

**SECURITIES LITIGATION  
UNIFORM STANDARDS ACT  
– THE YEAR IN REVIEW**

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July 2003

## TABLE OF CONTENTS

	<b>Page</b>
I. OVERVIEW OF SLUSA.....	1
II. DEFINITION OF “COVERED CLASS ACTIONS”.....	4
III. SCIENTER.....	6
IV. THE “IN CONNECTION WITH” REQUIREMENT.....	7
V. “COVERED SECURITIES” DEFINED .....	10
VI. PRESERVED ACTIONS AND THE DELAWARE CARVE-OUT .....	10
VII. THE SLUSA DISCOVERY STAY .....	12

**SECURITIES LITIGATION UNIFORM STANDARDS  
ACT OF 1998 (“SLUSA”) – THE YEAR IN REVIEW**

**I. Overview of SLUSA.**

A. Enacted in 1998, SLUSA extremely limits most securities fraud class actions based on state law, whether pursued in state or federal court. The Act amends § 16 of the Securities Act of 1933 (the “1933 Act”) (15 U.S.C. § 77p) and § 28 of the Securities Exchange Act of 1934 (the “1934 Act”) (15 U.S.C. § 78bb), to provide that any “covered class action” involving a “covered security” that is filed in state court is preempted, and “shall be removed” to the federal court for the district in which the action is pending. SLUSA was expressly enacted to curtail the plaintiffs’ practice of filing securities cases in state courts to avoid the proscriptions of the Private Securities Litigation Reform Act of 1995, 15 U.S.C. §§ 78u-4, 78u-5 *et seq.* (“PSLRA”). *See* Conference Report of the Committee of Conference, H.R. 105-803 (October 9, 1998) (SLUSA’s dual purposes are “prevent[ing] plaintiffs from seeking to evade the protections that Federal law provides against abusive litigation by filing suit in State, rather than in Federal, court” and “implement[ing] a uniform law of securities fraud”).

B. SLUSA provides that:

[N]o covered class actions based upon the statutory or common law of any State or subdivision thereof may be maintained in any State or Federal court by any private party alleging –

- (1) an untrue statement or omission of a material fact in connection with the purchase or sale of a covered security; or
- (2) that the defendant used or employed any manipulative or deceptive device or contrivance in connection with the purchase or sale of a covered security. 15 U.S.C. § 77p(b); 15 U.S.C. § 78bb(f)(1).

C. Thus, SLUSA has four elements: (1) a covered class action, (2) that is based on state law; (3) alleging a misrepresentation or omission of material fact or the use of any manipulative or deceptive device or contrivance; (4) “in connection with” the purchase or sale of a covered security.

**D. Retroactivity Analysis.**

1. SLUSA applies to all lawsuits filed after its enactment, regardless of when the underlying events occurred. *See Gray v. Seaboard Secs., Inc.*, 241 F. Supp. 2d 213, 218 (N.D.N.Y. 2003) (Plaintiff argued that to the extent the alleged misconduct preceded SLUSA’s enactment, claims directed at that conduct were not preempted. Held: action was preempted, notwithstanding that alleged misconduct preceded SLUSA’s enactment).

2. *Accord W.R. Huff Asset Mgmt. Co., LLC v. Kohlberg Kraus Roberts & Co., L.P.*, 234 F. Supp. 2d 1218, 1226-27 (N.D. Ala. 2002) (holding that SLUSA applied to pre-enactment conduct in case filed after enactment, even though effect was to bar certain causes of action as untimely).

