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STACKING THE DECK: THE SECURITIES LITIGATION UNIFORM STANDARDS ACT OF 1998 AND FEDERAL PREEMPTION OF STATE LAW CLAIMS AGAINST CORPORATE DIRECTORS

SARAH WOLF REUST*

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*Associate, Squire Patton Boggs. J.D. Class of 2019, Sandra Day O'Connor College of Law at Arizona State University. Many thanks to Professor Myles Lynk for his insightful comments and guidance, and to my husband for his continued and unstinting love and support.

I. INTRODUCTION

In an effort to regulate the large volume of securities bought and sold daily in the United States, a wide body of legislation has arisen to protect all parties to these transactions. This opens the door for plaintiffs to bring suit when they feel that they have been wronged. After being charged a fee that was not listed in her contract, one plaintiff launched a class action under state law for breach of contract and breach of fiduciary duty.[1] In a separate class action suit, another plaintiff felt that she had received financial advice that was negatively influenced by undisclosed incentives.[2] In pursuit of a forum to hear their grievances, both classes of plaintiffs became yet another chapter in an ongoing circuit split on the proper handling of these types of claims.

Propelled by a high volume of meritless class action securities lawsuits, Congress enacted the Private Securities Litigation Reform Act of 1995 ("PSLRA"). This act established higher federal pleading standards for class action lawsuits alleging securities fraud as a way to stem the tide of baseless claims.[3] However, in many cases plaintiffs responded by simply moving their claims into state court to avoid these higher standards.[4] Congress responded by enacting the Securities Litigation Uniform Standards Act of 1998 ("SLUSA"). SLUSA closed the state court loophole by barring claims alleging a "misrepresentation or omission of a material fact in connection with the purchase or sale of a covered security" from being brought in a state court.[5]

Although SLUSA was meant to be "targeted and narrow," it arguably has been applied far more broadly than originally intended. It now threatens to preempt not only securities fraud lawsuits brought under federal law in state courts, but also claims arising under state law causes of action.[6] This expansion of coverage is illustrated by the United States Court of Appeals for the Seventh Circuit's broad interpretation of SLUSA in two opinions released simultaneously; *Goldberg v. Bank of America, N.A.* and *Holtz v. JPMorgan Chase Bank.*[7] These decisions run the risk of eliminating legitimate state law claims based on breach of contract and fiduciary duty. Eliminating these legitimate causes of action intrudes into the realm of state law and may leave plaintiffs with meritorious claims with no recourse. The Seventh Circuit found that SLUSA precludes any class action based on a claim arising under state law if the plaintiff could have asserted a federal securities law claim on the same facts, even if the state law claim does not require

[1] Goldberg v. Bank of Am., 846 F.3d 913, 922 (7th Cir. 2017).
[2] Holtz v. JPMorgan Chase Bank, N.A., 846 F.3d 928 (7th Cir. 2017).
[3] *See* Private Securities Litigation Reform Act of 1995, Pub. L. No. 104-67, 109 Stat. 737.
[4] 143 CONG. REC. S10,476 (daily ed. Oct. 7, 1997).
[5] 15 U.S.C. § 78bb(f)(1)–(2) (2012).
[6] CONG. REC., *supra* note 4, at 4.
[7] *Goldberg*, 846 F.3d at 922; *Holtz*, 846 F.3d at 928.

the assertion of an omission or misrepresentation of a material fact.[8] This wide preemption of state law claims goes beyond congressional intent. Congress clearly stated its intent to preserve "the appropriate enforcement powers" of the state when it enacted SLUSA.[9]

The Supreme Court has moved to limit SLUSA's lengthening reach. In *Cyan, Inc. v. Beaver County Employees Retirement Fund*, the Court ruled that SLUSA does not strip state courts of jurisdiction over certain federal claims.[10] While this is a promising ruling, it does not go far enough. Courts should also allow states to maintain jurisdiction over legitimate state law claims such as breach of contract and breach of fiduciary duty that are related to the purchase and sale of securities.

Other legal scholars have discussed this issue with varied conclusions, but this Article proposes a different solution.[11] This Article contends that in order to avoid preempting legitimate state law actions, federal courts should examine whether a case can prevail without the allegation of an omission or misrepresentation. Moreover, in determining whether a claim can succeed without the barred allegations, courts should examine only elements necessary to the claim itself, without any consideration of elements needed to rebut potential defenses. This would serve the dual purpose of preventing plaintiffs from bringing a state court claim that is in actuality a federal securities fraud case while also allowing legitimate state breach of contract or breach of fiduciary duty actions to continue. It would thus, as much as possible, leave intact the legitimate division between state regulated corporate law and federally regulated securities law.

To support this contention, this Article will proceed as follows. Part II begins by surveying the history of SLUSA and the motivations behind its enactment. Part III focuses on the ways in which SLUSA has been modified and interpreted to create the law as it is today by examining the split between circuits and the overly broad interpretation of SLUSA by some courts. Part IV examines the history of the Seventh Circuit decisions in *Holtz* and *Goldberg*, and how they widen the existing circuit split. Part V discusses the conflict between the need for uniformity in judicial interpretation of the laws regulating federal securities, and the need for states to be able to enforce their own corporate law and hear traditional state law claims. Part VI analyzes the Seventh Circuit decisions and argues that their overbroad analysis raises federalism concerns and intrudes into the territory of state law. Finally, Part VII argues that courts should adopt a modified version of the Third Circuit's approach. This modified approach would allow bona fide state law claims to remain in state court but weed out claims that are merely fraud suits seeking to avoid higher federal pleading standards. This would allow states to maintain their enforcement powers but respond to congressional concern regarding meritless federal securities lawsuits.

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[8] Petition forWrit of Certiorari at 6, *Goldberg*, 836 F.3d 913 (7th Cir. 2017) (No. 16-1541) 2017 WL 2705565.
[9] H.R. REP. NO. 105-803, at 1–2 (1998) (Conf. Rep.).
[10] *Cyan, Inc. v. Beaver Cty. Emps. Ret. Fund*, 138 S. Ct. 1061, 1069 (2018).
[11] *See, e.g.*, Christopher R. Bellacicco, *Putting the "Uniform" Back in the Securities Litigation Uniform Standards Act of 1998: The Case for Applying a Reasonable Relationship Approach*, 63 CATH. U. L. REV. 195, 216 (2013); Gregory Kendall, *The Artful Dodgers: Securities Fraud, Artful Pleading, and Preemption of State Law Causes Under the Securities Litigation Uniform Standards Act*, 81 U. CIN. L. REV. 657, 673–74 (2012); Cecelia A. Glass, *Sword or Shield? Setting Limits on SLUSA's Ever-Growing Reach*, 63 Duke L.J. 1337 (2014).

II. BACKGROUND

A. The Rise of Class Actions

While groups of plaintiffs have litigated together for centuries, the modern American class action was created in 1966 with the revision of Rule 23 of the Federal Rules of Civil Procedure.[12] Rule 23 allows a group of people with a common cause of action to be jointly represented by a lead plaintiff, provided certain standards are met.[13] In the 1960s, with the rise of movements such as environmentalism and the civil rights struggle, class action lawsuits became an increasingly popular tool for activists to effect change.[14] Rule 23 was meant to make it easier for plaintiffs to certify a class and hold defendants accountable for actions that an individual plaintiff likely would not have the resources to pursue.[15] Additionally, one of the dominant lines of thought at the time of the 1966 revision was that class action litigation could supplement direct government regulation of securities and other similar markets.[16]

The need to regulate the securities market had grown in the wake of the Great Depression.[17] After the 1929 stock market crash, the federal government tried to renew faith in the securities market by enacting regulations meant to protect investors.[18] Congress enacted the Securities Act of 1933 and the Securities Exchange Act of 1934 in an effort to prevent fraud and ensure that investors received complete and accurate information.[19] In particular, §10(b) of the 1934 Act makes it illegal "[t]o use or employ, in connection with the purchase or sale of any security . . . any manipulative or deceptive device . . . ."[20] To establish a claim, plaintiffs must show (i) manipulation or deception through a misrepresentation or omission in a statement or document in connection with the purchase or sale of a security; (ii) scienter[21]; and (iii) materiality.[22] Despite its relatively simple language,10(b) has sparked a host of federal securities litigation.[23]

While litigation under the 1933 and 1934 acts allowed investors to protect themselves against potential fraud, it also opened the door to meritless suits, known as "strike suits."[24] These suits were often filed without concrete evidence of wrongdoing, and for the sole purpose of securing a settlement and extorting quick money from a corporate defendant.[25] Once the complaints were filed, the plaintiffs would then frequently use discovery as a "fishing expedition" in an attempt to uncover evidence to substantiate their claims.[26] All the while, the corporate defendant was faced with high discovery costs and the bad publicity that accompanies fraud

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[12] *See* STEPHEN C. YEAZELL, FROM MEDIEVAL GROUP LITIGATION TO THE MODERN CLASS ACTION, 238 (1987).
[13] *See* FED. R. CIV. P. 23.
[14] YEAZELL, *supra* note 12, at 240–44.
[15] *Id.* at 232.
[16] S. REP. NO. 104-98, at 4 (1995) (Conf. Rep.); *Id.*
[17] Tom C. W. Lin, *A Behavioral Framework for Securities Risk*, 34 SEATTLE U. L. REV. 325, 329 (2011).
[18] S. REP. NO. 104-98, at 4 (1995) (Conf. Rep.).
[19] Lin, *supra* note 17, at 329.
[20] 15 U.S.C. § 78j(b) (2012).
[21] The definition of scienter includes "a defendant's intention to deceive, manipulate, or defraud." Patrick Berarducci & Larry J. Obhof, *Supreme Court Clarifies Scienter Pleadings*, 17 BUS. L. TODAY 10, 12 (2007).
[22] 17 C.F.R. § 240.10b–5 (2012).
[23] *See, e.g.*, Basic Inc. v. Levinson, 485 U.S. 224 (1998).
[24] H.R. REP. NO. 105-803, at 13 (1998) (Conf. Rep.).
[25] *Id.*
[26] *See id.*; *see also* Brian Phillip Murray, *Lifting the PSLRA "Automatic Stay" of Discovery*, 80 N.D. L. REV. 405, 409 (2004).

lawsuits.[27] As the cost of discovery and preparing for trial is often very high, corporate defendants were frequently faced with immense pressure to settle.[28] Although the chances were slight, the possibility of huge losses if the plaintiffs won at trial also often contributed to settlements of meritless claims.[29] The true winners of these meritless settlements were often the plaintiffs' lawyers.[30] Each member of the class received relatively small individual payments while the lawyer received a proportion of the entire class settlement.[31] Additionally, the threat of meritless litigation often led to a "chilling" of corporate disclosure. Corporations would often refrain from making forward looking statements for fear of class action lawsuits claiming that these disclosures had been misleading.[32]

