even the most meritorious of state-law claims simply because they have a distant connection to nationally traded securities, no matter how remote.[115]

B. *Misrepresentations, the Carve-Out, and a Circuit Split*

Despite Congress's intentions to exclude certain types of claims from SLUSA's grasp, a circuit split has developed over the meaning of "alleging a misrepresentation" and the meaning of the Delaware carve-out. This Section reviews the approaches taken by the Third, Sixth, and Ninth Circuits before looking to a decision out of the

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110. *Id.* at 520.

111. *Id.* at 519–20.

112. *Id.* at 518 (quoting *Amicus Curiae* Brief of Certain Members of Congress in Support of Appellants and Addressing the Securities Litigation Uniform Standards Act at 10, *Roland*, 675 F.3d 503 (No. 11-11048), 2011 WL 6167175).

113. *Id.* at 517.

114. *See id.* at 518 (noting that it is important to "preserv[e] . . . the right of individuals to bring suit" (quoting S. REP. NO. 105-182, at 8 (1998)).

115. *See Amicus Curiae* Brief of Certain Members of Congress in Support of Appellants and Addressing the Securities Litigation Uniform Standards Act, *supra* note 112, at 7–8 ("'[SLUSA] will permit meritorious claims to continue to be filed while preventing the migration of baseless class actions to state court.'" (alteration in original) (quoting 144 CONG. REC. H6055 (daily ed. July 21, 1998) (statement of Rep. Thomas Bliley))).

Seventh Circuit that not only further exacerbates this split but also completely guts the purpose of the carve-out without so much as acknowledging its importance.

1. *The Literalist Approach.* One approach in determining whether a state-law claim must be dismissed asks whether a complaint includes *any* allegations of the type that SLUSA bars, "pure and simple."[116] In *Segal v. Fifth Third Bank, N.A.*,[117] the Sixth Circuit considered a case about a "planned corporate scheme" in which the bank-defendant Fifth Third allegedly invested in its own proprietary mutual funds rather than in the superior funds of its competitors.[118] In considering whether the claim fell within SLUSA's scope, the Sixth Circuit looked to the plain language of SLUSA and the Supreme Court's admonition in *Dabit* to broadly interpret the statute to effectuate its purpose.[119] Working under this artful pleading approach, the court observed that it was not the name of the claim or the words used to describe a cause of action that mattered; rather, it was the actual substance underlying the complaint.[120] Accordingly, the court was not persuaded by the plaintiff's emphasis on the *elements* of his state-law claims for breach of fiduciary duty, breach of contract, and unjust enrichment—none of which legally depended on misrepresentations.[121] Ultimately, the court concluded that the combination of SLUSA's broad language[122] and *Dabit*'s directive[123] left

116. Segal v. Fifth Third Bank, N.A., 581 F.3d 305, 311 (6th Cir. 2009). This has been dubbed the literalist approach. Brown v. Calamos, 664 F.3d 123, 127 (7th Cir. 2011).

117. Segal v. Fifth Third Bank, N.A., 581 F.3d 305 (6th Cir. 2009).

118. *Id.* at 308, 310.

119. *Id.* at 310–11. Though the Supreme Court has not had occasion to interpret this particular passage of SLUSA, the Sixth Circuit found the Court's interpretation of SLUSA's "in connection with" language to be instructive. *Id.* at 310.

120. *See id.* at 310–11 ("The question under SLUSA is not whether the complaint uses the prohibited words . . . . It is whether the complaint covers the prohibited theories, no matter what words are used (or disclaimed) in explaining them.").

121. *Id.* In fact, despite pronouncing that the plaintiff's claim involved no misrepresentations, the claim actually announced that the "gravamen" of the plaintiff's allegations was that Fifth Third had not dealt honestly with its beneficiaries on an ongoing basis while continually purchasing and selling nationally traded securities. *Id.* at 311.

122. *See id.* at 311 ("It asks whether the complaint includes these types of allegations, pure and simple.").

123. *See id.* ("Add to this the Supreme Court's admonition that SLUSA's prohibitions must be 'broad[ly]' construed." (alteration in original) (quoting Merrill Lynch, Pierce, Fenner & Smith Inc. v. Dabit, 547 U.S. 71, 86 (2006))).

it with no choice but to hold that any action involving even a hint of misrepresentation must be dismissed.[124]

In a later case, *Atkinson v. Morgan Asset Management, Inc.*,[125] the Sixth Circuit emphasized that only those claims that fit expressly within the reach of the carve-out's language will be saved from preclusion.[126] The plaintiffs claimed that the value of their redeemable mutual-fund shares had declined due to the defendants' unjustified risky behavior.[127] The plaintiffs attempted to fit their claim within the first carve-out, which protects claims regarding "the purchase or sale of securities by the issuer or an affiliate of the issuer exclusively from or to holders of equity securities of the issuer."[128] Thus, the plaintiffs asserted that their option to redeem shares qualified as a purchase despite their acknowledgement that they already held their shares when the misconduct began, making them merely holders.[129] The court did not buy this neat trick or the argument that congressional intent did not extend to this type of claim, and held that the plaintiffs' claim squarely fell within *Dabit*'s reach.[130]

2. *The Essential-to-Success Approach.* Contrasted with the Sixth Circuit, the Third Circuit takes a more nuanced view of whether a complaint alleges fraud or misrepresentation in connection with a covered transaction. The Third Circuit focuses not on every single word in a complaint but rather on only those allegations that are essential or necessary for the complaint's success. In *Rowinski v. Salomon Smith Barney Inc.*,[131] the Third Circuit addressed a complaint alleging that Salomon Smith Barney had disseminated biased research in violation of contracts with its brokerage clients and in violation of Pennsylvania consumer-protection laws.[132] The court questioned separately whether the complaint "allege[d] a material

124. *Id.* at 310.
125. Atkinson v. Morgan Asset Mgmt., Inc., 658 F.3d 549 (6th Cir. 2011).
126. *Id.* at 554.
127. *Id.* at 551–52.
128. *Id.* at 553 (quoting 15 U.S.C. § 77p(d)(1)(B) (2006)).
129. *Id.*
130. *Id.* at 554.
131. Rowinski v. Salomon Smith Barney Inc., 398 F.3d 294 (3d Cir. 2005).
132. *Id.* at 297.

misrepresentation" and whether any misrepresentation was "in connection with" the purchase or sale of securities.[133]

In *Rowinski*, allegations of misrepresentation were indisputably littered throughout the plaintiff's complaint.[134] For example, with respect to the plaintiff's state-law breach-of-contract claim, the plaintiff alleged that Salomon breached its contracts to provide its brokerage clients with unbiased investment research when it disseminated biased research reports with artificially inflated ratings.[135] The plaintiff argued that because misrepresentations or omissions were not a necessary *legal* element of such a claim under state law, SLUSA did not apply.[136] The court reasoned that SLUSA requires only that an action "allege[]" misrepresentations,[137] not that misrepresentation be the legal basis of the claim.[138] On this plain reading of the statute, the court concluded that "[w]here . . . allegations of a material misrepresentation serve as the *factual* predicate of a state law claim, the misrepresentation prong is satisfied under SLUSA."[139] Here, the factual basis of the breach-of-contract claim was that the reports, disseminated regularly (and often in connection with purchases and sales of securities), contained material misrepresentations. This, the court held, was enough to satisfy SLUSA preclusion.