E. **Timing of Removability Determination.**

1. Under 28 U.S.C. § 1446, defendants have 30 days from receipt of notice of the filing of the complaint or of an “amended pleading, motion, order or other paper” giving rise to removal jurisdiction.
2. Because jurisdiction is determined at the time of removal, subsequent pleading amendments do not eliminate jurisdiction. *See Behlen v. Merrill Lynch*, 311 F.3d 1087 (11th Cir. 2002), *cert. denied*, 123 S. Ct. 2583 (2003) (Plaintiff argued that once he amended his complaint to attempt to eliminate any allegations giving rise to SLUSA preemption, the district court lost subject matter jurisdiction to decide the motion to remand. Held: the district court had the discretion to retain jurisdiction over the amended complaint. Provided that the allegations gave rise to subject matter jurisdiction at the time of removal, subsequent actions did not divest the court of jurisdiction).
3. **Removability Based on Proposed Jury Instruction.** In *Burns v. Prudential Secs., Inc.*, 218 F. Supp. 2d 911, 914-915 (N.D. Ohio 2002), defendants removed the action two years after it was filed, on the morning trial was to commence. The plaintiff-investors asserted claims for breach of fiduciary duty and misrepresentation against the brokerage firm and broker who managed their accounts, for improperly liquidating their accounts without authorization. *Id.* at 913. Plaintiffs initially indicated an intent to rely on evidence of fraud, but only to rebut defendants’ ratification defense, and not as an affirmative claim. When plaintiffs proposed a jury instruction on fraud, however, defendants requested that plaintiffs amend the complaint to assert a fraud claim. Plaintiffs instead withdrew the instruction, and defendants filed a motion in limine to bar evidence of fraud. Denying the motion, the court ruled that fraud was part of the pleading. Defendants then removed. The court found the removal timely under 28 U.S.C. § 1446(b), holding that defendants did not have a basis for removal until receipt of plaintiffs’ proposed jury instruction. However, the case was remanded because the claims did not arise in connection with the sale of securities.

F. **Reviewability of Remand Order.**

1. The Second and Ninth Circuits recently held that remand orders under SLUSA are not subject to appellate review.

2. In *Abada v. Charles Schwab & Co., Inc.*, 300 F.3d 1112 (9th Cir. 2002), the plaintiff-investor asserted exclusively state law claims for unfair business practices and negligent and intentional misrepresentation against the defendant-brokerage company, based on allegedly misleading statements about its capacity to conduct internet trading transactions. After the district court denied a motion to remand under SLUSA, plaintiffs added a claim under § 10(b). The case was then transferred to a different judge. In opposing defendants' motion to dismiss, plaintiffs asked the court to reconsider the denial of the motion to remand. The district court then remanded on the basis that federal question jurisdiction was lacking because only some of the state law claims in the complaint were preempted by SLUSA. *Abada v. Charles Schwab & Co., Inc.*, 127 F. Supp. 2d 1101 (S.D. Cal. 2000). The Ninth Circuit held that because the remand was nondiscretionary and was based on lack of subject matter jurisdiction, there was no basis for appellate review under 28 U.S.C. § 1447(d). Since federal question jurisdiction must exist at the time of removal, the amendment to add a claim under § 10(b) did not give rise to federal question jurisdiction. 300 F.3d at 1117-18.
  - a) On the day *Abada* was decided, the Ninth Circuit also denied review of a similar remand order in an unpublished opinion. *See Shaw v. Charles Schwab & Co., Inc.*, No. 01-55306, 45 Fed. Appx. 651 (9th Cir. Aug. 21, 2002).
  - b) Following the denial in *Shaw*, the California trial court ruled that because the federal court's determination of whether or not SLUSA applied was jurisdictional, it was not *res judicata*. The court then found that the claims were preempted, and dismissed the action under SLUSA. *Shaw v. Charles Schwab & Co., Inc.*, Fed. Sec. L. Rep. (CCH) ¶ 92,413, at 92,090 (Cal. Super. Ct. Mar. 7, 2003).
3. In *Spielman v. Merrill Lynch, Pierce, Fenner & Smith, Inc.*, 332 F.3d 116 (2d Cir. 2003), the customer alleged that the defendant brokerage company misrepresented the nature and amount of transaction fees associated with the type of deposit account, constituting breach of contract, breach of implied covenant of good faith and fair dealing, fraud, negligent misrepresentation, breach of fiduciary duty, and violation of New York's consumer protection statute. The district court remanded on the basis that the allegations were not sufficiently connected to the value of or consideration for covered securities to be in connection with purchase or sale. *Spielman v. Merrill Lynch, Pierce, Fenner & Smith, Inc.*, Fed. Sec. L. Rep. (CCH) ¶ 91,619, at 97,645 (S.D.N.Y. Oct. 9, 2001). On appeal, the Second Circuit held that because the remand was based on lack of subject matter jurisdiction, it was not a reviewable order. 332 F.3d at 127.