B. The Pendulum Shifts: The Origins of SLUSA

By the 1990s, many commentators and corporate defendants felt that the pendulum had swung too far in favor of class action plaintiffs. As a result, it began to swing the other way with increased protection for corporate defendants and greater regulation of securities class action lawsuits.[33] This pushback manifested itself in the enactment of the Private Securities Litigation Reform Act of 1995 (PSLRA).[34] Concerned about the rising number of strike suits, which "unnecessarily increase[ed] the cost of raising capital and chill[ed] corporate disclosure," Congress enacted higher pleading standards for securities fraud claims in an effort to weed out meritless suits.[35] Among other requirements, the PSLRA mandates that the defendant's false statements be pleaded with particularity, that the pleading create a strong inference of scienter (intent or knowledge of wrongdoing), and that the pleading prove loss causation.[36] Additionally, the PSLRA requires a stay of discovery until the court has deemed the pleading sufficient.[37] This prevented plaintiffs from filing baseless claims and then attempting to find substance for their allegations in discovery.[38] Nevertheless, class action plaintiffs and their lawyers continued to find ways to file meritless suits by simply filing them in state, rather than federal, court and under state, rather than federal, causes of action.[39]

After the enactment of the PSLRA, there was a noticeable uptick in class action securities fraud cases in state court, where they weren't subject to the PSLRA's heightened pleading standards.[40] Because the PSLRA only regulates federal securities fraud claims, plaintiffs were able to circumvent the statute by filing their actions under state law theories and in state courts.[41] By

[27] *See* H.R. REP. NO. 105-803, at 13 (1998) (Conf. Rep.).
[28] *Id.*
[29] *See* S. REP. NO. 104-98, at 6–7 (1995) (Conf. Rep.).
[30] *See id.* at 6.
[31] *See id.*
[32] *Id.* at 5.
[33] *See id.*
[34] *See generally* Private Securities Litigation Reform Act of 1995, Pub. L. No. 104-67, 109 Stat. 737.
[35] S. REP. NO. 104-98, at 6–7 (1995) (Conf. Rep.).
[36] Private Securities Litigation Reform Act of 1995, Pub. L. No. 104-67, 109 Stat. 737.
[37] *Id.*
[38] *See* S. REP. NO. 104-98, at 14 (1995) (Conf. Rep.).
[39] *See* H.R. REP. NO. 105-803, at 14–15 (1998) (Conf. Rep.).
[40] *Id.*
[41] *See id.*

bringing their cases under a state, rather than federal securities claim, plaintiffs were able to avoid congressional intent to eliminate strike suits.[42]

This apparent loophole led Congress to enact the Securities Litigation Uniform Standards Act of 1998 (SLUSA).[43] Worried that plaintiffs were using state courts to circumvent the regulations of the PSLRA, Congress mandated the removal to federal court and dismissal of state securities fraud class action lawsuits.[44] Congress, worried by the "development of different standards in State courts," hoped thereby to establish uniform law in this area.[45]

Under SLUSA, a case is subject to removal to federal court and dismissal, if it is a "covered class action," or a class action of more than fifty members, and it alleges "a misrepresentation or omission of a material fact in connection with the purchase or sale of a covered security."[46] This language allows courts to preempt not only actions filed as fraud lawsuits, but also suits that are filed under other state law theories. The defendant must simply show that the plaintiff has asserted a misrepresentation or omission in connection with a covered security to have a case removed and dismissed.[47] This wording prevents plaintiffs from circumventing the PSLRA by using "artful pleading" to disguise a case that is in reality a fraud claim as a different cause of action.[48] Plaintiffs make use of artful pleading when they "[articulate] an inherently federal claim in state-law terms."[49] This would prevent a claim that is in actuality a federal claim from being heard in federal courts and deny defendants their right to removal. SLUSA's wording is designed to prevent such artifices and keep federal securities class action lawsuits in federal court.

Once a judge has determined that a cause of action falls under SLUSA, the judge can dismiss the case either with or without prejudice.[50] If dismissed with prejudice, plaintiffs can no longer bring the claim as a class action under the same cause of action and their claims are not heard. The issue this raises is whether this preempts legitimate state law claims, which would frustrate the aims of federalism and risk leaving plaintiffs with no recourse.[51]

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[42] *See id.*

[43] Securities Litigation Uniform Standards Act of 1998, Pub. L. No. 105–353, 112 Stat 3227.

[44] 15 U.S.C. § 78bb(f)(1)–(2) (2012).

[45] *See* 143 CONG. REC. S10,475 (daily ed. Oct. 7, 1997) ("[SLUSA] sets national standards for stocks that are traded on the national markets.").

[46] 15 U.S.C. § 78bb(f)(1)–(2) (2012). A covered security is one that is "(A) listed, or authorized for listing, on the New York Stock Exchange or the American Stock Exchange, or listed, or authorized for listing, on the National Market System of the Nasdaq Stock Market (or any successor to such entities); (B) listed, or authorized for listing, on a national securities exchange (or tier or segment thereof) that has listing standards that the Commission determines by rule (on its own initiative or on the basis of a petition) are substantially similar to the listing standards applicable to securities described in subparagraph (A); or (C) a security of the same issuer that is equal in seniority or that is a senior security to a security described in subparagraph (A) or (B)." 15 U.S.C. §§ 78bb(f)(5)(E) (2012); 15 U.S.C. § 77r (2018).

[47] *See id.*

[48] The artful pleading doctrine is a mechanism that federal courts use to remove a case from state to federal court by recharacterizing state claims as federal claims. This doctrine applies where a plaintiff brings a case from state to federal court, despite the plaintiff having filed the claim purely under state law. This occurs when the court determines that, "regardless of characterization, the plaintiff is essentially asserting a federal claim." Stanley Blumenfeld Jr., *Artful Pleading and Removal Jurisdiction: Ferreting out the True Nature of a Claim*, 35 UCLA L. REV. 315, 319–20 (1987). For more information on the artful pleading doctrine, *see id.*

[49] Brennan v. Southwest Airlines Co., 134 F.3d 1405, 1409 (9th Cir.1998).

[50] Joseph Weinstein & Joseph Rodgers, *Out Of Court: Dismissals With Prejudice Under SLUSA*, LAW 360, Nov. 28, 2011, https://www.law360.com/classaction/articles/287870/out-of-court-dismissals-with-prejudice-under-slusa.

[51] *See* Cecelia A. Glass, *Sword or Shield? Setting Limits on SLUSA's Ever-Growing Reach*, 63 Duke L.J. 1337 (2014).

C. History: Federal Forums as Friendly to Corporate Defendants

Corporate defendants have long viewed the federal courts as being more favorable to their interests.[52] In fact, there have been "[p]rotests against the federal courts and their perceived favoritism towards business" since the 1870s."[53] By contrast, corporate defendants often cited local prejudice as a reason to prefer federal court.[54] Corporations frequently perceived state judges, who were and are often elected, as favoring local litigants over foreign businesses in an effort to be reelected.[55] Additionally, federal courts had a higher cost of litigation, which corporations could more easily absorb. Federal courts also had longer wait times and different procedural rules, which led corporate defendants to prefer federal courts.[56] It was also historically more difficult to travel to federal courts due to "distance and delay," and this was traditionally more problematic for plaintiffs.[57] For these reasons corporate defendants historically tried their utmost to get their cases into federal court, while plaintiffs used every mechanism available to stay out of it.[58]

In the 1930s and 40s, the perceptions of federal courts began to change.[59] The advent of new technology and changes in administration meant that the previous "distance and delay" advantage of corporate defendants decreased.[60] Also during this period, conservative federal judges began to be replaced by Roosevelt appointees, and the political and social orientation of the federal bench began to shift.[61] As a result, the perception of federal courts as being friendly to corporate defendants began to fade.[62]

Today, public perception seems to be swinging back again.[63] Once again, "[p]laintiffs view the federal courts as increasingly dominated by judges sympathetic to business interests and defendants. Defendants view state courts, particularly where judges are elected, as pro-plaintiff, and, in certain venues, as beholden to plaintiffs' attorneys."[64] Federal courts are now also widely perceived to be more likely to grant summary judgment against plaintiffs, less likely to certify

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[52] *See generally* Edward A. Purcell, Jr., *Litigation and Inequality: Federal Diversity Jurisdiction in Industrial America*, 1870-1958. New York: Oxford University Press, 1992.
[53] *Id.* at 387.
[54] *Id.*
[55] *See* Edward F. Sherman, *Introduction to the Symposium: Complex Litigation: Plagued by Concerns Over Federalism, Jurisdiction and Fairness*, 37 AKRON L. REV. 589, 598 (2004).
[56] PURCELL, *supra* note 52, at 87.
[57] *Id.* at 388.
[58] *See id.* at 87–88
[59] *See id.* at 388.
[60] *Id.*
[61] *Id.* at 219–20, 230–31.
[62] *Id.* at 388.
[63] 145 CONG. REC. H8568 (daily ed. Sept. 23, 1999) (statement of Rep. Meehan) ("The industry knows that the rules for certifying and maintaining class actions are far more favorable to corporate defendants."). It is a commonly held belief among plaintiffs' and defense attorneys alike that federal courts are more sympathetic to corporate defendants. However, relatively little empirical study has been done on the relative outcomes in states vs. federal court. One of the few studies on the differences between state and federal court outcomes focused on class action litigation. It found that there is less correlation between attorney's expectations and judicial outcomes than the industry commonly believes. However, federal judges were more likely than state judges to deny class certification. Moreover, despite the fact that state and federal courts have statistically similar final rulings, the monetary recovery is substantially larger in state courts. Thomas E. Willging & Shannon R. Wheatman, *An Empirical Examination of Attorneys' Choice of Forum in Class Action Litigation*, FED. JUD. CTR. 1, 10–12 (2005), https://www.fjc.gov/content/empirical-examination-attorneys-choice-forum-class-action-litigation-0. For more information on class action statistics in state vs. federal courts, see *id.*
[64] Sherman, *supra* note 55, at 598.

class actions, and more likely to dismiss cases on the pleadings.[65] Commentators have also argued that the federal courts' interpretations of the Federal Rules of Civil Procedure have become increasingly friendly to defendants and resulted in increasingly early disposition of cases before they reach trial.[66] Bolstered by thirty million dollars in corporate lobbying efforts to persuade Congress to enact create higher pleading standards for class action fraud cases, the PSLRA seemed to follow this trend.[67] Finally SLUSA was enacted after lobbying by corporations, particularly in the tech industry, a frequent target of class action litigation.[68] The tech industry gave four million dollars to Congressional candidates in 1995 and 1996, and over 1.2 million dollars in the months leading up to the introduction of SLUSA.[69] By mandating removal and dismissal of even nonfraud state law claims, SLUSA furthers the tendency to consider federal courts as friendly to defendant corporations.