At first glance this might seem to be the same approach that the Sixth Circuit advocated in *Segal*, because the Third Circuit was also unwilling to take a formalistic approach based on the legal elements of a state-law claim. However, in a more nuanced case, the Third Circuit clarified its approach. In *LaSala v. Bordier et Cie*,[140] a case involving a "classic 'pump-and-dump' scheme" executed by two

133. *See id.* at 299–300 (noting that "[t]he misrepresentation issue is straightforward" but "[t]he 'in connection' issue is more difficult"). *Rowinski* was decided before both *Dabit* and *Kircher*, so its approach was not influenced by either of those decisions.

134. *See id.* ("Plaintiff's complaint is replete with allegations that . . . readily satisfy the misrepresentation requirement under SLUSA.").

135. *Id.*

136. *Id.* at 300.

137. *Id.* (quoting 15 U.S.C. § 78bb(f)(1) (2006)).

138. *Id.* This reading of the plain language of the statute adopted by the Third Circuit is in line with the definition of "allegation" in Black's Law Dictionary. Black's defines "allegation" as "[s]omething declared or asserted as a matter of fact" and distinguishes it from a "material allegation," which is "an assertion that is essential to the claim." BLACK'S LAW DICTIONARY 86–87 (9th ed. 2009).

139. *Rowinski*, 398 F.3d at 300 (emphasis added).

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

directors of the now-bankrupt AremisSoft who covered their tracks by running money through two Swiss banks,[141] the court distinguished between necessary factual allegations and extraneous allegations that need not have been pleaded.[142] Under this approach, an allegation is a factual predicate to a claim, and therefore requires SLUSA preclusion if it "gives rise to liability."[143] For example, in *Rowinski*, there would have been no breach of contract without the fraudulent reports—there was no way to factually disentangle the fraud from the claims or the improper transactions. Conversely, due to the unique nature of Swiss law in *LaSala*, any claims that the directors of the Swiss banks had violated their fiduciary duties did not require a showing of misrepresentation—any description of such behavior could have been omitted and a viable claim would have stood under Swiss law.[144]

Despite this arguably more lenient essential-to-success approach, plaintiffs nonetheless cannot circumvent SLUSA by omitting an allegation of a misrepresentation if, whether or not properly pled, a factual allegation of misrepresentation is evident from a reasonable understanding of the complaint.[145] To make this determination, the Third Circuit agrees with other circuits that a court should look beyond the face of a complaint.[146] However, contrary to the approach of the Sixth Circuit, the Third Circuit has also established that every passing mention of a possible misrepresentation does not trigger SLUSA.[147] This distinction between the actually complained-of misconduct and other extraneous details allows a court to both broadly interpret SLUSA as required by *Dabit*, yet also be mindful of

141. *Id.* at 126.

142. *Id.* at 141.

143. *Id.*

144. *Id.*

145. Rowinski v. Salomon Smith Barney Inc., 398 F.3d 294, 304 (3d Cir. 2005); *cf. LaSala*, 519 F.3d at 141 ("In other words, when one of a plaintiff's *necessary* facts is a misrepresentation, the plaintiff cannot avoid SLUSA by merely altering the legal theory that makes that misrepresentation actionable." (emphasis added)).

146. *See Rowinski*, 398 F.3d at 301 (joining other courts in "scrutiniz[ing] the pleadings to arrive at the 'essence' of a state law claim, in order to prevent artful drafting from circumventing SLUSA preemption").

147. *See LaSala*, 519 F.3d at 141 ("While it may be unwise . . . to set out extraneous allegations of misrepresentations in a complaint, the inclusion of such extraneous allegations does not operate to require that the complaint must be dismissed under SLUSA.").

the purposes of the Delaware carve-out when determining whether a claim must be precluded.[148]

3. *The Distinct-Claim Approach.* The Ninth Circuit offers yet another approach to making this determination, in which to avoid preclusion, the claim must be "distinct" from those claims alleging fraud.[149] In crafting this approach, the Ninth Circuit has favorably cited to both the Sixth Circuit literalist approach and the Third Circuit essential-to-success approach without acknowledging a difference between the two.[150] The Ninth Circuit has also suggested that if "the essence" of a claim is based on fraudulent behavior then the claim is precluded[151] and that misrepresentation need not be a legal element of a claim for that claim to be precluded.[152] For example, a breach-of-contract claim, such as the claim in *Rowinski*, would still be dismissed under this distinct-claim approach, because the essence of the claim is grounded in fraud rather than in simple breach of contract. In contrast, a breach-of-fiduciary-duty claim alleging that a corporation improperly benefitted one class of shareholders to the detriment of another would not be dismissed under this approach.[153]

The most notable feature of the Ninth Circuit's approach is its willingness to allow plaintiffs the opportunity to amend their complaints to avoid SLUSA's reach. The court has recognized the potential for "artful pleading" as a way to circumvent the reach of the statute,[154] but it has been equally concerned with the inequity surrounding dismissal of valid state-law claims merely because a defendant was able to construe them as federal in nature.[155] Though only dicta, this concern suggests that the distinct-claim approach is

148. *See id.* at 135 ("Congress did not intend SLUSA to reach any corporate-originated claims . . . ." (emphasis omitted)).

149. *See* Madden v. Cowen & Co., 576 F.3d 957, 967 (9th Cir. 2009) (holding that the claim must be precluded "because Madden's complaint cannot be read as making a *distinct* claim" separate from the misrepresentations alleged elsewhere in the complaint (emphasis added)).

150. Proctor v. Vishay Intertechnology Inc., 584 F.3d 1208, 1222 n.13 (9th Cir. 2009).

151. Stoody–Broser v. Bank of Am., N.A., 442 F. App'x 247, 248 (9th Cir. 2011).

152. *Id.* (citing *Proctor*, 584 F.3d at 1222 n.13).

153. *See id.* at 249 ("[A] complaint may allege a violation of . . . fiduciary duty . . . so long as the complaint does not allege, either expressly or implicitly, misrepresentations, omissions, or fraudulent practices . . . .").

154. *Id.*; *see* U.S. Mortg., Inc. v. Saxton, 494 F.3d 833, 843 (9th Cir. 2007) (remarking that "a plaintiff may avoid SLUSA dismissal through amendment" (emphasis omitted)).

155. *Saxton*, 494 F.3d at 843.

perhaps the most deferential to the traditional balance in this field between state and federal realms of influence.[156]

C. Brown v. Calamos *and the Dismantling of the Delaware Carve-Out*

Despite the availability of these three approaches, the Seventh Circuit's *Brown* decision crafted a new approach to this question that underscores the risks inherent in an overbroad interpretation of SLUSA. As this Part highlights, *Brown* effectively condones a practice by defendants of using the protections of SLUSA not as a shield from meritless litigation but as a sword against legitimate state-law claims.

In *Brown*, the Seventh Circuit was faced with interpreting a claim for breach of fiduciary obligation that expressly disclaimed any allegations of securities fraud.[157] The plaintiff class was composed of owners of the common stock of a closed-end investment fund.[158] The fund also issued shares of "auction market preferred stock" (AMPS), for which interest rates were set through an auction process.[159] When the market crashed in 2008, the market for the AMPS dried up, and the owners of the preferred stock were stuck with the low interest rates set at the most recent auction.[160] Though not obligated to do so, the fund redeemed the preferred shares at a price above their market price.[161] The fund did replace this money, but had to do so by borrowing at much higher interest rates on shorter term paper, thereby increasing the risk to the fund.[162]

The plaintiffs' complaint alleged that the fund only bought back the AMPS "to curry favor with the investment banks and brokerage houses," which Calamos, the fund's parent, relied upon to market

156. *Cf.* Madden v. Cowen & Co., 576 F.3d 957, 971 (9th Cir. 2009) ("The testimony before Congress . . . suggests that the purpose of [the carve-out] was to preserve state-law actions brought by shareholders against their own corporations in connection with extraordinary corporate transactions requiring shareholder approval . . . .").

