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SOUTHERN DISTRICT CIVIL PRACTICE ROUNDUP

Expert Analysis

SLUSA's Broad Definition Of 'Covered Class Action'

A new chapter is now being written in the ongoing battle between defendants seeking dismissal of securities class actions under the Securities Litigation Uniform Standards Act[1] (SLUSA) and plaintiffs attempting to avoid SLUSA and proceed with their claims in state court. Legislative efforts to reign in securities class actions began with the Private Securities Litigation Reform Act of 1995,[2] which imposed strict pleading requirements on claims brought under the federal securities laws. When securities plaintiffs sought refuge from the PSLRA's pleading requirements in state court, Congress enacted SLUSA,[3] which requires dismissal of "(1) [] a 'covered' class action (2) based on state statutory or common law that (3) alleges that defendants made a 'misrepresentation or omission of a material fact' or 'used or employed any manipulative device or contrivance in connection with the purchase or sale' (4) of a covered security."[4]

Defining SLUSA's reach has been a continual battleground between plaintiffs and defendants, with past disputes centering on issues such as whether artfully pleaded state common law claims in fact involve misrepresentations relating to securities[5] and whether any relationship with a covered security is close enough to be "in connection with the purchase or sale" of such securities.[6] The latest front in those battles concerns the question of what constitutes a "covered class action," under SLUSA, with

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courts giving that threshold term a surprisingly expansive meaning. We discuss below three recent cases from the U.S. District Court for the Southern District of New York—two brought individually, rather than as class actions,[7] and the third brought by a trustee appointed under the Securities Investor Protection Act (SIPA),[8] all of which were held to be "covered class actions," for purposes of SLUSA.

MDL Litigation

Southern District Judges Sidney H. Stein in *In re Citigroup Securities Litigation* and Judge P. Kevin Castel in *In re Bank of America Corp. Securities, Derivative, and ERISA Litigation* each confronted the question of whether individual actions that related to pending multidistrict litigations (MDL) should be treated as covered class actions under SLUSA. In *In re Citigroup Securities Litigation*, the plaintiff, Wesley Odom, had alleged claims as a shareholder under federal and state statutes and Florida common law relating to alleged misrepresentations made by Citigroup. Odom's claims arose from the same alleged misrepresentations that had given rise to multiple other lawsuits, including two securities class actions consolidated before Stein as an MDL. Odom's case was filed originally in state court in Florida, removed by Citigroup to federal court, and then transferred by the JPML to Stein as part of the Citigroup MDL.

In *In re Bank of America Corp. Securities, Derivative, and ERISA Litigation* two individual plaintiffs and their investment vehicle brought claims of fraud, breach of fiduciary duty and negligent misrepresentation, as both purchasers and holders of Bank of America stock. Plaintiffs' claims related to alleged misrepresentations and omissions concerning Bank of America's financial condition and its acquisitions of Merrill Lynch and Countrywide Financial. Those allegations closely paralleled allegations in a consolidated class action complaint against Bank of America, pending in an MDL before Judge Castel. As with *In re Citigroup*, plaintiffs' case had been filed originally in state court in Florida, was removed to federal court, and then transferred by the Joint Panel on Multidistrict Litigation (JPML).

In both cases, the plaintiffs' claims, although not styled as class actions, were held to be "covered class actions" subject to dismissal under SLUSA. The rationale for treating these seemingly individual actions as "covered class actions" lies in SLUSA's broad definition of that term. Specifically, SLUSA defines "covered class action" to include "(i) any single lawsuit in which (I) damages are sought on behalf of more than 50 persons or prospective class members…; or (II) one or more named parties seek to recover damages on a representative basis on behalf of themselves and other unnamed parties similarly situated[.]"[9]

Somewhat less intuitively, however, SLUSA also includes within the definition of a "covered class action," "(ii) any group of lawsuits filed in or pending in the same court and involving common questions of law or fact, in which (I) damages are sought on behalf of