III. INTERPRETING SLUSA

A. Merrill Lynch, Pierce, Fenner & Smith, Inc. v. Dabit: The Supreme Court's Broad Reading of SLUSA

SLUSA has given rise to a great deal of litigation in the almost twenty years since its enactment.[70] In *Merrill Lynch, Pierce, Fenner & Smith, Inc. v. Dabit*, the Supreme Court held that SLUSA should be interpreted broadly, while also bearing in mind that there is a "general presumption that Congress does not cavalierly pre-empt state-law causes of action."[71] In *Merrill Lynch,* Sahdi Dabit, a former Merrill Lynch stockbroker brought suit on behalf of a class of other stockbrokers.[72] He alleged breach of fiduciary duty because Merrill Lynch disseminated misleading research, thereby manipulating stock prices and hurting the brokers' clients, causing them to take their business elsewhere.[73] Dabit argued that his case was not precluded by SLUSA because it was not "in connection with the purchase or sale of securities."[74] He claimed that Merril

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65 Adam N. Steinman, *What is the Eerie Doctrine (and What Does it Mean for the Contemporary Politics of Judicial Federalism?)*, 84 NOTRE DAME L. REV. 245, 248 (2008).
66 For more information on the judicial trend in the Federal Rules of Civil Procedure, see Arthur R. Miller, *Simplified Pleading, Meaningful Days in Court, and Trials on the Merits: Reflections on the Deformation of Federal Procedure*, 88 N.Y.U. L. Rev. 286 (2013).
67 *See* STEVEN A. RAMIREZ, LAWLESS CAPITALISM: THE SUBPRIME CRISIS AND THE CASE FOR AN ECONOMIC RULE OF LAW 58 ((N.Y.U. Press 2013).
Joseph A. Grundfest & Michael A. Perino, *Securities Litigation Reform: The First Year's Experience* (John M. Olin Program in Law and Econ. Working Paper Paper No. 140, 1997); Leslie Eaton, *The Silicon Valley Gang; An Influential Industry With lots of Money is Getting its way on Capitol Hill*, N.Y. TIMES, June 11, 1998, http://www.nytimes.com/1998/06/11/business/silicon-valley-gang-influential-industry-with-lots-money-getting-its-way-capitol.html.
69 Eaton, *supra* note 68.
70 *See, e.g.*, Freeman Investments, L.P. v. Pacific Life Ins. Co., 704 F.3d 1110, 1114–15 (9th Cir. 2013); Segal v. Fifth Third Bank, N.A., 581 F.3d 305, 310 (6th Cir. 2009); LaSala v. Bordier et Cie, 519 F.3d 121, 127 (3d Cir. 2008); Stoody-Broser v. Bank of Am., 442 F. App'x. 247, 248–49 (9th Cir. 2011); Kircher v. Putnam Funds Tr., 403 F.3d 478, 483–84 (7th Cir. 2005).
71 Merrill Lynch, Pierce, Fenner & Smith Inc. v. Dabit, 547 U.S. 71, 87 (2006) (quoting Medtronic, Inc. v. Lohr, 518 U.S. 470, 485 (1996)).
72 *Id.* at 75.
73 *Id.* at 75–76.
74 *See id.* at 77.

Lynch's omissions had only caused him to hold stocks longer than he would have otherwise, not to purchase or sell any.[75]

The United States District Court for the Southern District of New York dismissed the suit, finding that it fell within the meaning of SLUSA.[76] On appeal, the United States Court of Appeals for the Second Circuit reversed, holding that SLUSA only preempts state-law class-action claims brought by plaintiffs who have a private remedy under federal law.[77] There was, however, no private cause of action under federal law for Dabit's claim. Under a previously decided case, *Blue Chip Stamps v. Manor Drug Stores*, only plaintiffs who suffered a loss due to purchasing or selling securities (not merely holding them) had standing to sue for securities fraud in federal court.[78] The Second Circuit thus held that that Dabit's claim was not precluded by SLUSA as he had no claim arising under federal law.[79]

A few months later, however, the United States Court of Appeals for the Seventh Circuit heard the same issue in a separate case and came to the opposite conclusion. In *Kircher v. Putnam Funds Trust*, the Seventh Circuit held that SLUSA also preempts state law class action claims for which federal law provides no private remedy.[80]

When *Merril Lynch* went before the Supreme Court on appeal, the Court resolved the circuit split by holding that Dabit's claims were preempted.[81] The Supreme Court agreed with the Seventh Circuit. It determined that allowing claims such as Dabit's would allow plaintiffs to circumvent the PSLRA simply by claiming that they suffered injury through holding securities, rather than buying or selling them.[82] This would allow them to avoid federal court, which Congress expressly designed SLUSA to prevent.[83] The Court ultimately held that the "in connection with" language of SLUSA had to be interpreted broadly in order to properly effectuate SLUSA and close the state court loophole.[84] The Court further remarked that this decision did not completely leave the plaintiffs without recourse. The plaintiffs were still able to file suit in state court, they simply could no longer use the class action device.[85] The Court did not discuss the fact that the individual amounts in question were likely not high enough to justify litigation or cover attorney costs, thereby effectively leaving plaintiffs without recourse.

B. State Court Jurisdiction: The Supreme Court Examines SLUSA's Scope

The Supreme Court additionally examined the scope of SLUSA in a decision released on March 20, 2018. In *Cyan, Inc. v. Beaver County Employees Retirement Fund*, the Court held that SLUSA does not strip state courts of jurisdiction over claims under the Securities Act of 1933 ("1933 Act").[86] It further held that SLUSA does not permit defendants to remove class actions

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[75] *See id.* at 76.
[76] *Id.*
[77] *Id.* at 77–78.
[78] *See id.* at 77; Blue Chip Stamps v. Manor Drug Stores, 421 U.S. 723, 754–55 (1975) (holding that a plaintiff class, in a federal securities action is limited only to actual purchasers and sellers of securities).
[79] *Id.*
[80] Kircher v. Putnam Funds Trust, 403 F.3d 478, 483–84 (7th Cir. 2005).
[81] *Merrill Lynch, Pierce, Fenner & Smith Inc*, 547 U.S. at 86–89.
[82] *Id.*
[83] *See id.* at 86–87.
[84] *See id.* at 86–89.
[85] *Id.* at 87.
[86] *Cyan, Inc.*, 138 S. Ct. at 1069 (2018).

alleging 1933 Act claims from state to federal court.[87] In this case, Cyan, a telecommunications company, had an Initial Public Offering, in which the plaintiff investors purchased securities.[88] After Cyan's stock price fell, several of the investors brought a class action lawsuit in California superior court alleging that Cyan's registration statement contained material misstatements, in violation of the 1933 Act.[89]

15 U.S.C. § 77v(a), gives state courts concurrent jurisdiction over suits brought under the 1933 Act. However, § 77v(a) creates an exception for cases brought under § 77p, "with respect to covered class actions."[90] The Court held that § 77p bars certain securities class actions based on state law, but says nothing about federal law.[91] Because this section "says nothing, and so does nothing," the Court concluded that the background section of 77v(a), under which the investor's claims could remain in state court, continues to govern.[92] The Court emphasized several times that SLUSA only applies to class actions brought under state law, but it did not differentiate between state law causes of action used solely to circumvent the PSLRA and legitimate state law claims.

Cyan argued that the "covered class actions" language of § 77v(a) referred to § 77p(f)(2), which defines class actions as consisting of fifty or more persons, not to § 77p as a whole. This section does not specify a state or federal cause of action.[93] The Court rejected this argument because it was inconsistent with the plain reading of § 77v(a), and because this interpretation would strip states of jurisdiction even over securities that are not traded on the national stock exchange.[94] Securities that are not traded on the national stock exchange are not of federal concern, but are instead of state concern.[95] SLUSA, therefore, maintains a state's legal authority to address them.[96] The Court went on to highlight that states have been adjudicating 1933 Act claims for sixty-five years. It refused to give SLUSA a "broader reading than its language can bear," particularly because to do so would create a drastic change in the 1933 Act's jurisdictional framework.[97] The Court has not, however, interpreted the remaining provisions of SLUSA regarding an omission or misrepresentation in a securities offering. It also has not discussed when state law claims are or are not preempted.

C. State Law Exemptions to SLUSA

According to *Merrill Lynch*, there is a "general presumption that Congress does not cavalierly pre-empt state-law causes of action."[98] In the realm of corporate law, states usually rely on their own statutory law.[99] "Because corporations are themselves creatures of state law, it has long been common practice to allow states to police the behavior of officers and directors . . . ."[100]

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[87] *Id.*
[88] *Id.* at 1068
[89] *Id.*
[90] *Id.* at 1069 (quoting 15 U.S.C.S. § 77v(a) (2012)).
[91] *Id.*
[92] *Id.*
[93] *Id.* at 1070
[94] *Id.* at 11.
[95] *Id.* (quoting *Chadbourne & Park LLP v. Troice*, 571 U.S. 377, 387-88 (2014)).
[96] *Id.* (quoting *Chadbourne & Park LLP v. Troice*, 571 U.S. 377, 387-88 (2014)).
[97] *Id.* at 1075.
[98] *Merrill Lynch, Pierce, Fenner & Smith Inc*, 547 U.S. at 87 (quoting Medtronic, Inc. v. Lohr, 518 U.S. 470, 485 (1996)).
[99] Glass, *supra* note 11, at 1346.
[100] *Id.* at 1346–47.

In fact, there is evidence that Congress considered states' interests in regulating their own corporations when enacting SLUSA.[101] Moreover, Congress expressly took federalism concerns into account over the course of its hearings.[102] Some representatives worried that "[SLUSA] could have the unintended effect of preempting certain claims arising from transactions in which both the state and federal governments have a strong interest."[103] These concerns are manifested in express exemptions to SLUSA, which balance state interests.[104]

SLUSA does not preempt derivative suits brought by shareholders on behalf of a corporation.[105] This allows states to police behavior of the corporations in their jurisdiction and protect their citizens from corporate misconduct. Congress, therefore, understood the needs of states to regulate corporations within their jurisdiction and deferred to the states on matters of state law.

The second exemption is known as the Delaware Carve-Out because it was modeled after a contemporary Delaware law.[106] Congress took into account that "[m]any state courts, particularly those in Delaware, have developed expertise and a coherent body of case law which provides guidance to companies and lends predictability to corporate transactions."[107] It thus added the Delaware Carve-Out. The Carve-Out excludes from SLUSA's scope state actions brought by shareholders against their own corporations in connection with extraordinary corporate transactions such as mergers and tender offers.[108] These suits often involve an omission or misrepresentation and covered securities. However, by their nature they are internal, corporate transactions of the kind that state law has traditionally regulated.[109]

These two exemptions show evidence of Congressional intent to preserve causes of action that are traditionally left to the states.[110] They reflect a desire to preserve the "expertise and coherent body of case law" that Delaware and other states had created to guide corporations.[111] The recent Seventh Circuit decisions in *Holtz* and *Goldberg* upset this balance and force traditional state law causes of action into the federal courts.