157. Brown v. Calamos, 664 F.3d 123, 126 (7th Cir. 2011).

158. *Id.* at 125.

159. *Id.* The fund invested the capital it obtained from common shareholders and preferred shareholders. *Id.* Any return on investment, minus the fund's expenses (including dividends paid to the preferred shareholders), benefitted the common stockholders, who effectively were the owners of the fund. *Id.*

160. *Id.* at 126.

161. *Id.*

162. *Id.*

shares in its future funds.[163] As articulated by the court, "[T]he parent sold its child . . . down the river, in breach of its fiduciary obligations to the fund's common shareholders, in order to placate banks and brokers."[164] The plaintiffs alleged that these actions violated the directors' duties "not to unfairly favor the interest of one class of shareholders over another . . . [and] not to cause one class of shareholders to receive a benefit greater than that to which they are entitled at the expense of another class of shareholders."[165] The complaint did not include any allegations of fraud or misrepresentation, but it did include reference to a public statement made by the fund that the AMPS's term would be perpetual.[166]

The Seventh Circuit followed the lead of other circuits in looking beyond the face of the complaint—but went even further. Based on one sentence in the complaint,[167] the court determined that the plaintiffs were "at least implicitly" alleging that the fund had made misleading omissions by not warning the common stockholders of the potential for future self-dealing.[168] From there, the court embarked on an imaginative journey to predict the potential course of future litigation, including various arguments the plaintiffs might have made.[169] Despite the hypothetical nature of this analysis, it was central to the court's decision to dismiss the plaintiffs' claims with prejudice.[170]

In determining which approach applied, the court analyzed and rejected the approaches of the Sixth, Third, and Ninth Circuits and

163. *Id.*

164. *Id.*

165. Complaint at 21, *Brown*, 664 F.3d 123 (No. 10-cv-06558).

166. *Brown*, 664 F.3d at 126.

167. This sentence read: "The Fund's public statements indicated that the holders of its common stock could realize, as one of the significant benefits of this investment, leverage that would continue indefinitely, because . . . the term of the AMPS was perpetual." Complaint, *supra* note 165, at 6.

168. *See Brown*, 664 F.3d at 127 ("A misleading omission is also alleged, at least implicitly: . . . an allegation of failure to disclose a conflict of interest that if disclosed would have given pause to potential investors.").

169. *See id.* at 126–27 (noting that the quoted passage of the complaint did not say the fund had made a misrepresentation "in so many words" but nonetheless determined that a jury "might" find this missing statement "insinuated" an essential element of the complaint); *see also id.* at 131 (returning to this line of inferences as a key reason for refusing to allow leave to amend the complaint).

170. *See id.* at 131 (observing that any potential amendment would not be credible "*if we are correct* that the allegation [of fraud] *may well be* central to the plaintiff's case" (emphases added)).

formulated a new approach somewhere between that of the Sixth and Third Circuits.[171] In rejecting the Sixth Circuit's literalist approach, the court expressed concern about the ambiguity surrounding the word "alleging," noting that essentially everything in a complaint is an allegation but also acknowledging that not everything is a "charge[] of misconduct for which the plaintiff is seeking relief."[172] The court also was, somewhat ironically, mindful that the literalist approach "could lead to inconclusive haggling over whether an implication of fraud could be extracted from allegations in the complaint that did not charge fraud directly."[173] In rejecting the Ninth Circuit's distinct-claim approach, the court doubted that allowing the dismissal of claims without prejudice would not undercut SLUSA's purpose.[174] In addition, the court was leery that the Third Circuit's essential-to-success approach would allow plaintiffs to slide so-called "inessential" allegations of fraud back into future litigation once they had avoided preclusion by removing those same claims.[175] Ultimately, the court determined that the plaintiffs' case would be doomed under any standard, but settled on a standard whereby a suit is "barred by SLUSA only if the allegations of the complaint make it likely that an issue of fraud will arise in the course of the litigation."[176]

Though this approach purports to leave the door open for duty-of-loyalty claims to proceed without being barred by SLUSA, the court's discussion of how this particular suit might have proceeded untouched makes that open door seem more like a mouse hole. This approach also ignores a key component of the carve-out analysis: the nature of the transaction in which the alleged misconduct took place. According to the court, had the fund originally said nothing about the benefits of its format of leverage and investment, and had the fund mentioned that any redemption of the AMPS might be motivated by self-interested concerns about future relationships with investment

171. *Id.* at 128–29.

172. *Id.* at 128.

173. *Id.* Despite the Seventh Circuit's concern about this "inconclusive haggling," the court spent a sizable portion of its opinion doing just that—attempting, ex ante, to predict what would or would not become a central issue in any future litigation.

174. *See id.* at 127 ("An intermediate approach, found in *Stoody–Broser v. Bank of America*, . . . allows the removed suit to be dismissed without prejudice . . . . We are doubtful about this approach." (citation omitted)).

175. *Id.*

176. *Id.* at 128–29.

banks, the suit might have been able to proceed.[177] The court refused to recognize the plaintiffs' assertion that the misconduct was unrelated to Calamos's initial sales pitch but instead stemmed from its redemption of the AMPS from the preferred shareholders to the detriment of the fund.[178] Furthermore, the court indicated that every allegation of a conflict of interest or breach of the duty of loyalty would implicitly include an omission or misrepresentation.[179] This represents a potentially massive intrusion into the state-law domain that is neither mandated by—nor an intended result of—SLUSA.

III. Analyzing the Approaches

As explained in Part II, lower courts have taken varying approaches to interpreting SLUSA's reach, particularly as their interpretations relate to the scope of the Delaware carve-out. Although the Supreme Court's precedent counsels in favor of a broad interpretation of the statute's reach,[180] this reading is necessarily constrained by due regard for congressional intent, existing judicial interpretations of related statutes, and federalism considerations. Federalism is particularly important given the historical role it has played in interpreting the overlap between federal and state securities

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177. *Id.* at 129; *see also id.* (explaining that, while not barred by SLUSA, such a suit "would have to be brought as a derivative suit").

178. *Id.* at 130.

179. *See id.* ("The allegation of fraud would be difficult and maybe impossible to disentangle from the charge of breach of the duty of loyalty . . . . [N]o sane investor would knowingly put himself at the mercy of a disloyal investment manager . . . ."). Interestingly, in an earlier opinion also authored by Judge Posner, the Seventh Circuit dismissed the idea that every broken promise amounts to a misrepresentation or fraud. *See* Consolidation Servs., Inc. v. KeyBank Nat'l Ass'n, 185 F.3d 817, 823 (7th Cir. 1999) ("CSI's lawyer labors under a deep misunderstanding of the meaning of the word 'misrepresentation.' To him, a promise that is not fulfilled, for whatever reason, is a misrepresentation. This view would turn every breach of contract into a fraud."). The court went on to say that absent other evidence, when a party makes a promise, but later for some reason changes her mind, this simply does not amount to fraud. *See id.* ("A promise is fraudulent only if it misrepresents the promisor's state of mind . . . ."). This seems to be exactly what the court called fraud in *Brown*—the fund originally indicated that the term of the AMPS would be perpetual, but later changed its mind. *Brown*, 664 F.3d at 126–27. That the fund had a bad-faith reason for changing its mind should not impact whether the original statement was a misrepresentation, particularly when the statement itself was not at issue. *See Consolidation Servs.*, 183 F.3d at 823 (holding that a promise is fraudulent if *at the time it was made* it misrepresents the promisor's state of mind, with *any* later change of mind not bearing on this initial determination). These holdings are in deep conflict.