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more than 50 persons; and (II) the lawsuits are joined, consolidated, or otherwise proceed as a single action for any purpose."[10]

Judges Stein and Castel each found the individually commenced actions before them fit within the definition of a "covered class action." In *In re Bank of America Corp. Securities, Derivative, and ERISA Litigation*, Castel noted that "plaintiffs commenced this action on their own behalves and not as a purported class action[.]"[11] Likewise, in *In re Citigroup Securities Litigation*, Stein noted that plaintiff "seeks damages for himself,"[12] "did not purposefully direct his lawsuit to this Court," that his complaint was not "a verbatim copy of the other complaints," and that he was not "represented by the same counsel as other plaintiffs."[13] Nevertheless, both cases constituted covered class actions by virtue of the fact that they had been transferred by the JPML to be heard in connection with other pending actions involving the same alleged conduct by the same defendants.[14]

Castel observed in *Bank of America* that "SLUSA's definition of a 'covered class action' is not limited solely to class actions as conceived under Rule 23, Fed.R.Civ.P." Instead, "[u]nder SLUSA, a 'covered class action' may consist of '*any group* of lawsuits filed or…pending in the same court and involving common questions of law or fact,' which seek damages for more than 50 persons and 'proceed as a single action *for any purpose*.'"[15] Under that reading, he concluded that the action before him, having been transferred by the JPML for coordinated or consolidated pretrial proceedings, "falls within 'any group of lawsuits' that 'proceed[s] as a single action for any purpose,' and therefore constitutes a 'covered class action' under SLUSA."[16]

Stein made clear in *Citigroup* that formal joinder with related cases in the MDL is not required for a case to fall within the covered class action definition, finding that "even if two actions have not been formally joined or consolidated, they are proceeding 'as a single action for any purpose' within the meaning of SLUSA when they are grouped together as part of an MDL."[17]

Claims Asserted by a Trustee

Judge Jed S. Rakoff also adopted a broad definition of the term "covered class action" in his recent decision in *Securities Investor Protection Corp. v. Bernard L. Madoff Investment Securities, LLC*, an action brought by Irving H. Picard, the trustee appointed under SIPA to administer the estate of Bernard L. Madoff Investment Securities, LLC (Madoff Securities). Pursuant to a settlement with former Madoff Securities customers, the trustee had received assignments of the former customers' claims against certain entities, including various so-called Madoff "feeder funds." After concluding that the trustee had authority to accept assignment of such claims and that the assignments conferred standing on the trustee to pursue them, the court turned to the issue of whether pursuit of such claims was barred by SLUSA.[18]

> Judges Stein and Castel each found the individually commenced actions before them fit within the definition of a 'covered class action.'

Rakoff focused closely on the subsection of the definition of a covered class action that brings within SLUSA's preclusive scope "any single lawsuit in which…damages are sought on behalf of more than 50 persons… and questions of law or fact common to those persons…without reference to issues of individualized reliance on an alleged misstatement or omission, predominate over any questions affecting only individual persons or members."

He concluded that the reference to 50 or more persons encompassed the injured persons who were the original owners of the claims at issue, making the case a covered class action under SLUSA notwithstanding that it was brought by a single assignee.[19] Where the trustee stood "in the shoes of the assignees," and where "[q]uestions of reliance, damages, and the like would be addressed to the thousands of customers and other creditors who assigned their claims to the Trustee, just as they would in a shareholder class action," the court concluded that the action was a covered class action under SLUSA.[20]

Rakoff rejected the Trustee's argument that he was entitled to the benefit of a "counting" provision contained in SLUSA, "under which 'a corporation, investment company, pension plan, partnership, or other entity, shall be treated as one person or prospective class member, but only if the entity is not established for the purpose of participating in the action.'"[21] Finding that "the counting provision is intended to preserve the rights of preexisting entities, such as corporations and pension plans to assert claims *on their own behalf*,"[22] he held that the provision would not apply to a trustee pursuing claims assigned by others, who was, "in effect an entity 'established for the purpose of participating in the action,'" and therefore excluded from the scope of the counting provision.[23]

Conclusion

As these cases indicate, even a plaintiff who takes great pains to avoid SLUSA's reach can find that its individual action may be a class action for SLUSA purposes. Notably, removal and transfer may mean that plaintiff's counsel cannot control whether SLUSA applies, even when the action is first commenced as an individual action in a court where no related action is pending.