## II. **Definition of “Covered Class Actions”.**

- A. SLUSA defines “covered class actions” to include:
1. any single lawsuit in which –
    - a) damages are sought on behalf of more than 50 persons or prospective class members, and questions of law or fact common to those persons or members of the prospective class, without reference to issues of individualized reliance on an alleged misstatement or omission, predominate over any questions affecting only individual persons or members; or
    - b) one or more named parties seek to recover damages on a representative basis on behalf of themselves and other unnamed parties similarly situated, and questions of law or fact common to those persons or members of the prospective class predominate over any questions affecting only individual persons or members; or
  2. any group of lawsuits filed in or pending in the same court and involving common questions of law or fact, in which –
    - a) damages are sought on behalf of more than 50 persons; and
    - b) the lawsuits are joined, consolidated, or otherwise proceed as a single action for any purpose. 15 U.S.C. § 77p(f)(2); 15 U.S.C. § 78bb(f)(5).
- B. For purposes of calculating the number of persons involved in a class action, corporations, investment companies, pension plans, partnerships and other entities, provided they have not been established for the purpose of the action, are treated as a single person under SLUSA. 15 U.S.C. § 77p(f)(2)(C); 15 U.S.C. § 78bb(f)(5)(D).
- C. **No Need for Class Determination.** In *Behlen*, 311 F.3d at 1092, the plaintiff argued that until the state court had determined whether or not class certification would be granted, the action was not removable as a covered class action. Held: determination of removability does not require a ruling on class certification, but only the assertion of class claims. *Id.* To hold otherwise would lead to lengthy state court motion practice that would undermine the purpose of SLUSA, namely, to shift covered class actions to federal court. *Id.*
1. Moreover, SLUSA not only provides for removal of class actions, but also for removal of non-class actions asserted on behalf of 50 more plaintiffs, including actions that are consolidated (for discovery or otherwise) on

behalf of groups of plaintiffs. 15 U.S.C. § 77p(f)(2); 15 U.S.C. § 78bb(f)(5).

D. **Effect on 1933 Act Claims in State Court.**

1. The first reported decision to consider whether SLUSA allows the removal of 1933 Act claims filed in state court was *In re Waste Mgmt., Inc. Sec. Litig.*, 194 F. Supp. 2d 590 (S.D. Tex. 2002), which held that such claims were not removable.
2. Another court has followed *Waste Management* in holding that 1933 Act claims are not removable under SLUSA. *Nauheim v. Interpublic Group of Cos., Inc.*, No. 02-C-9211, 2003 WL 1888843 (N.D. Ill. April 16, 2003).
  - a) The court's reasoning was based on the fact that read literally, SLUSA's removal provision only provides for removal of covered class actions that are "based upon the statutory or common law of any state." § 77p(b). Actions under the 1933 Act, by contrast, are based upon federal law. *Id.*
3. Two subsequent cases disagree with *Waste Management*.
  - a) In *Brody v. Homestore, Inc.*, 240 F. Supp. 2d 1122 (C.D. Cal. 2003), the court denied a motion to remand 1933 Act claims filed in California state court based on alleged accounting violations. The court concluded that Congress intended to authorize broad removal of securities actions filed in state court, including 1933 Act claims. The court also found that the amendment to § 77v(a) to provide that 1933 Act claims are not removable "except as set forth" in § 77p(c) would be meaningless under any other analysis. *Id.* at 1124.
  - b) *Accord Alkow v. TXU Corp.*, Nos. 3:02-CV-2738-K, 3:02-CV-2739-K, 2003 WL 21056750 (N.D. Tex. May 8, 2003).