180. *See* Merrill Lynch, Pierce, Fenner & Smith Inc. v. Dabit, 547 U.S. 71, 74 (2006) ("The background, the text, and the purpose of SLUSA's pre-emption provision all support [a] broad[] interpretation . . . .").

law.[181] This Part examines the historical reach of Section 10(b) and relevant federalism concerns related to the separation of federal securities law and state fiduciary-duty law. This Part also highlights the problems inherent in the Sixth and Seventh Circuits' approaches to interpreting SLUSA.

A. *"Alleging a Misrepresentation"—Looking to Section 10(b) for Guidance*

1. *The Limits on the Reach of Section 10(b) Should Inform SLUSA's Preemptive Reach.* The language of SLUSA bears striking similarities to the language of Section 10(b) and Rule 10b–5.[182] Further indicating the parallel nature of the two provisions, the Joint Explanatory Statement of the Committee of Conference replaced the omission and misrepresentation language of SLUSA with the word "fraud" when describing its purpose.[183] Therefore, as the Supreme Court has done, it is appropriate as a matter of statutory interpretation to construe the two provisions as having the same meaning.[184]

Unfortunately, courts have not always clearly defined the full scope of what constitutes a meritorious Section 10(b) action—and in particular, the interpretation of the "in connection with" requirement.[185] Congress would have been aware of this ambiguity when enacting both the PSLRA and SLUSA, and it could have opted to clarify it.[186] The Supreme Court has said that the PSLRA, rather than clarifying this muddied area, actually codified judicial

181. *See supra* notes 57–59 and accompanying text.

182. For comparison of the language of the two statutory provisions, see *supra* note 38 and accompanying text. Rule 10b–5 specifically provides that it is unlawful "[t]o employ any device, scheme, or artifice to defraud" or "[t]o make any untrue statement . . . or to omit to state a material fact." 17 C.F.R. §§ 240.10b–5(a) to (b) (2013).

183. H.R. REP. NO. 105-803, at 13 (1998) (Conf. Rep.); *see also* Magyery v. Transamerica Fin. Advisors, Inc., 315 F. Supp. 2d 954, 961 (N.D. Ind. 2004) (noting that "the word 'fraud' [in the Joint Explanatory Statement of the Committee of Conference] is used in place of the misrepresentation or omission language in the statute" because Congress intended federal courts to be "the exclusive venue for most securities class action lawsuits").

184. *Dabit*, 547 U.S. at 85–86; *see supra* note 39 and accompanying text.

185. *See* O'Hare, *supra* note 10, at 329 & n.29 (collecting sources describing the difficulty courts have had in establishing a clear test for the "in connection with" requirement).

186. *See* 73 AM. JUR. 2D *Statutes* § 77 (2012) ("[T]he legislature is presumed to have adopted prior judicial constructions of a law unless a contrary intention is expressed in the new version."); *see also, e.g.*, United States v. Wells, 519 U.S. 482, 495 (1997) ("[W]e presume that Congress expects its statutes to be read in conformity with this Court's precedents . . . .").

interpretations of the Rule 10b–5 implied right of action up to that point.[187] Because of this, SLUSA cannot *substantively* extend the reach of Section 10(b) but rather *procedurally* makes federal court the only venue for these actions.[188] It therefore is helpful to consider exactly what misconduct Congress wanted litigated and where—if anywhere—Congress intended for such litigation to take place in the first instance.

As an illustration, *Brown*'s interpretation of the reach of SLUSA leaves directors and officers with an interesting choice. They can fully disclose any unfair act they would like to carry out before acting.[189] In that event, according to the Seventh Circuit, a state claim is not precluded by SLUSA and investors can proceed with an action in state court.[190] Alternatively, they can decide not to disclose their planned self-dealing. In addition to self-dealing, this commits directors and officers to an omission, at the very least, which thus bars any state-law fiduciary-duty claims because plaintiffs would likely allege such omissions, even if the allegation is implicit. However, investors would most likely be left with no remedy at all because it is highly likely that a director or officer who mistreats a class of shareholders for her own benefit would do so without first warning them so that, under the Seventh Circuit's approach in interpreting SLUSA, the suit would be removed to federal court. Once in federal court, the allegations would be judged by the Court's Section 10(b) jurisprudence, under which it is likely that the director or officer's actions, though dishonest, would not rise to the level of deception required for a successful Section 10(b) claim.[191]

187. *See* Stoneridge Inv. Partners, LLC v. Scientific-Atlanta, Inc., 552 U.S. 148, 166 (2008) ("It is appropriate for us to assume that when § 78u–4 was enacted, Congress accepted the § 10(b) private cause of action as then defined but chose to extend it no further.").

188. This is not to disagree with or disregard the holding in *Dabit*. As the Court noted there, the specific misconduct at issue was identical to that of a typical Section 10(b) suit and therefore "unquestionably qualifie[d] as fraud in connection with the purchase or sale of securities." *Dabit*, 547 U.S. at 89 (quotation marks omitted).

189. *See* Brown v. Calamos, 664 F.3d 123, 129 (7th Cir. 2011) (explaining that defendants who make a full and accurate disclosure at the outset might prevent later allegations of fraud but not of a breach of the duty of loyalty).

190. *Id.*

191. *See* Santa Fe Indus., Inc. v. Green, 430 U.S. 462, 474 n.14 (1977) ("[T]he failure to give advance notice [is] not a material nondisclosure within the meaning of the statute or the Rule.").

Much as no sane investor would subject herself to a disloyal investment manager,[192] it seems unlikely that any rational director would subject herself to suit when she could hide behind SLUSA instead. Although the Court in *Dabit* brought misconduct that was clearly actionable under Section 10(b) (albeit by a different plaintiff) within SLUSA's scope, the Seventh Circuit brings within SLUSA's grasp a whole new sweep of misconduct regarding certain types of corporate affairs that have never been actionable under Section 10(b). This cannot be the result Congress intended.

2. *The Seventh Circuit Takes the Artful Pleading Doctrine Too Far*. Because SLUSA includes a preclusion provision, it should be subject to the artful pleading doctrine.[193] Under this maxim, a court looks behind the words of a complaint to determine the true nature of the claim, typically for the purpose of determining whether a federal court has subject matter jurisdiction. Appellate courts have consistently applied the artful pleading doctrine when determining whether SLUSA mandates removal and dismissal.[194]

The artful pleading doctrine prevents plaintiffs from avoiding removal when it is in fact proper,[195] and thus the doctrine is particularly applicable to SLUSA. The artful pleading doctrine allows a court—not the parties—to make these important removal

192. *See supra* note 179.

193. *See* Roland v. Green, 675 F.3d 503, 520 (5th Cir. 2012) (explaining that under the artful pleading doctrine "even though the plaintiff has artfully avoided any suggestion of a federal issue, removal is not defeated by the plaintiff's pleading skills in hiding [a] federal question" (alteration in original) (quoting Bernhard v. Whitney Nat'l Bank, 523 F.3d 546, 551 (5th Cir. 2008) (quotation mark omitted))). In most circumstances, the plaintiff is the master of her complaint, *see* Franchise Tax Bd. v. Constr. Laborers Vacation Trust for S. Cal., 463 U.S. 1, 22 (1983) ("[W]e have often repeated that 'the party who brings a suit is master to decide what law he will rely upon' . . . ." (quoting The Fair v. Kohler Die & Specialty Co., 228 U.S. 22, 25 (1913))), and the well-pleaded-complaint rule enables a plaintiff to "avoid federal jurisdiction by exclusive reliance on state law." Caterpillar Inc. v. Williams, 482 U.S. 386, 392 (1987). However, in the event that an area of state law is preempted by federal law, courts will employ the artful pleading doctrine to ensure that the plaintiff cannot skirt removal by strategically avoiding any mention of federal questions in her pleadings. *See Franchise Tax Bd.*, 463 U.S. at 22 ("[I]t is an independent corollary of the well-pleaded-complaint rule that a plaintiff may not defeat removal by omitting to plead necessary federal questions in a complaint."). The doctrine also applies "when Congress has . . . expressly provided for the removal of particular actions asserting state law claims." Romano v. Kazacos, 609 F.3d 512, 519 (2d Cir. 2010).