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[101] *The Securities Litigation Uniform Standards Act of 1998: Hearing on S.1260 Before the Committee on Banking, Housing and Urban Affairs, Subcommittee on Securities*, 105th Cong. (Oct. 29, 1997) [hereinafter *Hearing*] (statement of Isaac C. Hunt, Jr., Commissioner, SEC).
[102] *Id.*
[103] *Id.*
[104] 15 U.S.C. § 78bb(f)(5)(C)(2012); *Hearing*, *supra* note 101, at 47–48 (statement of Arthur Levitt, Jr., Chairman and Isaac C. Hunt, Jr., Comm'r, U.S. Securities and Exchange Commission).
[105] 15 U.S.C. § 78bb(f)(5)(C)(2012).
[106] Glass, *supra* note 11, at 1347.
[107] *Hearing*, *supra* note 101, at 12 (statement of Isaac C. Hunt, Jr., Comm'r, U.S. Securities and Exchange Commission).
[108]15 U.S.C. § 78bb(f)(3)(A)(2016); *Hearing*, *supra* note 101, at 64 (statement of Herbert E. Milstein, Senior Partner, Cohen, Milstein, Hausfeld & Toll, P.L.L.C.)..
[109] Glass, *supra* note 11, at 1347–48.
[110] *See id.*
[111] *Hearing*, *supra* note 101, at 12 (statement of Isaac C. Hunt, Jr., Comm'r, U.S. Securities and Exchange Commission); *see also Glass*, *supra* note 11 at 1350 (quoting 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, 502 (2002)).

D. "Omission or Misrepresentation": The Circuit Split

In interpreting SLUSA, another split among the circuits has developed over how best to read the provision in the statute requiring the dismissal of claims that allege a "material omission or misrepresentation."[112] Some courts have held that it must be interpreted broadly to fully effectuate SLUSA. Others have worried that interpreting SLUSA too broadly will lead to the preemption of legitimate state law claims, such as a breach of contract claim that involves securities.[113]

1. The Sixth Circuit "Literalist"[114] Approach

The United States Court of Appeals for the Sixth Circuit has adopted a "literalist" approach, under which it dismisses a complaint if it contains any allegation of an omission or misrepresentation.[115] This is true even if the omission or misrepresentation is not material to the claim.[116] For instance, in *Segal v. Fifth Third Bank, N.A.*, plaintiffs sued under the theories of breach of fiduciary duty, unjust enrichment, and breach of contract.[117] They alleged that (1) the defendant invested fiduciary assets in inferior funds, rather than stronger funds run by the bank's competitors; (2) that the defendant breached the agreement to provide plaintiffs with individualized attention by using automated management; and (3) that the defendant "invested too many of the funds' assets in low-yielding investments [to] cover (. . .) tax liabilities."[118] The Sixth Circuit reasoned that "[SLUSA] does not ask whether the complaint makes 'material' or 'dependent' allegations of misrepresentations in connection with buying or selling securities. It asks whether the complaint includes these types of allegations, pure and simple."[119] Because the claim alleged that the defendant made misrepresentations regarding the operation of the trust accounts, the Sixth Circuit held that the case was barred by SLUSA.[120]

The Sixth Circuit therefore does not examine the complaint further if it perceives any omission or misrepresentation at all.[121] Proponents of this approach point out that it is consistent with a plain reading of SLUSA, however, it runs the risk of preempting a legitimate state law claim which happens to involve a misrepresentation or omission that is extraneous to the main complaint.[122]

2. The Third Circuit "Looser"[123] Approach

The United States Court of Appeals for the Third Circuit has adopted a "looser" approach under which the court preempts a claim only if proof of a material omission or misrepresentation

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[112] 15 U.S.C. § 78bb(f)(1)–(2)(2012); *see also* Goldberg v. Bank of Am., 846 F.3d 913, 922 (7th Cir. 2017) (Hamilton, J., dissenting).
[113] *Goldberg*, 846 F.3d at 920–21 (Hamilton, J., dissenting).
[114] *Id.* at 918 (Flaum, J., concurring).
[115] *Id.*
[116] Segal v. Fifth Third Bank, N.A., 581 F.3d 305, 311 (6th Cir. 2009).
[117] *Id.* at 309–10.
[118] *Id.* at 308.
[119] *Id.* at 311.
[120] *See id.* at 310–11.
[121] *See id.* at 311.
[122] *See id.*
[123] *Goldberg*, 846 F.3d at 918 (7th Cir. 2017) (Flaum, J., concurring).

is essential to the claim.[124] For example, in *LaSala v. Bordier et Cie*, the plaintiffs brought claims asserting, in pertinent part, violations of Swiss money laundering laws.[125] The claims alleged that directors of a corporation "had (. . .) artificially inflated stock price[s] by representing that [their] financial position was stronger than it was."[126] The claims further alleged that the defendants then sold all of their accumulated shares.[127] When the true financial condition of the company was discovered several months later, the prices plummeted and the plaintiffs, unfortunate purchasers of this stock, lost a great deal of money.[128] All of this allegedly took place with the assistance and knowledge of the corporation's banks, the defendants in this case.[129]

The Third Circuit held that "when an allegation of misrepresentation in connection with a securities trade, implicit or explicit, operates as a factual predicate to a legal claim, that ingredient is met."[130] "To be a factual predicate, the fact of a misrepresentation must be one that gives rise to liability, not merely an extraneous detail."[131] If, however, a misrepresentation or omission is inessential to the claim, or an "extraneous detail," then the court does not preempt it.[132] The court found that all that was required to prove a violation of Swiss money laundering laws was that the defendants failed to investigate and freeze money laundering activities.[133] Thus, the court held that the allegations of misrepresentation—that the company's directors misrepresented the financial state of the company—were extraneous.[134] These allegations were not required for the plaintiffs to succeed on the money laundering claim.[135] The court therefore held that this claim was not precluded by SLUSA.[136]

This approach allows courts to weed out claims that are truly securities fraud claims framed as state law claims through artful pleading. Conversely, if the claim does not require the misrepresentation or omission to stand, then it is not simply a fraud claim, but a separate cause of action in its own right.

3. The Ninth Circuit "Intermediate"[137] Approach

The United States Court of Appeals for the Ninth Circuit has adopted an "Intermediate" approach.[138] This intermediate approach formerly entailed dismissing suits that contained allegations of omissions or misrepresentations without prejudice.[139] This gave plaintiffs an opportunity to refile their complaints in state court without running up against SLUSA's mandates.[140]

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[124] *Id.*
[125] *See* LaSala v. Bordier et Cie, 519 F.3d 121, 127 (3d Cir. 2008).
[126] *Id.* at 126.
[127] *Id.*
[128] *See id.*
[129] *Id.*
[130] *Id.* at 141.
[131] *Id.*
[132] *Id.*
[133] *Id.*
[134] *Id.*
[135] *Id.*
[136] *Id.*
[137] *Goldberg*, 846 F.3d at 918 (7th Cir. 2017) (Flaum, J., concurring).
[138] *Id.*
[139] Stoody-Broser v. Bank of Am., 442 F. App'x. 247, 248–49 (9th Cir. 2011).
[140] *Id.*

This approach changed slightly with the 2013 case of *Freeman Investments, L.P. v. Pacific Life Ins. Co.*.[141] In *Freeman Investments*, plaintiffs bought variable life insurance from the defendant.[142] The plaintiffs alleged that defendant levied excessive cost of insurance charges and brought suit for breach of contract, breaching the duty of good faith and fair dealing, and unfair competition under California law.[143] The original complaint contained allegations of "systematic concealment and deceitful conduct" which led the United States District Court for the Central District of California to dismiss the case with prejudice.[144] However, the Ninth Circuit reversed on the counts of breach of contract and breach of duty of good faith and fair dealing.[145] The court held that "[t]o succeed on this claim, plaintiffs need not show that Pacific misrepresented the cost of insurance or omitted critical details. They need only persuade the court that theirs is the better reading of the contract term."[146]

Conversely, the court found that the unfair competition claim violated SLUSA, as the California code defined unfair competition as "any unlawful, unfair or fraudulent business act or practice."[147] The court held that this brought the claim into the ambit of SLUSA because plaintiffs needed to prove a misrepresentation or omission to succeed on this claim.[148] The Ninth Circuit affirmed the dismissal of the unfair competition claim, but reversed the dismissal as to the other two claims, on the condition that the "plaintiffs amend their complaint to remove any reference to (. . .) concealment or (. . .) omission."[149] The court remanded with instructions that the district court grant leave for the plaintiffs to file an amended complaint.[150]

The Ninth Circuit thus employed the same "necessary to the claim" reasoning as the Third Circuit, bringing this "looser" approach into the majority.[151] Even under this new approach, however, the Ninth Circuit often additionally dismisses suits without prejudice if they contain material allegations of omissions or misrepresentations.[152] This allows the plaintiffs to refile the case without the offending allegations.[153] Some critics, in particular those on the Seventh Circuit, have expressed concern that this could leave too great an avenue for artful pleading.[154] They argue that a plaintiff could omit the offending allegations to bring the complaint into court, but would then be tempted to reinsert them at a later date.[155]

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[141] *See* Freeman Investments, L.P. v. Pacific Life Ins. Co., 704 F.3d 1110, 1115–16 (9th Cir. 2013).
[142] *Id.* at 1113.
[143] *Id.* at 1114.
[144] *Id.*
[145] *Id.* at 1118.
[146] *Id* at 1115.
[147] *Id.* at 1116 (quoting CA. BUS. & PROF. CODE § 17200).
[148] *Id* at 1118.
[149] *Id.* at 1118.
[150] *Id.*
[151] Goldberg v. Bank of Am., 846 F.3d 913, 918 (7th Cir. 2017) (Flaum, J., concurring); *Id.* at 922–23 (Hamilton, J., dissenting).
[152] *Id.* at 918 (Flaum, J., concurring).
[153] E.g., Freeman Investments, L.P. v. Pacific Life Ins. Co., 704 F.3d 1110, 1116 (9th Cir. 2013).
[154] *Goldberg*, 846 F.3d at 918 (Flaum, J., concurring).
[155] *Id.*

4. The New Seventh Circuit Approach

The Seventh Circuit has created a new approach in its recent holdings in *Holtz v. JPMorgan Chase Bank* and *Goldberg v. Bank of America, N.A.*.[156] Before these holdings, the Seventh Circuit operated under the *Brown* standard, which held that 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 . . . ."[157] This interpretation becomes even broader under *Holtz* and *Goldberg*. In these cases the Seventh Circuit held that SLUSA precludes any state law class action if the plaintiff could have pled the case as a federal securities law claim, even if the case does not turn on an omission or misstatement of a material fact.[158]