1. 15 U.S.C. §§77p(b), 78bb(f).
2. 15 U.S.C. §§77z-1, 78u-4.
3. See *In re Herald*, 730 F.3d 112, 118 (2d Cir. 2013) (reviewing history of SLUSA's adoption).
4. *Romano v. Kazacos*, 609 F.3d 512, 518 (2d Cir. 2010) (internal citations omitted).
5. See, e.g., *Brown v. Calamos*, 664 F.3d 123 (7th Cir. 2011) (rejecting plaintiff's attempt to characterize claim as one for breach of fiduciary duty and finding, instead, that claim was for misrepresentations in connection with the purchase and sale of securities).
6. See *Merrill Lynch, Pierce, Fenner & Smith, Inc. v. Dabit*, 547 U.S. 71, 126 S.Ct. 1503 (2006) (holding that claims by plaintiffs who neither sold nor purchased stock but held a stock are nonetheless claims made in connection with the purchase or sale of the stock, for purposes of SLUSA). In an earlier article, we discussed litigation over the meaning of "in connection with," as used in SLUSA. See Edward M. Spiro and Judith L. Mogul, "SLUSA's 'In Connection With' Rule: How Close Is Close Enough?" New York Law Journal (Oct. 7, 2010).
7. See *Markey v. Citigroup*, 2013 WL 6728102 (S.D.N.Y. Dec. 20, 2013); *In re Citigroup Sec. Litig.*, — F.Supp.2d —, 2013 WL 6569875 (Dec. 13, 2013); *In re Bank of America Corp. Sec., Derivative, and ERISA Litig.*, 2013 WL 6504801 (Dec. 11, 2013).
8. See *Securities Inv. Protection Corp. v. Bernard L. Madoff Investment Sec., LLC*, — F.Supp.2d —, 2013 WL 6301415 (S.D.N.Y. Dec. 5, 2013).
9. 15 U.S.C. §78bb(f)(5)(B)(i).
10. 15 U.S.C.A. §78bb(f)(5)(B)(ii).
11. 2013 WL 6504801, at *5.
12. 2013 WL 6569875, at *7. A week after deciding *In re Citigroup Sec. Litig.*, Stein decided *Markey v. Citigroup*, 2013 WL 6728102 (S.D.N.Y. Dec. 20, 2013), another related case, on essentially the same basis.
13. 2013 WL 6569875, at *9.
14. See 28 U.S.C. §1407 (governing multidistrict litigation).
15. 2013 WL 6504801, at *6 (quoting 15 U.S.C, §78bb(f)(5)(B)(ii); emphasis added by the court).
16. Id. This approach, and that taken by Judge Stein in *Citigroup*, is consistent with the result in *Amorosa v. Ernst & Young*, 672 F.Supp.2d 493, 517 (S.D.N.Y. 2009), aff'd, 409 Fed. Appx. 412 (2d Cir. 2011). There, the district court held that plaintiffs, who had opted out of a class action against AOL Time Warner were, nevertheless, proceeding in coordination with the class action and other pending actions. As this indicates, even opting out of a class action will not allow a plaintiff to escape SLUSA's preemption of "covered class actions."
17. 2013 WL 6569875, at *8.
18. 2013 WL 6301415, at *4-*5.
19. Id. at *7.
20. Id.
21. Id., at *6 (quoting 15 U.S.C. §78bb(f)(5)(D)).
22. Id., at *7 (emphasis added).
23. Id. (quoting 15 U.S.C. §78bb(f)(5)(D)).