194. *See, e.g.*, *Roland*, 675 F.3d at 520 (explaining that there are two situations in which the artful pleading doctrine applies and that SLUSA qualifies under both); *Romano*, 609 F.3d at 519 (same); Segal v. Fifth Third Bank, N.A., 581 F.3d 305, 310–11 (6th Cir. 2009) (noting that a claimant cannot avoid SLUSA's application through artful pleading).

195. *Romano*, 609 F.3d at 518–19.

determinations. Eliminating the potential to evade the PSLRA was a primary objective of Congress in enacting SLUSA, and the ability to simply disclaim or plead around SLUSA would severely undermine this goal.[196] Accordingly, courts should continue to look beyond the face of a well-pleaded complaint in search for "a securities fraud wolf dressed up in a breach of contract [or fiduciary duty] sheep's clothing,"[197] as courts, including the Third, Sixth, Seventh, and Ninth Circuits, are doing.

What the artful pleading doctrine does not do is give courts an opportunity to turn nonpreempted state claims into federal claims—though this is exactly what happened in *Brown*. SLUSA's preclusive effect should be limited to only those state-law claims alleging actions essentially amounting to securities fraud.[198] It is doubtful, for example, that any court would read a complaint that alleges simple theft of one's security portfolio to be preempted by federal securities law because there has been some preemption in the field. That is effectively what the Seventh Circuit held in *Brown*, however. By reading complaints so broadly as to turn every state-law claim that happens to involve some amount of dishonesty and some connection to nationally traded securities into allegations of fraud, the court cast too wide a net for a statute described as a "targeted" solution to a specific problem.[199] The Seventh Circuit's decision not only extends the bounds of SLUSA and the general rules about pleadings, but also implicates important federalism concerns.

196. *See* 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.").

197. Felton v. Morgan Stanley Dean Witter & Co., 429 F. Supp. 2d 684, 693 (S.D.N.Y. 2006). There is a difference between a plaintiff who states a valid cause of action that simply does not, under any reading, implicate SLUSA, and a plaintiff who pleads around it. *Cf.* Green v. Ameritrade, Inc., 279 F.3d 590, 599 (8th Cir. 2002) (holding that an amended complaint deleting any reference to purchase or sale of securities, including amending the prayer for relief, sufficiently removed the complaint from SLUSA's ambit). For an argument in favor of allowing plaintiffs to actually plead around SLUSA, see O'Hare, *supra* note 10, at 373–75. Professor O'Hare is wary that courts will not be able to tell the difference between a plaintiff who is attempting to evade SLUSA and one who is pleading a noncovered claim. *See id.* at 375 ("If plaintiffs are not permitted to plead around SLUSA, courts will be forced to expend substantial resources to determine whether they should re-write the plaintiff's claim in order to preempt it.").

198. *See* 15 U.S.C. § 78bb(f) (2012) (banning securities fraud); *see also supra* note 60.

199. *See supra* note 60.

B. *Federalism Concerns Counsel Against an Overbroad Interpretation of SLUSA*

Federalism concerns were at the forefront of congressional debates over SLUSA. Though there have been arguments against the dual state-federal securities regulation system,[200] the fields of corporate law and securities law have historically operated under a dual system of regulation—states regulate corporations, including the behavior of officers and directors, and the federal government regulates nationally traded securities.[201] Though the separation between the two spheres has never been absolute, SLUSA as enacted (but perhaps not as currently interpreted) cannot be said to have dramatically disrupted this balance.[202]

1. *The Delicate Balance Between State and Federal Regulation of Corporations Would Be Disrupted if the Seventh Circuit's Approach Were Adopted*. Historically, there has been mutual respect for the boundaries of these spheres of regulation.[203] When interpreting the reach of Section 10(b), the Supreme Court and lower courts have acknowledged these boundaries.[204] The Fifth Circuit took this into account when formulating its interpretation of SLUSA's "in connection with" requirement in *Roland*.[205] The Third Circuit's approach, which looks only to those allegations that are essential to success, [206] also allows room for courts to respect this balance.

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200. *See, e.g.*, William L. Cary, *Federalism and Corporate Law: Reflections on Delaware*, 83 YALE L.J. 663, 663 (1974) ("In the management of corporate affairs, state statutory and case law has always been supreme, with federal intrusion limited to the field of securities regulation. Perhaps now is the time to reconsider the federal role.").

201. *See* Jones, *supra* note 57, at 884 (noting that courts frequently insist on "maintaining a bright line between the corporate and securities law domains"); *supra* note 59.

202. In fact, courts have recognized this limit on SLUSA's reach. *See, e.g.*, Rowinski v. Salomon Smith Barney Inc., 398 F.3d 294, 299 (3d Cir. 2005) ("SLUSA furthers the uniform application of federal fraud standards without expanding or constricting the substantive reach of federal securities regulation." (citing 15 U.S.C. § 78a (2006))).

203. *See* O'Hare, *supra* note 34, at 501 ("Just as the Delaware courts have sought to respect the anti-fraud provisions of the federal securities laws, Congress has attempted to respect state corporate law.").

204. *See, e.g.*, SEC v. Zandford, 535 U.S. 813, 825 n.4 (2002) ("[O]ur analysis does not transform every breach of fiduciary duty into a federal securities violation."); Gochnauer v. A.G. Edwards & Sons, Inc., 810 F.2d 1042, 1049 (11th Cir. 1987) ("Since not every instance of financial unfairness or breach of fiduciary duty will constitute a fraudulent activity under § 10(b) or Rule 10b–5, federal courts should be wary of foreclosing common law breach of fiduciary duty actions which supplement existing federal or state statutes.").

205. Roland v. Green, 675 F.3d 503, 518 (5th Cir. 2012).

206. For a description of the essential-to-success approach, see *supra* Part II.B.2.

The lack of federal fiduciary standards must also inform the interpretation of SLUSA's reach. Before SLUSA, states had securities laws that predated the 1933 Act and the 1934 Act.[207] There were (and still are) no such national standards governing fiduciary relationships.[208] Despite proposals,[209] Congress has not chosen to create such standards even though this regulation seems within the realm of its Commerce Clause power.[210] After decades of a dual-regulation approach to securities law, SLUSA represents a departure from this practice. If SLUSA is interpreted to preempt even the most traditional of state-law fiduciary-duty claims without providing any substitute, this would represent the potential for a complete elimination of remedies. Courts should require that Congress speak more clearly before construing SLUSA to effect such a result.[211]

2. *The Seventh Circuit Brings Within SLUSA's Reach Many Traditional State Claims*. SLUSA was specifically designed to preserve traditional state-law powers and to stop the migration of suits from federal court to state court, thereby ensuring a level of uniformity.[212] Fiduciary-duty claims have long been brought in state court, typically a court in an issuer's state of incorporation, and they do not pose the risk of vexatious litigation about which courts interpreting SLUSA have been wary.[213] Many of those who opposed SLUSA felt that states could handle this migration to state courts on

207. Perino*, supra* note 26, at 279.

208. *See Roland*, 675 F.3d at 518 ("Notably, state common law breach of fiduciary duty actions provide an important remedy not available under federal law.").