IV. THE NEW SEVENTH CIRCUIT DECISIONS

A. Holtz v. JPMorgan Chase Bank

The *Holtz* case involved incentives that financial advisers at JPMorgan Chase Bank received.[159] The bank manages its clients' portfolios of securities and its affiliates sponsor mutual funds in which clients can place their capital.[160] The bank's website proclaims that it acts in its clients' best interests.[161] However, the plaintiffs alleged that the bank incentivized its financial advisers to put the bank's interests before the interests of their clients.[162] The bank allegedly paid advisers more to sell the bank's own mutual funds, as opposed to third-party mutual funds,[163] even when the bank's mutual funds had higher fees and lower returns than third-party funds would have.[164]

Patricia Holtz, one of the investors, filed a suit in the United States District Court for the Northern District of Illinois as a representative of a class of investors whose portfolios had also been managed by JP Morgan Chase Bank.[165] She brought state law claims of breach of contract and breach of fiduciary duty, as the bank had not prioritized acting in their clients' best interests.[166] The district court found that the claim was preempted by SLUSA, holding that it was "difficult and maybe impossible to disentangle" the fraud from plaintiffs' contractual and fiduciary duty claims.[167] Holtz appealed to the United States Court of Appeals for the Seventh Circuit.[168]

The Seventh Circuit held that Holtz's suit depended on the allegation that the Bank concealed the incentives it gave its employees.[169] The court reasoned that if the bank had told

[156] *See generally*, Holtz v. JPMorgan Chase Bank, N.A., 846 F.3d 928 (7th Cir. 2017); *Goldberg*, 846 F.3d at 915–16.
[157] Brown v. Calamos, 664 F.3d 123, 128–29 (7th Cir. 2011).
[158] Petition for Writ of Certiorari at 6, Goldberg v. Bank of Am., 836 F.3d 913 (7th Cir. 2017) (No. 16-1541) 2017 WL 2705565.
[159] *Holtz*, 846 F.3d 928, 929 (7th Cir. 2017).
[160] *Id.*
[161] *Id.*
[162] *Id.*
[163] Holtz v. J.P. Morgan Secs. LLC, No. 12-cv-7080, 2013 U.S. Dist. LEXIS 90066, at *3–4 (N.D Ill. June 26, 2013).
[164] *Holtz*, 846 F.3d at 929.
[165] *Id.*
[166] *Holtz*, 2013 U.S. Dist. 90066, at *4.
[167] Id. at *9–10 (quoting Brown v. Calamos, 664 F.3d 123, 129 (7th Cir. 2011)).
[168] *See Holtz*, 846 F.3d at 929.
[169] *Id.* at 930.

clients that their investment advisers were compensated more for selling mutual funds owned by the bank, there would be no state contract or fiduciary duty claim.[170] It held that nondisclosure was, therefore, a "linchpin" of the suit.[171] It further reasoned that allowing this claim to go forward would counteract the aims of SLUSA.[172] The Seventh Circuit added that if Holtz had claimed that the bank created a hidden conflict of interest only after she had invested the money, the claim could have continued.[173] Because she did not claim the conflict of interest only arose after the investment, her claim necessarily hung upon the bank's nondisclosure—an omission of a material fact.[174]

The court further held that permitting plaintiffs to "avoid the Litigation Act by contending that they have 'contract' claims about securities, rather than 'securities' claims, would render the Litigation Act ineffectual, because almost all federal securities suits could be recharacterized as contract suits about the securities involved."[175]

Finally, the court held that a claim is preempted if that claim could possibly be a securities fraud claim, even if not a winning one.[176] "Sometimes a plaintiff will . . . not have a winning federal securities claim (even though he might have a good claim under state law), but *Dabit* holds that SLUSA applies whether or not a federal securities theory would succeed."[177] The Seventh Circuit also reiterated the justification in *Dabit*, that this interpretation of SLUSA does not completely preempt any claims.[178] It merely preempts plaintiffs seeking relief through the vehicle of a class action lawsuit.[179] Plaintiffs are still free to pursue claims individually.[180]

B. Goldberg v. Bank of America, N.A.

The complaint in *Goldberg* revolved around custodial accounts in La Salle Bank through which clients would invest securities.[181] If at the end of each day the account had a cash balance, it would be "swept" into a mutual fund that the client chose from an approved list.[182] Under the terms of the agreement, in return for its services, the bank was to receive a fee in accordance with its schedule of compensation and reimbursement for out-of-pocket expenses.[183]

Stephen Richek,[184] who was the trustee of the Seymour Richek Revocable Trust, opened a custodial account for the trust with LaSalle.[185] Bank of America later acquired La Salle.[186] After the acquisition, Bank of America sent out a notification to all of its customers, that a certain fee

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[170] *Id.*
[171] *Id.*
[172] *Id.*
[173] *Id.* at 931.
[174] *Id.*
[175] *Id.* at 930–31.
[176] *Id.* at 933.
[177] *Id.*
[178] *Id.* at 934
[179] *Id.*
[180] *Id.*
[181] Goldberg v. Bank of Am., 846 F.3d 913, 915 (7th Cir. 2017).
[182] *Id.*
[183] Petition for a Writ of Certiorari at 4, Goldberg v. Bank of Am., 846 F.3d 913 (7th Cir. 2017) (No. 16-1541) 2017 WL 2705565.
[184] The trustee is now Margaret Richek-Goldberg, who is the current lead-plaintiff.
[185] *Goldberg*, 846 F.3d at 915.
[186] *Id.*

was no longer being charged.[187] LaSalle had been accepting reinvestment fees from the mutual funds based on the average daily invested balance LaSalle had "swept" from the custodian accounts.[188] Richek had not known about this fee until he received this notice because it was not in the contract's schedule of compensation.[189] Thus, Richek contended that the bank had breached the contract by charging a fee that was not part of the contractually agreed compensation.[190]

Richek sued in state court on behalf of a class of all the persons and entities who maintained custody accounts at LaSalle.[191] The class brought suit for breach of contract and breach of fiduciary duty.[192] The bank subsequently removed the case to federal court under SLUSA.[193] The United States District Court for the Northern District of Illinois then held that the complaint was "replete with allegations that the Bank failed to disclose (or omitted) details regarding fees . . . ."[194] It ruled that the complaint, therefore, alleged an omission in connection with the sale of securities, and was preempted by SLUSA.[195] Richek appealed to the United States Court of Appeals for the Seventh Circuit.[196]

In a short opinion, referring the reader to the *Holtz* case for clarification, the Seventh Circuit affirmed the district court's dismissal.[197] It held that the plaintiff's claim depended on the fact that Bank of America had not told its clients that it was taking the disputed fee.[198] Therefore, the court concluded the claim depended on an omission and was preempted by SLUSA.[199] The court held that this applies even if the plaintiff could not recover damages in a class action under federal law.[200]

Judge Flaum concurred, adding that in his opinion, Goldberg's complaint was preempted under all three of the tests employed by other circuits.[201] He stated that in both the breach of fiduciary duty and the breach of contract claims, the claim mentioned that the defendant had not disclosed the extra fee.[202] Flaum then specified that under the literalist approach the claims were very clearly barred because this could easily be read as requiring a misrepresentation or omission.[203] Likewise, he claimed that under the "looser" Third Circuit approach, the claim would also be preempted.[204] In his opinion, the omission or misrepresentation was far more than an "extraneous detail" because the claim rests on the fact that the defendant had not told its customers about the fee.[205] Finally, Flaum worried that dismissing the claim without prejudice as the Ninth

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[187] *Id.*
[188] *See id.*
[189] *Id.*
[190] *See id.*
[191] *Id.*
[192] *Id.*
[193] *Id.*
[194] Richek v. Bank of Am. N.A., No. 10-cv-6779, 2011 U.S. Dist. LEXIS 86105, at *19 (N.D. Ill. Aug. 4, 2011).
[195] *Id.*
[196] *See Goldberg*, 846 F.3d at 913.
[197] *Id.* at 916.
[198] *Id.* at 915–16.
[199] *Id.*
[200] *Id.* at 916.
[201] *Id.* at 919–20.
[202] *Id.*
[203] *Id.* at 919.
[204] *Id.*
[205] *Id.*

Circuit does would create the risk that the plaintiffs would reinsert the offending allegations after refiling.[206]

In a lengthy dissent, Judge Hamilton contended that the claim alleged only breach of contract and fiduciary duty, rather than fraud.[207] He claimed that the majority's holding results in the dismissal of perfectly good contract claims and allows defendants to do "extraordinary feats of legal jiu jitsu" to avoid liability.[208] Hamilton reasoned that "[j]ust as plaintiffs cannot avoid SLUSA through crafty pleading, defendants may not recast contract claims as fraud claims by arguing that they 'really' involve deception or misrepresentation."[209]

Hamilton also argued that the majority's opinion disrupts the federalism balance in SLUSA.[210] In particular, Hamilton pointed to the Supreme Court's federalism reasoning in *Merrill Lynch, Pierce, Fenner & Smith Inc. v. Manning*.[211] In *Manning*, the court warned against interpreting exclusive federal jurisdiction too broadly so as not to interfere with the independence of state governments and courts.[212]

Hamilton instead argued that the Seventh Circuit should adopt the "necessary to the claim" reasoning of the Third and Ninth Circuits.[213] According to Hamilton, this approach would avoid both artful pleading on the part of the plaintiff, and the "jiu jitsu" move on the part of the defendant.[214] This approach would mandate that claims which are securities fraud cases in substance be dismissed, while allowing legitimate state law claims to continue.[215]

C. The Holdings in these Cases:

In these two decisions, released on the same day, the Seventh Circuit held that the claims in both *Golberg* and *Holtz* were preempted by SLUSA because they alleged an omission or misrepresentation, and were therefore fraud claims in disguise.[216] In essence, the decisions in *Goldberg* and *Holtz* held that SLUSA precludes any state law class action for breach of contract if the plaintiff could have tried to plead the case as a federal securities law claim, even if the case does not turn on an omission or misstatement of a material fact.[217] These holdings create federalism concerns because they intrude on state law of breach of contract and breach of fiduciary duty claims. They also risk leaving plaintiffs who have legitimate complaints without any recourse in either state or federal court. Unfortunately, these concerns are unlikely to be soon resolved, as the Supreme Court has denied both Holtz's and Goldberg's petitions for certiorari.[218]

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[206] *Id.*
[207] *Id.* at 920 (Hamilton, J., dissenting).
[208] *Id.* at 921–22.
[209] *Id.* at 919–20.
[210] *Id.* at 926.
[211] *Id.* at 927.
[212] *Id.*
[213] *Id.* at 921; *see* section IV(C).
[214] *Goldberg*, 846 F.3d at 922 (Hamilton, J., dissenting).
[215] *Id.*
[216] *Holtz*, 846 F.3d 928, 930 (7th Cir. 2017); *Goldberg*, 846 F.3d at 915–16 (majority opinion).
[217] Petition for a Writ of Certiorari at 6, Goldberg v. Bank of Am., 846 F.3d 913 (7th Cir. 2017) (No. 16-1541) 2017 WL 2705565.
[218] *Holtz*, 846 F.3d 928, 930 (7th Cir. 2017), *cert. denied*, 86 U.S.L.W. 3150 (U.S. Oct. 2, 2017) (No. 16-1536); Goldberg v. Bank of Am., 846 F.3d 913 (7th Cir. 2017), *cert. denied*, 86 U.S.L.W. 3150 (U.S. Oct. 2, 2017) (No. 16-1541); *see also Holtz v. JPMorgan Chase Bank, N.A. Petition for certiorari denied on October 2, 2017*, SCOTUSBLOG (Oct. 2, 2017), http://www.scotusblog.com/case-files/cases/holtz-v-jpmorgan-chase-bank-n/;

V. THE CONFLICT: FEDERAL INTERESTS IN UNIFORM REGULATION VS. FEDERALISM CONCERNS

Two important interests conflict in examining the scope of SLUSA: the federal government's interest in regulating the interstate purchase and sale of securities, and state interests in adjudicating claims arising under their own corporate laws. It is important to have one body of law because of the national character of the securities in question.[219] The securities transactions at issue in these cases do have a national scope. For example, in order for a security to be a "covered security" under SLUSA, it must be traded on a national exchange.[220] The Supreme Court has also held that "[t]he magnitude of the federal interest in protecting the integrity and efficient operation of the market for nationally traded securities cannot be overstated."[221] Thus, as these securities are bought and sold in every state, there is an advantage to uniform law in this area.