E. **Actions Seeking Damages.**

1. **Meaning of Damages.** In *Feitelberg v. Merrill Lynch & Co., Inc.*, 234 F. Supp. 2d 1043, 1046-1048 (N.D. Cal. 2002), plaintiffs sought restitution and disgorgement under California's unfair business practices statute, Cal. Bus. and Prof. Code § 17200, based on the defendant's settlement of an investigation by the New York State Attorney General into alleged analyst misconduct. Plaintiff sought remand on the basis that disgorgement and restitution are not "damages" under 15 U.S.C. § 78bb(f)(5). The court found that under federal law, these monetary remedies fall within the type of actions preempted by SLUSA.

2. **Damages in Primarily Derivative Action.** In *Shen v. Bohan*, Fed. Sec. L. Rep. (CCH) ¶ 92,223 (C.D. Cal. Oct. 17, 2002), two derivative actions for breach of fiduciary duty arising out of a merger transaction were consolidated. An amended complaint added a class action claim for breach of fiduciary duty arising from the failure to conduct a shareholders' meeting. Following the amendment, defendants removed. Granting plaintiffs' motion to remand, the court held that the damages prayer related to the derivative, rather than the class claim, and that the claims therefore did not constitute a covered class action.

F. **Presence of Uncovered Claims.** Courts are divided over SLUSA's effect on complaints that include a mixture of preempted and non-preempted claims.

1. *Compare Greaves v. McAuley*, Fed. Sec. L. Rep. (CCH) ¶ 92,414 (N.D. Ga. Feb. 7, 2003) (Plaintiff argued based on § 77p(d)(4) that the presence of one unremovable claim required remand of the entire action. Defendants argued based on 15 U.S.C. § 77p(c) that because the action was a "covered class action," all claims were preempted. Held: because the court lacked jurisdiction over the claims affected by the Delaware carve-out, the entire action was remanded); *with*
2. *Falkowski v. Imation Corp.*, 309 F.3d 1123 (9th Cir. 2002), *as amended by* 320 F.3d 905 (9th Cir. 2003) (fraud claim preempted; breach of contract claim permitted to proceed); *Gray v. Seaboard Secs., Inc.*, 241 F. Supp. 2d 213, 219-220 (N.D.N.Y. 2003) (court determined SLUSA preemption as to each claim).

III. **Scienter.**

- A. Previous decisions reached different conclusions as to whether a complaint must allege scienter to be removable under SLUSA. *Compare Denton v. H&R Block Fin. Advisors*, Fed. Sec. L. Rep. (CCH) ¶ 91,618 (N.D. Ill. Oct. 4, 2001) (fiduciary duty claim sufficiently alleged deception to be preempted); *with MDCM Holdings Inc. v. Credit Suisse First Boston Corp.*, Fed. Sec. L. Rep. (CCH) ¶ 91,939 (S.D.N.Y. June 25, 2002) (fiduciary duty and breach of implied covenant claims did not sufficiently allege deception to be preempted).
- B. Two subsequent decisions have held that the state law claim need not contain an express scienter element to be preempted:
  1. *See Feitelberg*, 234 F. Supp. 2d at 1049-1051 (although complaint did not directly allege "scienter" and state unfair competition statute did not require it, allegations that brokerage firm issued favorable research reports in order to increase investment banking revenues sufficiently alleged deceptive conduct such that claim fell within SLUSA) ("In other words, if it looks like a securities fraud claim, sounds like a securities fraud claim

and acts like a securities fraud claim, it is a securities fraud claim, no matter how you dress it up.”);

2. *In re Worldcom, Inc.*, No. 02 Civ. 4816 DLC, 2003 WL 21385870 (S.D.N.Y. June 17, 2003) (Claim for common law negligence asserted against auditor preempted. While negligence is not actionable under § 10(b), SLUSA bars more than simply state law claims requiring scienter).