209. *See, e.g.*, *Corporate Rights and Responsibilities: Hearings Before the S. Comm. on Commerce*, 94th Cong. 57 (1976) (Statement of A.A. Sommer, Jr., Partner, Jones, Day, Reavis & Pogue) ("[T]here is a lot to be said for a Federal corporation law that would be of an 'enabling' sort, similar to those that exist in States . . . ."); Cary, *supra* note 200, at 701–02 (proposing a Federal Corporate Uniformity Act).

210. Cary, *supra* note 200, at 703.

211. *Cf.* Bates v. Dow AgroSciences LLC, 544 U.S. 431, 449 (2005) ("If Congress had intended to deprive injured parties of a long available form of compensation, it surely would have expressed that intent more clearly.").

212. *See* Merrill Lynch, Pierce, Fenner & Smith Inc. v. Dabit, 547 U.S. 71, 82 (2006) (noting that Congress enacted SLUSA both to prevent plaintiffs from "bringing class actions under state law, often in state court" and to "'prevent certain State private securities class action lawsuits alleging fraud from being used to frustrate the objectives of' the Reform Act" (quoting Securities Litigation Uniform Standards Act of 1998, Pub. L. No. 105-353, § 2(5), 112 Stat. 3227, 3227)).

213. *See* O'Hare, *supra* note 34, at 499 n.98 (explaining that although "courts were primarily concerned with respecting the traditional roles of state and federal law . . . , [t]hey were . . . also worried that Delaware courts would become a haven for frivolous securities litigation").

their own if they felt it necessary.[214] Indeed, states can address any potential vexatious securities-fraud litigation problems that may arise in their courts; in fact, they have already done so in the area of corporate law through heightened procedural requirements for bringing class or derivative suits, and through the business judgment rule.[215] Some Members of Congress were concerned that SLUSA was solving a problem that did not exist;[216] the Seventh Circuit's interpretation of SLUSA risks validating this concern by entangling all breaches of the fiduciary duty of loyalty with fraud.

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Unlike the Seventh Circuit's approach, the Third Circuit's approach is mindful that sometimes claims will include facts or allegations that need not be included.[217] Though a narrative in a complaint might include historical information that implies potential misrepresentations, it will not always rise to the level of being essential to success. Furthermore, any presence of a misrepresentation or omission does not automatically satisfy SLUSA's misrepresentation-in-connection-with-a-securities-trade requirement.[218] This essential-to-success approach is a useful starting point for courts looking to balance SLUSA's necessarily broad reach post-*Dabit* with the federalism concerns that underpin its enactment.

IV. GETTING TO THE HEART OF THE MATTER: HOW COURTS SHOULD APPROACH SLUSA INTERPRETATION

Given the tumultuous nature of post–Great Recession securities markets, it is essential that Congress's intent to protect corporations from meritless strike suits be effectuated wherever appropriate. However, this should not be done at the expense of small investors and others harmed by the self-dealing actions of directors and

214. California, the state most impacted, did in fact propose legislation to address the increase in court filings. *See* Perino, *supra* note 26, at 274 n.3 ("Another by-product of the [PSLRA] was a bruising political battle over California's Propositions 201 and 211, two competing state ballot initiatives. Proposition 201 purported to apply many of the [PSLRA]'s provisions to state causes of actions, whereas Proposition 211 would have established private securities fraud causes of action that were more plaintiff-favorable than federal law.").

215. *See supra* notes 77–86 and accompanying text.

216. *See supra* note 31.

217. *See supra* notes 145–48 and accompanying text.

218. *See supra* notes 131–33 and accompanying text.

officers. This Part advocates a two-pronged approach to interpreting SLUSA that should help to balance these concerns. Under the first prong, courts should determine whether the suit at issue is of the type Congress was attempting to eliminate. In particular, courts should look to whether the specific transaction involved is of the type exempted by the Delaware carve-out. From there, courts should proceed to the second step to determine whether the action at the heart of a plaintiff's complaint is one that is traditionally guided by state law. In this second step, courts should be especially cognizant that the core violation is some form of misrepresentation, as opposed to a violation that flows from the defendant's behavior, the wrongfulness of which is not solely dependent on disclosure.

A. *Courts Should Ask if the Suit Is of the Type Congress Was Attempting To Avoid*

In developing an approach to interpreting SLUSA's preemptive reach, it is essential to understand what exactly Congress was attempting to preempt. As discussed previously, the three primary concerns that motivated the passage of the PSLRA were strike suits, discovery abuse, and a chilling of forward-looking statements.[219] Similarly, SLUSA was enacted to plug a very specific hole in the PLRSA: the unintended migration of plaintiffs to state court to avoid the procedural hurdles of the PSLRA.[220] Preemption should be construed broadly enough to achieve these goals, but no further.

1. *Congress Was Focused Only on Certain Types of Fraud Suits*. When interpreting the reach of SLUSA, it is informative to examine the types of claims brought in state courts between 1995 and 1998 that were *not* previously brought in state court before the PSLRA. Presumably, these are the only types of claims that should be preempted. The legislative history belies any suggestion that Congress intended to foreclose shareholder suits alleging, for example, that negligent investment advisors were retained to advise on an acquisition, or that officers failed to disclose material information related to proxy statements.[221]

Before the PSLRA was enacted in 1995, the most common cases brought in state court were "corporate law claims alleging breaches of

219. *See supra* notes 24–27 and accompanying text.

220. *See supra* notes 28–29 and accompanying text.

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

fiduciary duty in connection with mergers or other corporate transactions, which have traditionally been filed in state court."[222] When the increase in state filings began post-1995, the new types of actions brought included "financial misrepresentation cases" and "false forecast" cases[223]—exactly the type of actions that would be subject to the PSLRA's heightened pleading requirements and would threaten the effectiveness of the safe harbor for forward-looking statements. Furthermore, many actions were filed concurrently in state and federal court. These were clear attempts to evade the impact of the discovery stay and created the very lack of uniformity that Congress had sought to eliminate.[224] The evidence underlying these alleged trends, however, was disputed.[225] But it was undisputed that any change in federal regulation of securities-fraud litigation should not impact traditional state regulation of corporations.[226] The current case law shows that SLUSA has led to a substantial federal incursion into an area traditionally handled by state courts applying state law.[227]

Accordingly, courts should not hesitate to dismiss these suits targeted by the PSLRA, but they should hesitate to dismiss cases that historically would have been brought in state court before the PSLRA and SLUSA, as Congress intended the Delaware carve-out to exclude them. Though this determination will not always be clear, it is impossible to ignore this mandate where Congress has explicitly spoken about the specific ill it was attempting to remedy.

Of course, the Supreme Court in *Dabit* declared in no uncertain terms that SLUSA should be interpreted broadly,[228] but that does not doom this approach. In fact, this approach is more in line with *Dabit* than those approaches taken by some of the lower courts. First, the

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222. Perino, *supra* note 26, at 308.

223. *See id.* at 312–13 (noting the distinctions in how claims were pled in the pre- and post-PSLRA periods).

224. *See id.* at 303 (describing conclusions of the Grundfest-Perino study presented to Congress during hearings on SLUSA). For mention of the Grundfest-Perino study, see *supra* note 29.

225. *See supra* note 31.