Securities of publicly traded companies can also be regulated by the federal government under the commerce clause.[222] As securities are traded commercially by individuals and entities located in different states, they qualify as interstate commerce and can therefore be federally controlled.[223] The Supreme Court held that Congress may use federal law to regulate "(1) the use of the channels of interstate commerce; (2) the instrumentalities of interstate commerce, or persons or things in interstate commerce; and (3) activities that substantially affect interstate commerce, and that within each category, Congress' regulatory power is plenary."[224] Because SLUSA regulates only national securities markets and expressly deals with claims pertaining to nationally traded securities, the statute is a constitutional exercise of federal authority to regulate these markets.

Nevertheless, states also have compelling interests in this area. Corporations are incorporated under state law.[225] Each state, therefore, wishes to have the authority to regulate corporations incorporated under its laws. Federal regulations should not intrude too far into the realm of corporate law, and federal courts should draw and respect a line between federal regulation of securities and intruding upon the state law of contract and breach of fiduciary duty. Additionally, courts historically strive to honor the line between federal regulation of securities and state corporate regulation.[226] For example, in *Santa Fe Industries, Inc. v. Green*, the court held: "[A]bsent a clear indication of congressional intent, we are reluctant to federalize the substantial portion of the law of corporations that deals with transactions in securities, particularly where established state policies of corporate regulation would be overridden."[227] The Seventh Circuit's broad interpretation of SLUSA threatens to blur this line in the sand. As the dissent in *Goldberg* noted, "[i]n our prior SLUSA cases, we have taken care to leave room for state-law claims for

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Goldberg v. Bank of America., Petition for certiorari denied on October 2, 2017, SCOTUSBLOG (Oct. 2, 2017), http://www.scotusblog.com/case-files/cases/goldberg-v-bank-america-n/.

[219] *See, e.g.*, Merrill Lynch, Pierce, Fenner & Smith Inc. v. Dabit, 547 U.S. 71, 78 (2006).

[220] 15 U.S.C. §§ 78bb(f)(5)(E) (2012); 15 U.S.C. § 77r (2012).

[221] *Merrill Lynch, Pierce, Fenner & Smith Inc.*, 547 U.S. at 78.

[222] Riley v. Merrill Lynch, Pierce, Fenner & Smith, Inc., 292 F.3d 1334, 1346 (11th Cir. 2002).

[223] 15 U.S.C. §§ 78bb(f)(5)(E) (2012).

[224] *Riley*, 292 F.3d at 1346.

[225] Jim Whitlatch, *Diversity Jurisdiction and Alien*, 59 IND. L. J. 659, 659 (1984) (discussing diversity jurisdiction over corporations).

[226] Santa Fe Indus. v. Green, 430 U.S. 462, 479 (1977).

[227] *Id.*

breach of contract, at least."[228] The Seventh Circuit's decisions, however, threaten to eliminate most breach of contract and fiduciary duty claims that have a connection to securities.

In addition to the interests of the states, it is consistent with congressional intent to allow bona fide state law claims to be brought in state court.[229] While Congress was prepared, when enacting SLUSA, to accept the preclusion of relief to a small number of cases, it likely did not want to intrude so far into the realm of corporate law as to preempt traditional state claims such as breach of contract.[230] It acknowledged that "[b]ecause a number of states allow claims that cannot be brought under federal law, and because it is not always cost-effective for plaintiffs to proceed individually, the bill will preclude relief as a practical matter for some small investors who may have been defrauded."[231]

However, Congressional records also show that SLUSA was meant to preempt "only those class actions that have recently migrated to State court, while leaving traditional State court actions and procedures solidly in place."[232] Breach of contract and breach of fiduciary duty claims have been litigated in state court before the PSLRA was enacted and constitute traditional state law claims.[233] Additionally, SLUSA's exemptions, such as the Delaware Carve-Out, show that Congress left avenues for state courts to hear certain actions that they have an interest in hearing. Arthur Levitt, a commissioner of the Securities Exchange Committee, also specified that "[c]are should be taken in proposing solutions to the Reform Act's problems to safeguard the benefits of our dual system of federal and state law that has served investors well for over 60 years."[234] In fact, Congress specifically worried that SLUSA would have "the unintended effect of preempting

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[228] Goldberg v. Bank of Am., 846 F.3d 913, 922 (7th Cir. 2017) (Hamilton, J., dissenting).

[229] *See* H.R. REP. NO. 105-803, at 1–4 (1998) (Conf. Rep.).

[230] *Hearing*, *supra* note 101, at 78 (statement of Michael A. Perion, Lecturer at Stanford Law School and Co-Director of the Law School's Roberts Program in Law, Business, and Corporate Governance).

[230] *Hearing*, *supra* note 101, at 47 (statement of Arthur Levitt, Jr., Chairman and Isaac C. Hunt, Jr., Comm'r, U.S. Securities and Exchange Commission).

[231] *Hearing*, *supra* note 101, at 47 (statement of Arthur Levitt, Jr., Chairman and Isaac C. Hunt, Jr., Comm'r, U.S. Securities and Exchange Commission).

[232]143 CONG. REC. S10,477 (daily ed. Oct. 7, 1997); *Hearing*, *supra* note 101, at 59(statement of Harry Smith Mayor, Greenwood, Mississippi) (While Congress has substantial powers to govern the Nation directly, including in areas of intimate concern to the States, the Constitution has never been understood to confer upon Congress the ability to require the States to govern according to Congress' instructions.) (quoting New York v. United States, 505 U.S. 144 (1992)).

[233] *See, e.g.*, Hesston Corp. v. Kays, 870 P.2d 17 (Kan. 1994) (involving a class action lawsuit for breach of contract and fiduciary duty, by stockholders dissenting a merger); Fletcher v. Sec. Pac. Nat'l Bank, 591 P.2d 51 (Cal. 1979) (bringing a class action lawsuit for breach of contract and unfair trade practice, complaining of bank's practice of quoting interest calculated on the basis of a 360-day year); Steinberg v. Chicago Med. Sch., 371 N.E.2d 634 (Ill. 1977) (bringing a class action lawsuit for breach of contract, alleging that a medical school failed to evaluate applications according to the academic criteria in the school's bulletin); Diamond v. Oreamuno, 248 N.E.2d 910 (N.Y. 1969) (bringing a class action lawsuit for breach of fiduciary duty alleging that corporate officers used inside information in securities transactions); Harris v. Shearson Hayden Stone, Inc., 441 N.Y.S.2d 70 (N.Y. App. Div. 1981) (bringing a class action lawsuit for breach of fiduciary duty alleging that defendant securities and commodities broker mishandled their accounts); Brown v. Halbert, 76 Cal. Rptr. 781(Cal. Ct. App. 1969) (bringing a class action lawsuit for breach of fiduciary duty alleging that a dominant stockholder sold shares for a higher price not made available to minority shareholders).

[234] *Hearing*, *supra* note 101, at 49 (statement of Arthur Levitt, Jr., Chairman and Isaac C. Hunt, Jr., Comm'r, U.S. Securities and Exchange Commission).

traditional state corporate governance claims."[235] The Seventh Circuit's decisions, however, enable the circumstances that some members of Congress feared.

VI. WHY THE SEVENTH CIRCUIT'S HOLDINGS TAKE SLUSA TOO FAR

The Seventh Circuit's holdings in *Holtz* and *Goldberg* and the more general trend of the pushback against strike suits has swung the pendulum too far. The broad interpretation of SLUSA now runs the risk of eliminating legitimate breach of contract and fiduciary duty suits. This intrudes into the realm of state law causes of action, counteracts the ideals of federalism, and potentially leaves plaintiffs with no forum willing and able to adjudicate these claims.

A. Intrusion into State Law

The holding in *Holtz* is problematic. Even if "almost all federal securities suits could be recharacterized as contract suits about the securities involved," this does not mean that all breach of contract suits that involve securities in any way should be preempted.[236] While SLUSA was designed to prevent artful pleading, the court in *Holtz* applied an overbroad interpretation in this case. The mere existence of a parallel federal cause of action does not mean the plaintiff must assert that cause of action if a valid, alternative, state law claim exists.[237]

> The artful pleading rule is rarely applied since the plaintiff is given broad leeway to choose the claim on which she wishes to rely. *The fact that she may have an alternative or parallel federal claim does not mean that she must assert that claim. Only when the state claim on which she relies is itself truly a federal claim will this rule be applied.*[238]

While the claim in *Holtz* could arguably have been filed as a federal securities claim, it also was a legitimate state law claim, and the plaintiffs should have been allowed to bring it. The claim in *Holtz* did not require a material omission or misrepresentation. The claim simply stated that "[the bank] failed to provide the independent research, financial advice, and due diligence required by the parties' contract and their fiduciary relationship." [239] This claim does not inherently require an omission. Instead, it is the basis for the ordinary state law claims of breach of contract and breach of fiduciary duty.[240]

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[235] *Hearing*, *supra* note 101, at 40 (statement of Arthur Levitt, Jr., Chairman and Isaac C. Hunt, Jr., Comm'r, U.S. Securities and Exchange Commission).
[236] Holtz v. JPMorgan Chase Bank, N.A., 846 F.3d 928, 930–31 (7th Cir. 2017).
[237] A. IDES & C.N. MAY, CIVIL PROCEDURE CASES AND PROBLEMS 303 (2nd ed. 2006).
[238] *Id.* (emphasis added). For examples of the use of this doctrine to enforce federal preemption of state law claims, *see* Aetna Health, Inc. v. Davila, 542 U.S. 200 (2004); Beneficial National Bank v. Anderson, 539 U.S. 1 (2003); Osborn v. Bank of the United States, 22 U.S. 738 (1824); T&E Pastorino Nursery v. Duke Energy Trading & Mktg., L.L.C., 268 F. Supp. 2d 1240 (S.D. Cal. 2003) .
[239] *Holtz*, 846 F.3d at 930.
[240] State courts have long been litigating breach of contract and breach of fiduciary duty claims. *See, e.g.*, Martin v. Heinold Commodities, 643 N.E.2d 734 (Ill. 1994) (bringing a breach of fiduciary duty claim, alleging that a broker misrepresented the nature of foreign service fees in the price of overseas commodity options); Chavin v. Gen. Emp't Enters., Inc., 584 N.E.2d 147 (Ill. 1992) (alleging breach of fiduciary duty to shareholders due to directors' adoption of a share purchase rights plan); Steinberg v. Chi Med. Sch., 371 N.E.2d 634 (Ill. 1977) (bringing a class action lawsuit for breach of contract, alleging that a medical school failed to evaluate applications according to the academic criteria in the school's bulletin).

