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A legal update from Dechert's White Collar and Securities Litigation Group

Supreme Court Rules SLUSA Reaches Holder Class Actions

Whether securities class actions asserting state law claims can avoid dismissal under the Securities Litigation Uniform Standards Act of 1998 ("SLUSA") if the plaintiffs and class are merely holders of the securities at issue had split the lower courts. Now the U.S. Supreme Court has ruled that SLUSA applies to holder actions in the same way that it applies to actions by purchasers or sellers. The Court's ruling closes off a favorite, and potentially significant, class action plaintiff technique for attempting to avoid SLUSA.

On March 21, 2006, in *Merrill Lynch, Pierce, Fenner & Smith, Inc., v. Dabit*, 547 U.S. __, 2006 U.S. LEXIS 2497 (2006), the Supreme Court ruled that for "purposes of SLUSA pre-emption," the distinction between holders and purchasers or sellers "is irrelevant; the identity of the plaintiffs does not determine whether the complaint alleges fraud 'in connection with the purchase or sale' of securities." *Id*. at *33. Justice Stevens wrote for a unanimous Court, vacating the judgment of the U.S. Court of Appeals for the Second Circuit. Justice Alito, who joined the Court after the case was argued, did not participate.

The question had been considered by more than a dozen district courts and several Courts of Appeals before it finally reached the Supreme Court. Class action counsel bringing claims against securities issuers or advisors under state law had increasingly styled them as being brought by and on behalf of holders of securities, rather than purchasers or sellers. They argued that holder actions were not subject to SLUSA's requirement that securities-type class actions asserting state law claims be dismissed at the initial stage of litigation.

Most of the lower courts had reached the conclusion that thirty-year-old *Blue Chip Stamps v. Manor Drug Stores*, 421 U.S. 723 (1975), required—or at least counseled—an interpretation of SLUSA which limited SLUSA's application only to suits brought by purchasers or sellers. In *Blue Chip Stamps*, the Supreme Court had first addressed whether there was any private right of action under Section 10(b) of the Securities Exchange Act of 1934, or SEC Rule 10b-5, and if there was, whether it was available to anyone or only to purchasers or sellers of the securities at issue.

Blue Chip Stamps retained the private right of action that many lower courts had long recognized, and the long-recognized limit on that right of action which permitted only purchasers and sellers to maintain a Section 10(b) or 10b-5 suit. Because SLUSA adopted language from Section 10(b) and Rule 10b-5—in providing that it applied to class actions "in connection with the purchase or sale" of a covered security—many courts concluded that *Blue Chip Stamps'* purchaser-seller rule was imported along with that language. Notably, the U.S. Court of Appeals for the Seventh Circuit had reached the opposite conclusion in *Kircher v. Putnam Funds Trust*, 403 F.3d 478 (2005), a consolidation of ten market-timing class actions.

The Supreme Court concluded that the "background, the text, and the purpose of SLUSA's pre-emption provision all support the broader interpretation adopted by the Seventh Circuit." *Id*. at *7. The Court emphasized that the "magnitude of the federal interest in protecting the integrity and efficient operation of the market for nationally traded securities cannot be overstated." *Id*. at *13. And it concluded that the *Blue Chip Stamps* purchaser-seller rule had not been imported into SLUSA.

The Court flatly rejected the argument that *Blue Chip Stamps*' purchaser-seller rule "stems from the text of Rule 10b-5—specifically, the "in connection with" language." *Id*. at *24. Rather, it found that

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Blue Chip Stamps had fashioned a judicially-crafted remedy based principally on policy considerations.

The Court also explained that the scope of Section 10(b)'s "in connection with" language had been interpreted for decades by the Supreme Court as very broad. Allegations were considered "in connection with" the purchase or sale of a security if the misconduct coincided with a securities transaction—"whether by the plaintiff or by someone else." *Id.* at *26. "[A]ny ambiguity on that score had long been resolved by the time Congress enacted SLUSA." *Id.* at *25.

The Court noted that the same policy considerations that supported the Court's decision in *Blue Chip Stamps* prompted Congress twenty years later to adopt first the Private Securities Litigation Reform Act of 1995, and then SLUSA. Both were aimed at deterring, or quickly disposing of, vexatious litigation that harmed the national securities markets. Noting that *Dabit* had begun as a case brought by purchasers of securities and had become, through amendments to the complaint, a case brought by holders, and that many lawsuits with similar allegations had been filed on both federal and state law theories of liability, the Court recognized that confining SLUSA narrowly would permit the very types of vexatious litigation the 1995 Reform Act and SLUSA were enacted to protect against, and therefore would undermine SLUSA's purpose. The Court further pointed out that holder class actions were a recent phenomenon, virtually unheard of before SLUSA was enacted.

Although asked by the parties only to rule on the *Blue Chip Stamps*/holder question, the Court concluded by also ruling that Dabit's allegations against Merrill Lynch met SLUSA's "in connection with" requirement. Dabit's allegations complained that Merrill Lynch provided him with biased securities research. The Court regarded this as alleging fraudulent manipulation of stock prices, which it concluded would definitely be "in connection with the purchase or sale" of securities, within the meaning of Section 10(b), Rule 10b-5 and SLUSA.

The case is now remanded to the Second Circuit for further proceedings consistent with the Court's opinion. The prior judgment of the Second Circuit in this case is vacated. More broadly relevant, however, is that SLUSA dismissal may no longer be avoided by carefully crafting either allegations or the class itself to assert holder claims, rather than purchaser or seller claims.

Practice group contacts

If you have questions regarding the information in this legal update, please contact the Dechert attorney with whom you regularly work or one of the attorneys listed. Visit us at www.dechert.com/financialserviceslit or www.dechert.com/whitecollar.

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