226. *See The Securities Litigation Uniform Standards Act of 1997: Hearing on S. 1260 Before the Subcomm. on Sec. of the S. Comm. on Banking, Hous., & Urban Affairs*, 105th Cong. 69, 71 (1998) (statement of John F. Olson, Partner, Gibson, Dunn & Crutcher) ("Everyone agrees that Federal legislation should not prevent States from making rules for the governance of corporations, or from imposing duties on the corporate directors and officers.").

227. For a review of this case law, see *supra* Part II.

228. *See supra* note 50 and accompanying text.

fatal flaw of Dabit's claim was that the *misconduct* he complained of was identical to that of a typical fraud claim under Section 10(b), even though Dabit himself could not have brought a claim under Section 10(b).[229] Congress clearly wished fraud in connection with securities transactions to be treated uniformly and believed this would be best achieved in federal courts, not state courts. Thus, *Dabit* likely reaches the right result. But it is a strained result to apply this thinking when a breach of the fiduciary duty of loyalty, not a failure to disclose, is the central component of a plaintiff's claims. If the Court in *Dabit* found instructive the comparison of the complained-of misconduct to a traditional Section 10(b) claim, lower courts should find such a comparison similarly helpful, even if the factual circumstances of different cases might not lead to the same result. Second, the Court also acknowledged the careful efforts of Congress to exempt certain types of claims from SLUSA's reach.[230] It would be odd if courts could disregard these explicit exemptions in interpreting SLUSA.

2. *Congress Specifically Excluded Those Fiduciary-Duty Suits That Were Likely also To Constitute Securities Fraud.* The inclusion of the derivative-action exemption and the Delaware carve-out indicates congressional awareness of potential overlap between the new national standard for securities fraud and areas traditionally handled by the states that Congress did not want to disturb.[231] In fact, Michael Perino, one of two authors of a report to Congress about the perceived migration of actions to state court,[232] noted in another article that his study did not include derivative actions *or class actions* based on breaches of fiduciary duties, as the filing of those suits in state court was likely not related to the PSLRA.[233] Therefore, the rare

229. Merrill Lynch, Pierce, Fenner & Smith Inc. v. Dabit, 547 U.S. 71, 89 (2006).

230. *Id.* at 87.

231. *See* O'Hare, *supra* note 34 at 504 ("The adoption of the Delaware carve-out, therefore, ensured that [SLUSA] would not impinge upon Delaware's need to regulate the conduct of corporate directors.").

232. Grundfest & Perino, *supra* note 29.

233. *See id.* at 303 n.128 ("The second kind of action in which companies can, and have traditionally been, sued in state court are class or derivative actions alleging breaches of officers' and directors' duties of loyalty, care, or candor. These cases are unlikely to be related to [SLUSA] [and are therefore not included in the Grundfest-Perino study]."); *see also* Richard W. Painter, *Responding to a False Alarm: Federal Preemption of State Securities Fraud Causes of Action*, 84 CORNELL L. REV. 1, 103 (1998) ("Cases filed *only* in state court should not have been counted as state securities cases unless they raised claims equivalent to claims that could have been brought in federal court. Otherwise, these state cases more closely resembled fiduciary duty claims under state corporate law.").

class-action breach-of-fiduciary-duty suit, such as the one in *Brown*, was not the type of suit that SLUSA was intended to reach. In defining the scope of SLUSA, Congress was aware that many state actions, primarily those in areas of corporate governance and control, had been and would continue to be brought in state court.[234] Courts should be equally cognizant of the scope of these exemptions and the implications they have on the limits on SLUSA's reach.

3. *The Presumption Against Complete Preemption Is Applicable to SLUSA*. Though SLUSA has been termed a statute of preclusion rather than one of preemption, courts must still remain cognizant of the general presumption against interpreting a statute in a way that would foreclose traditional state-law causes of action.[235] This presumption has been found to be particularly strong when coming to such a conclusion would entirely eliminate remedies traditionally available under state law.[236]

The Supreme Court has pronounced, "SLUSA does not actually pre-empt any state cause of action. It simply denies plaintiffs the right to use the class-action device to vindicate certain claims."[237] However, the Court has also recognized elsewhere the importance of the class-action device generally as a means of vindicating the rights of individuals who would not have incentive to otherwise pursue a claim.[238] It is unreasonable to say that the ability to bring an *individual* claim in state court diminishes the preemptive effect of SLUSA, considering that the class-action device may well be the only mode of recourse for noninstitutional investors seeking compensation for legitimate injuries.

Furthermore, the general presumption against interpreting a statute to preempt entrenched state-law causes of action cannot be forgotten when considering the reach of SLUSA.[239] When the Court held in *Dabit* that SLUSA extends to cover state-law holder claims, it

234. *See supra* Part I.D.

235. *See* Medtronic, Inc. v. Lohr, 518 U.S. 470, 485 (1996) (establishing the general presumption).

236. *See* Bates v. Dow AgroSciences LLC, 544 U.S. 431, 449 (2005) ("If Congress had intended to deprive injured parties of a long available form of compensation, it surely would have expressed that intent more clearly.").

237. Merrill Lynch, Pierce, Fenner & Smith Inc. v. Dabit, 547 U.S. 71, 87 (2006).

238. *E.g.*, Amchem Prods., Inc. v. Windsor, 521 U.S. 591, 617 (1997).

239. The Court in *Medtronic* also clarified that the presumption applies not only to the broad question of whether there was *any* preemption, but also narrowly to each question of the scope of preemption raised by the statute in question. *Medtronic*, 518 U.S. at 485.

recognized that although those claims were theoeretically available before SLUSA, the respondent in that case was only able to identify one time in which such a claim had actually been brought in state court.[240] Therefore, the Court explained, "[t]his is hardly a situation, then, in which a federal statute has eliminated a historically entrenched state-law remedy."[241] That same principle should counsel the opposite conclusion when considering the preemption of claims for breaches of fiduciary duties.[242] Claims for breach of fiduciary duty are "historically entrenched" state-law claims for which there is no federal parallel. Thus, plaintiffs would be completely without a remedy if the Seventh Circuit's approach were to be adopted as the prevailing legal test. Additionally, congressional intent is relevant to the scope of preemption,[243] and the existence of the carve-out is important evidence of such intent.[244]

B. Courts Should Look to the Heart of a Complaint

In ascertaining whether a complaint falls within one of these problematic categories,[245] courts should look to the heart of a complaint. Specifically, courts should look to the actions complained of rather than the words used to describe those actions.[246] Courts should be free to look beyond the face of a complaint or the name of a claim in determining SLUSA's reach.[247] If a claim could have been brought in federal court under Section 10(b), that is the end of the inquiry—the claim is preempted. If not, this analysis should not be a step-by-step inquiry into whether the plaintiff has a *winning* Section

240. *Dabit*, 547 U.S. at 88.

241. *Id.* (citing *Bates*, 544 U.S. at 449).

242. Furthermore, that the Court conducted this analysis in *Dabit* lends support to the proposition that the doctrine is applicable whenever a court is interpreting SLUSA's reach. That it came out the opposite way in one case should not preclude the inquiry in others. *See Medtronic*, 518 U.S. at 485 ("That approach is consistent with . . . federalism concerns . . . .").

243. *Id.*

244. *See supra* Part I.D.

245. *See supra* notes 222–27 and accompanying text.

246. This is an approach already taken in other instances, such as determining whether a multilayered fraud is in connection with the purchase or sale of a security, and therefore should not be novel or unworkable. *See, e.g.*, Roland v. Green, 675 F.3d 503, 522 (5th Cir. 2012) (looking to the "heart" of the fraud to determine if it was in connection with the purchase or sale of covered securities).