Similarly, in *Goldberg* the plaintiffs simply had to prove that the contract with the bank spelled out the terms of payment, and that the plaintiffs were charged a fee in contravention of that contract.[241] They also had to prove that the bank of which they were customers owed them a fiduciary duty, and that they breached this duty by charging them a fee that was not in the contract. These spell out legitimate breach of contract and breach of fiduciary duty claims. Disallowing these would mean that every time a class of clients is charged a fee in contravention of a contract, if the transaction is in connection with the sale of securities, they would be unable to pursue their claim. Many, if not most breach of contract claims that have any connection with securities would be preempted.[242]

The holdings in both *Holtz* and *Goldberg* push SLUSA too far into the realm of state law.[243] They do not implement congressional intent; they contradict it. The intent expressed in congressional hearings and through the two state law exemptions in the statute is no longer being honored. Thus, the exemptions are no longer sufficient to protect states' interests in ensuring that their citizens have effective recourse to state courts.[244] The exemptions, along with congressional records and legislative history, provide ample evidence of a congressional intent that traditional state law claims be preserved. Additionally, the Supreme Court's reasoning in *Cyan* gave deference to the fact that states had adjudicated the claims at issue for sixty-five years, and that securities not listed on the national exchange are of state rather than federal concern.[245] This reasoning indicates that the Court is reluctant to strip state courts of jurisdiction over cases that have traditionally been litigated there. Because the Seventh Circuit's interpretation of the law does not allow for these traditional state law claims to be brought in state court, they are not duly deferential to states' interests.

B. Preempted Plaintiffs: A Right Without a Remedy

While it is important to have uniformity in laws governing the interstate purchase and sale of corporate securities, this should not be done at the expense of plaintiffs' rights to assert other non-federal claims against corporate defendants, and states' rights to adjudicate claims against corporations that are established under their state laws.[246] States have an interest in hearing these cases in order to guarantee protection for their citizens. As courts may and often do dismiss these cases with prejudice, the Seventh Circuit's overly broad interpretation of SLUSA leaves class action plaintiffs with no avenue to get relief.[247] For example, there are no federal standards governing fiduciary relationships, which means plaintiffs would have no other way to bring such a case.[248] If a plaintiff has a "fatally flawed" securities fraud case, but a legitimate breach of contract or fiduciary duty case, they run the risk of being left without recourse if preempted by

[241] Goldberg v. Bank of Am., 846 F.3d 913, 921 (7th Cir. 2017) (Hamilton, J., dissenting).
[242] *See id.* at 924.
[243] *See supra* section VI.
[244] It would also be beneficial for Congress to clarify its intent that the cases preempted be solely securities fraud class action lawsuits. This would allow plaintiffs to bring legitimate state causes of action and also achieve uniformity across the circuits.
[245] *Id.* at 8–11.
[246] *See supra* section VI.
[247] Weinstein & Rodgers, *supra* note 50.
[248] *Cf.* Roland v. Green, 675 F.3d 503, 518 (5th Cir. 2012).

SLUSA. Their claims may not be heard in any court at all, leaving them with a right, but no remedy.[249]

In *Goldberg* for instance, it is unlikely that the claim would survive as a federal securities fraud lawsuit. A federal securities fraud claim must be in connection with the purchase or sale of securities.[250] Moreover, *Blue Chip Stamps v. Manor Drug Stores* limits the 10(b)(5) federal securities right of action to plaintiffs who were purchasers or sellers of securities.[251] If the suit in *Goldberg* were brought in a federal court, it is doubtful whether the court would hold that the claim is in connection with the purchase or sale of securities, because the fine in question was imposed periodically, whether money was transferred and invested in mutual funds or not.[252] Additionally, the bank imposed the fees on the average cumulative balances in the fund, not on the purchase or sale of an interest in the investment fund.[253] The claim would therefore likely be dismissed if it were brought in a federal court. The Seventh Circuit's decision left the plaintiffs in *Goldberg* with a claim that state courts could not hear and federal courts would not hear.

The class in *Holtz* would likely encounter a similar problem. Holtz's claim is one for the failure to perform contracted-for services, which led her to pay a fee for services she did not receive.[254] This claim is not dependent on members of the class having bought securities at all (and if they have not bought any, they do not have standing under *Blue Chip*). They only need to have paid for the services that the bank allegedly did not provide; in this case, giving investment advice in the clients' best interests.[255] In order to reframe this as a securities fraud suit, Holtz would need to seek damages for money lost due to plaintiffs purchasing the bank's preferred securities, rather than superior third-party securities. She would probably be unable to bring the suit in its current state. She would likely need to change the nature of the lawsuit and the plaintiffs involved.

Both cases also would likely not be able to meet the scienter requirement for a claim arising under section 10(b)(5) of the Securities Exchange Act of 1934. Under the PSLRA, plaintiffs must allege specific facts that give rise to a strong inference that the defendant acted with the required scienter.[256] The plaintiffs in *Goldberg* and *Holtz* may find it problematic to bring the proof required for the PSLRA's heightened pleading standards. They are, therefore, likely left with no recourse for their claims.

Although Congress may have anticipated that SLUSA would "preclude relief as a practical matter for some small investors who may have been defrauded," the statute now runs the risk, if too broadly interpreted, of precluding many claims that should gain relief under legitimate state breach of contract and fiduciary duty actions.[257] Because Congress meant to leave room for certain

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[249] *See, e.g.,* Marbury v. Madison 5 US 137, 163 (1803) ("[I]t is a general and indisputable rule, that where there is a legal right, there is also a legal remedy by suit or action at law, whenever that right is invaded.") (quoting WILLIAM BLACKSTONE, COMMENTARIES ON THE LAWS OF ENGLAND, 23 (3d vol. 1770)).
[250] 15 U.S.C. § 78j(b) (2012).
[251] *See* Merrill Lynch, Pierce, Fenner & Smith Inc. v. Dabit, 547 U.S. 71, 77 (2006).
[252] Reply Brief of Plaintiff-Appellant Stephen D. Richek at 1, Goldberg v. Bank of Am., N.A., 846 F.3d 913 (7th Cir. 2017) (No. 11-2989).
[253] *Id.*
[254] Brief and Appendix for Plaintiffs-Appellants at 25, Holtz v. JPMorgan Chase Bank, N.A., 846 F.3d 928, 929 (7th Cir. 2017) (No. 13-2609).
[255] *Id.*
[256] Samuel W. Buell, *What is Securities Fraud?*, 61 Duke L.J. 511, 550 (2011) (Determining that under the PSLRA, "plaintiffs must allege specific facts that give rise to a strong inference that the defendant acted with the required scienter . . . .").
[257] *Hearing*, *supra* note 101, at 47 (statement of Arthur Levitt, Jr., Chairman and Isaac C. Hunt, Jr., Comm'r, U.S. Securities and Exchange Commission).

state law, particularly relating to corporate law, it likely did not mean for bona fide traditional state law claims to be left without relief.[258]

In *Merril Lynch*, while acknowledging the "presum[ption] that Congress does not cavalierly pre-empt state-law causes of action," the Supreme Court also stated that this presumption "carries less force here than in other contexts" as it does not preempt individual causes of action, only class actions.[259] However, oftentimes the amount at issue per person is too small to justify a lawyer's costs. This leaves individual plaintiffs effectively without recourse, despite the fact that they can *technically* still bring suit.[260]

C. The "Artful Answer": Turning a Legitimate State Law Claim into a Federal Fraud Suit

The Seventh Circuit's decisions would also allow defendant corporations to turn a state law claim into a securities fraud claim through something akin to reverse artful pleading, or "turning gold into lead."[261] This "artful answer" allows defendants to preempt legitimate state claims and escape liability. If a plaintiff's case could have been filed as a federal securities claim, the defendant can escape liability by claiming that because the case could have been filed federally, it must be preempted by SLUSA, despite the fact that it may be a legitimate state law case. For instance, in *Goldberg*, the plaintiffs essentially had to prove that the defendants charged a fee that was not in the contract, and the bank had, therefore, breached the contract.[262] However, parties in contract disputes often disagree about the proper interpretation of the contract.[263] It would be inaccurate to say that "one party omitted a material fact by failing to anticipate, discover and disabuse the other of its contrary interpretation of a term in the contract."[264] Additionally, as the Ninth Circuit stated in *Freeman Investments, L.P. v. Pacific Life Ins. Co.*, "[t]o succeed on this claim, plaintiffs need not show that [the defendant] misrepresented the cost of insurance or omitted critical details. They need only persuade the court that theirs is the better reading of the contract term."[265] Therefore, the decisions in *Holtz* and *Goldberg* are too quick to preempt what should be a regular contract dispute governed by state law.

Moreover, the availability of a possible defense should not determine whether a claim is adequate. In fact, courts and civil procedure doctrine have specifically eschewed this type of logic.[266] For instance, under the well pleaded complaint rule, a case cannot enter federal court using subject matter jurisdiction if the only federal or constitutional issue is a defense that the plaintiff anticipates the defendant raising.[267] The plaintiff's claim for relief alone determines the

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[258] *Id.*
[259] Merrill Lynch, Pierce, Fenner & Smith Inc. v. Dabit, 547 U.S. 71, 87 (2006).
[260] *See* Scott v. Cingular Wireless, 161 P.3d 1000, 1007 (Wash. 2007) ("[A] primary function of the class suit is to provide a procedure for vindicating claims which, taken individually, are too small to justify individual legal action but which are of significant size and importance if taken as a group." (quoting Smith v. Behr Process Corp., 54 P.3d 665, 673 (Wash. Ct. App. 2002))).
[261] Goldberg v. Bank of Am., 846 F.3d 913, 921 (7th Cir. 2017) (Hamilton, J., dissenting).
[262] *Id.* at 920–21.
[263] *See, e.g.,* Webster v. N.Y. Life Ins. and Annuity Corp., 386 F. Supp. 2d 438, 441 (S.D.N.Y. 2005).
[264] *Id.*
[265] Freeman Investments, L.P. v. Pacific Life Ins. Co., 704 F.3d 1110, 1115 (9th Cir. 2013).
[266] *E.g.,* Louisville & Nashville R.R. Co. v. Mottley, 211 U.S. 149, 152–54 (1908).
[267] *Id.* at 152 ("[A] suit arises under the Constitution and laws of the United States only when the plaintiff's statement of his own cause of action shows that it is based upon those laws or that Constitution. It is not enough that the plaintiff alleges some anticipated defense to his cause of action and asserts that the defense is invalidated by some provision of the Constitution of the United States.")

presence or absence of subject matter jurisdiction.[268] A potential defense is insufficient.[269] Under this reasoning, a potential defense also should not be able to rule whether a case enters federal court under SLUSA.