247. *See supra* Part III.A.2.

10(b) claim,[248] but rather should ask whether the crux of what the plaintiff is complaining about amounts to securities fraud in connection with a transaction that is not covered by the Delaware carve-out.[249] Accordingly, simply omitting one element of a Section 10(b) claim, such as scienter, should not allow a plaintiff to avoid preclusion. However, some consideration of whether the alleged actions, in the aggregate, could have amounted to a violation of Section 10(b)—even before the PSLRA—is an approach that may best satisfy both congressional intent and federalism concerns. Put simply, courts should ask: Is the core violation some form of misrepresentation, as opposed to a violation that flows from the defendant's behavior, the wrongfulness of which is not solely dependent on disclosure?

If the alleged misconduct never could have amounted to a violation of Section 10(b) before the PSLRA, but could have given rise (and, more importantly, often did give rise) to a distinct state-law claim before SLUSA, preemption should not occur. As an example, in *Santa Fe Industries v. Green*,[250] a case that involved several breaches of fiduciary duty, the Supreme Court held that the plaintiffs were in the wrong court—they were in federal court when they should have been in state court.[251] Under the Seventh Circuit's approach in *Brown*, a plaintiff who filed a similar claim in state court could now presumably be removed and dismissed under SLUSA, despite the Court's clear statement in *Santa Fe* that such claims belonged in state court. Similarly, should one assume that a class action such as that brought in the seminal Delaware decision *Weinberger v. UOP, Inc*[252]—which was based on several breaches of fiduciary duty but included a failure to disclose the walk-away price of a bidder[253]—would now be removed to federal court under the *Brown* approach?

248. *Cf.* Kircher v. Putnam Funds Trust, 403 F.3d 478, 484 (7th Cir. 2005) ("[SLUSA] covers both good and bad securities claims—*especially* bad ones."), *vacated on other grounds*, 547 U.S. 633 (2006).

249. *Cf.* Feitelberg v. Merrill Lynch & Co., 234 F. Supp. 2d 1043, 1051 (N.D. Cal. 2002), *aff'd*, 353 F.3d 765 (9th Cir. 2003) ("In other words, if it looks like a securities fraud claim, sounds like a securities fraud claim and acts like a securities fraud claim, it is a securities fraud claim, no matter how you dress it up.").

250. Santa Fe Indus., Inc. v. Green, 430 U.S. 462 (1976).

251. *See id.* at 479–80 (refusing to apply Section 10(b) to claims limited to breach of fiduciary duties).

252. Weinberger v. UOP, Inc., 457 A.2d 701 (Del. 1983).

253. *Id.* at 709.

All told, preemption of these claims both contravenes congressional intent and affronts states' authority in this domain.

C. This Approach Strikes the Appropriate Balance

The approach advocated by this Note is more nuanced than the one advanced by the Sixth Circuit. Under that approach, any hint of a misrepresentation will lead to a dismissal.[254] In addition, this Note's approach also takes a more global view than that advanced by the Seventh Circuit in *Brown*. As explained above, according to the Seventh Circuit almost any actionable breach of a duty of loyalty will likely include at least an implicit omission or misrepresentation.[255] These two approaches lead to the dismissal of too many meritorious cases in the Sixth and Seventh Circuits. The approach recommended in this Note gives courts a touchstone for separating those complaints that try to evade SLUSA's reach from those that simply choose not to allege securities fraud, without reading the statute to preclude valid state-law claims.

For example, the approach advocated here likely would not have changed the result in the two cases from the Sixth Circuit discussed above.[256] In *Segal*, the court found that the complaint was full of allegations that the fund managers were running a "scheme."[257] This Note's approach would find that the actions complained of are exactly the type Congress was trying to avoid. The fund managers allegedly knew they were running a scheme when they advertised to investors, and they allegedly continued to misrepresent their intentions while purchasing and selling covered securities.[258] The breach-of-contract claim arguably was "a securities fraud wolf dressed up in a breach of contract sheep's clothing."[259] Conversely, in *Brown*, the improper actions were much more like traditional breach-of-fiduciary-duty claims than securities-fraud actions. The fund managers made a one-time decision to "[sell their] child . . . down the river, in breach of

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254. *See supra* Part II.B.1.

255. *See supra* Part III.A.1.

256. *See supra* Part II.B.1.

257. Segal v. Fifth Third Bank, N.A., 581 F.3d 305, 311 (6th Cir. 2009); *see also* Amended Class Action Complaint—Demand for Jury Trial ¶ 49–51, Segal v. Fifth Third Bank, N.A., No. 1:07-cv-348, 2008 WL 819290 (S.D. Ohio Mar. 25, 2008), 2007 WL 4742074 (providing details of the alleged scheme).

258. Amended Class Action Complaint—Demand for Jury Trial, *supra* note 257, ¶¶ 8, 49–51.

259. *See supra* note 197.

[their] fiduciary obligations to the fund's common shareholders, in order to placate banks and brokers."[260] The approach recommended in this Note gives courts a touchstone for separating those complaints that try to evade SLUSA's reach and those that fall victim to courts that help defendants avoid liability through an overbroad reading of the statute.

Most likely, the state-law cases that truly overlap with SLUSA's scope will fall within one of SLUSA's two express exemptions, leaving only those claims that largely amount to securities fraud and those that represent entirely distinct behavior. In cases like *Brown*, in which the misconduct and transactions involved are the essence of what the Delaware carve-out seeks to save from SLUSA's reach, the Third Circuit's approach is a good starting point for analyzing what truly is at the heart of a complaint and therefore whether preclusion is appropriate.[261] The approach advocated here—to consider whether the claim at issue is one Congress intended to prevent by focusing on the heart of the complained-of transaction—further clarifies, more closely than the other lower-court approaches discussed herein, how to soften the outcomes reached by the approaches taken in the Sixth and Seventh Circuits while still following *Dabit*'s admonitions.

CONCLUSION

SLUSA represents an attempted solution to a very important problem. There is little disagreement that the statute "abhor[s] strike suits and frivolous litigation of any stripe"[262] and was designed to minimize the possibility for these abusive actions. However, this does not mean that the law should allow for unfair business practices, particularly those that the states have made unlawful with fiduciary-duty laws. The reforms passed in the PSLRA and SLUSA represent important efforts to both allow only meritorious lawsuits in the field of securities regulation to proceed and to shield directors and officers from the distractions and costs of nonmeritorious litigation. They do not, and cannot, create an opportunity for defendants to evade liability for illegal behavior that is not covered by the statutes, in particular for violations of entrenched state laws such as fiduciary obligations.

260. Brown v. Calamos, 664 F.3d 123, 126 (7th Cir. 2011).

261. *See supra* Parts II.B.2, III.A.2.

262. H.R. REP. NO. 105-640, at 45 (1998).

SLUSA undeniably must be read broadly. However, it was not created in a vacuum, and therefore must also be interpreted broadly *to effectuate its purpose*. It is particularly important for courts to focus on congressional intent, statutory interpretation principles, and—due to the backdrop of dual regulation in the securities industry—federalism. The presence of the Delaware carve-out offers a unique opportunity to determine Congress's intent through an examination of the types of claims that should *not* be included in SLUSA's reach. Further, because SLUSA was enacted to solve a specific problem created by the PSLRA, it is important to look at the types of claims that SLUSA targeted—those that migrated from federal to state court, not those that remained in state court. This Note has argued that looking to the heart of a complaint is the best way to balance a broad reading of SLUSA with the important role federalism plays in the securities-law context.