The courts in *Goldberg* and *Holtz*, however, allowed a potential defense to the claims to determine whether the plaintiffs had alleged an omission or misrepresentation.[270] For example, in *Holtz*, if the defendants had told their clients they were providing incentives to financial advisers to sell their own mutual funds, there would have been no case.[271] The bank could have asserted the defense that it had told the plaintiffs about their actions, and there was therefore no breach of contract.[272] The fact that it did not tell the plaintiffs (the omission) precludes the defendants from asserting that defense. This is also the argument made by the concurrence in *Goldberg*. Judge Flaum stated that because Goldberg's claim required proving that the bank had not disclosed the extra fees to the plaintiffs, this claim alleged a material omission.[273] However, allowing SLUSA to preclude any claim that has a potential defense involving a clarification or disclosure would preclude many if not most state claims. This would unnecessarily preclude many bona fide state claims that should remain within the realm of state law. Courts should consequently interpret SLUSA in a way that only precludes true securities fraud class action lawsuits, and leaves legitimate state claims intact, keeping with the intent of the law.

VII. CAN THE CLAIM PREVAIL? HOW COURTS SHOULD INTERPRET AN "OMISSION OR MISREPRESENTATION"

The current circuit split could lead to forum shopping,[274] as litigants search for a circuit in which their most favorable interpretation of SLUSA is used. The Seventh Circuit's decisions in *Holtz* and *Goldberg* deepen this split. According to some, they may make "the Seventh Circuit . . . a friendlier place for banks and securities firms than it was last month."[275] As SLUSA was created to prevent forum shopping, it is in the best interests of the courts to adopt a uniform rule.[276] Courts should adopt a rule similar to that of the Third Circuit, which examines whether a case can prevail without the allegation of omission or misrepresentation. Moreover, in determining whether a claim can succeed without the barred allegations, courts should examine only elements necessary to the claim itself, without any consideration of elements needed to rebut potential defenses.

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[268] *Id.*
[269] *Id.*
[270] *Holtz*, 846 F.3d 928, 930 (7th Cir. 2017); Goldberg v. Bank of Am., 846 F.3d 913, 922 (7th Cir. 2017) (Hamilton, J., dissenting).
[271] *Holtz*, 846 F.3d at 930.
[272] *C.f. id.*
[273] *Goldberg*, 846 F.3d at 921 (Flaum, J., concurring).
[274] *See generally* Markus Petsche, *What's Wrong With Forum Shopping? An Attempt to Identify and Assess the Real Issues of a Controversial Practice*, 45 INT'L LAW. 1005, (2011) (explaining that forum shopping, in which a litigant deliberately searches through multiple courts or jurisdictions to find a forum that is most likely to give them favorable results, is generally disfavored. This practice has been criticized because it leads to inequality between litigants who have the opportunity to forum shop and those who do not, and a lack of uniformity in the law.).
[275] William F. Alderman & Christine Hanley, *A Fraud By Any Other Name: Seventh Circuit Holds That SLUSA Extends To Class Actions That Could Be Pursued Under Federal Securities Fraud Laws*, MONDAQ (Feb. 10, 2017), http://www.mondaq.com/unitedstates/x/567482/Securities/A+Fraud+By+Any+Other+Name+Seventh+Circuit+Holds+That+SLUSA+Extends+to+Class+Actions+That+Could+Be+Pursued+Under+Federal+Securities+Fraud+Laws.
[276] 143 CONG. REC. S10,477 (daily ed. Oct. 7, 1997).

The "literalist" Sixth Circuit approach is problematic. It does not look past the wording of the complaint to determine whether the complaint signifies a legitimate state law action. This would run the risk of preempting suits that are not really securities fraud class action suits and needlessly intruding into state law territory. Congress only meant to preempt a narrow set of cases, and the Sixth Circuit approach would likely unduly broaden the scope of SLUSA. [277]

The Ninth Circuit approach of allowing the refiling of a dismissed claim is also problematic. It creates too great a risk that the plaintiff will use artful pleading to get a claim that really is a securities fraud action into state court. The Seventh Circuit in particular worried that plaintiffs would take out the offending allegations to get the suit into state court, and then be tempted to reintroduce them later, because they "clearly thought they added something to their case."[278] This approach may also be inconsistent with the plain language of the statute, which states that claims alleging omissions and misrepresentations should be removed to federal court and dismissed. It does not mention giving leave to amend first.[279]

Courts instead should use the majority rule of the Third Circuit. This asks whether "the plaintiffs can prevail on their claims without proving the defendants engaged in deceptive misrepresentations or omissions."[280] In determining whether the plaintiffs can prevail without misrepresentations or omissions, the court should be careful not to examine whether misrepresentations or omissions would be necessary to rebut a potential defense. The court should simply focus on the complaint itself. Without this addition, it would still be possible to reach the outcome in *Holtz* and *Goldberg* which leads to intrusion into state law and could leave many breach of contract plaintiffs without recourse. In fact, this is the argument made by the defendant in *Holtz* in their response to the petition for certiorari.[281] In *Holtz* and *Goldberg*, the courts found that the defendants could not assert the defense of having told the plaintiff of its extra-contractual actions.[282] Because they could not assert the defense of disclosure, the courts found that the banks' omissions were necessary to the claim.[283] However, the plaintiffs in both cases only needed to prove that the defendants did something outside of the agreed upon terms in the contract, and possible availability of a potential defense should not determine the validity of a claim.[284]

The Third Circuit rule, with this addition, would prevent artful pleading on behalf of the plaintiffs but would not preempt legitimate breach of contract and fiduciary duty claims. If a claim can succeed without proving a misrepresentation or omission, then it is a bona fide breach of contract or breach of fiduciary duty claim. If, however, it turns out that a misrepresentation or omission is integral to the claim itself, then it is in reality a fraud claim and may not be based in state law. This rule will, therefore, still prevent artful pleading and weed out actions that should be securities fraud cases.

This rule would preserve the balance between state interests in regulating and adjudicating their own corporate and state law claims, and the interests of the federal government in preventing securities fraud suits from avoiding federal court. It would allow legitimate state law causes of

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[277] *Id.*
[278] Goldberg v. Bank of Am., 846 F.3d 913, 919 (7th Cir. 2017) (Flaum, J., concurring).
[279] Christopher R. Bellacicco, *Putting the "Uniform" Back in the Securities Litigation Uniform Standards Act of 1998: The Case for Applying a Reasonable Relationship Approach*, 63 CATH. U. L. REV. 195, 216 (2013).
[280] *Goldberg*, 846 F.3d at 921 (Hamilton, J. dissenting).
[281] Brief in Opposition at 7, Holtz v. JPMorgan Chase Bank, N.A., 846 F.3d 928 (7th Cir. 2017) (No. 16-1536).
[282] *See Holtz*, 846 F.3d at 930 (7th Cir. 2017); *Goldberg*, 846 F.3d at 915–16.
[283] *See Holtz*, 846 F.3d at 930; *Goldberg*, 846 F.3d at 915–16.
[284] *See, e.g.*, *Goldberg*, 846 F.3d at 915.

action to remain in state court and give plaintiffs in these cases relief. At the same time, this rule would also prevent artful pleading and preempt fraud cases simply seeking to avoid federal court.

Some may argue that this approach distorts the meaning of SLUSA because it does not preempt every complaint that alleges any omission or misrepresentation in the purchase or sale of securities. But this would be a mischaracterization of SLUSA's purpose. The statute was intended to correct the problem of plaintiffs alleging securities fraud avoiding the PSLRA. It was meant to address this problem in "a very targeted and narrow way, essentially preempting only those class actions that have recently migrated to State court, while leaving traditional State court actions and procedures solidly in place."[285] As traditional state law claims, courts should leave an avenue for legitimate contract and fiduciary duty actions. This modified Third Circuit approach is consistent with evidence of congressional intent.

Many contract or breach of fiduciary duty claims can be reframed as requiring proof of an omission or misrepresentation even if they need only prove that the other party acted contrary to either the terms of a contract or to their fiduciary duties. Courts must, therefore, look beneath the surface of the complaint to see if the misrepresentation or omission is necessary to it. They must examine the difference between a claim being invalid because it is not sufficient, and a claim being invalid because of a potential defense. In this way, courts can avoid the risk of reading in misrepresentations or omissions that are unnecessary to the complaint.[286]

Others may also argue that this standard is cumbersome to use and may result in judges permitting cases for sympathetic plaintiffs to proceed, when they should not. They may argue that a bright line approach such as the Sixth Circuit's literalist approach would be more manageable. Nevertheless, expedience should not dictate whether a plaintiff has access to a forum in which to litigate for relief. It would be more beneficial to examine each claim on a case by case basis to determine whether there is a legitimate state law cause of action. This would prevent a potentially harsh and unjust result in which bona fide state law claims are swept to the side, while the plaintiffs are left with no recourse.

VIII. CONCLUSION

While it is important to eliminate strike suits that needlessly burden courts and harass corporate defendants, it is also important to strike a balance with the interests of states and plaintiffs with legitimate claims. The pendulum should not swing so far as to allow defendant corporations to injure citizens without repercussions so long as the harm is small enough to make an individual action untenable. The Seventh Circuit's decisions in *Holtz* and *Goldberg* have swung this pendulum too far, as they allow defendants to obtain the dismissal of state law cases that do not require a misrepresentation or omission. Instead, courts should apply a modified version of the Third Circuit's test, allowing state law claims that do not require a misrepresentation or omission to prevail. Additionally, courts should only examine what the claim itself requires, without also considering potential defenses. This approach would prevent strike suits. Artful pleading would not remove the fact that if the claim is in reality a securities fraud action, it will rely on an omission or misrepresentation. At the same time, this approach would permit bona fide state law actions to continue, upholding state interests in governing their own corporations.

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[285] 143 CONG. REC. S10,477 (daily ed. Oct. 7, 1997).
[286] *See* Gregory Kendall, *The Artful Dodgers: Securities Fraud, Artful Pleading, and Preemption of State Law Causes Under the Securities Litigation Uniform Standards Act*, 81 U. CIN. L. REV. 657, 673–74 (2012).