#### IV. **The “In Connection With” Requirement.**

- A. Most of the caselaw under SLUSA has developed around the issue of whether alleged misrepresentations or omissions occur “in connection with” the purchase or sale of a covered security.
- B. Though decided under Rule 10b-5 and not involving SLUSA, the Supreme Court’s decision in *SEC v. Zandford*, 535 U.S. 813, 122 S.Ct. 1899, 153 L. Ed. 2d 1 (2002), is the touchstone for the “in connection with” requirement. In *Zandford*, the plaintiff-investor alleged that a broker converted customer funds for personal use. Giving a broad construction to the phrase “in connection with” under § 10(b), the Court held that it requires only that the “scheme to defraud and the sale of securities coincide,” for the conduct to be actionable under Rule 10b-5. *Id.* at 1903-04.
- C. Three circuit courts have now issued opinions interpreting the “in connection with” requirement. The Eighth and Eleventh Circuits had previously ruled on the issue in *Green v. Ameritrade*, 279 F.3d 590 (8th Cir. 2002) and *Riley v. Merrill Lynch, Pierce, Fenner & Smith, Inc.*, 292 F.3d 1334 (11th Cir. 2002).
  1. In *Imation Corp.*, 309 F.3d at 1130-1132, the complaint, filed on behalf of former employees, alleged breach of contract and fraud in connection with certain stock options granted as part of a merger. Looking to the 1933 and 1934 Acts’ definitions of “security,” which include unconsummated contracts to buy or sell securities, the court held that the complaint sufficiently alleged a more-than-tangential nexus between the alleged fraud and the purchase or sale of securities, and was preempted by SLUSA. *Id.*
  2. In *Behlen*, 311 F.3d at 1094, the plaintiff, an investor in mutual funds, asserted claims for breach of contract, breach of implied covenants, breach of fiduciary duty, unjust enrichment, negligence and money had and received, based on allegedly improper commissions. Plaintiff alleged that he was mistakenly sold a class of funds with a higher commission than those he had agreed to purchase, arguing that the alleged failure to disclose the nature of the commissions was incidental to, rather than in

connection with, his purchase of securities. Held: the commissions were an integral part of the transaction and the claim was barred. *Id.*

3. Similarly, in *Dudek v. Prudential Secs., Inc.*, 295 F.3d 875 (8th Cir. 2002), the plaintiff alleged that the defendant investment firm improperly sold tax-deferred annuities with increased fees to accounts that were already tax-deferred. Held: the asserted misrepresentations were in connection with the purchase of the securities; the claims were barred. *Id.* at 879.
4. Under varying fact patterns, district courts have reached different conclusions about what allegations satisfy SLUSA's "in connection with" requirement.
  - a) Decisions finding claims to be asserted in connection with the purchase or sale of securities and therefore preempted by SLUSA:
    - (1) *Feitelberg*, 234 F. Supp. 2d at 1052 (allegations that misleading analysts' research reports affected the prices of securities asserted claims in connection with the sale of securities);
    - (2) *Herndon v. Equitable Life Assurance Soc'y*, 253 F. Supp. 2d 1364, 1369 (S.D. Ga. 2002) (The complaint alleged that the insured under a variable life insurance policy was mis-designated as higher risk in order to charge higher premiums. Held: claims were in connection with a covered security and action was removable);
    - (3) *In re Merrill Lynch & Co., Inc. Research Reports Sec. Litig.*, Nos. 02 MDL 1484 (MP), 03 CV 1428 (MP), 03 CV 1429 (MP), 03 CV 1430 (MP), 2003 WL 21036085 (S.D.N.Y. May 6, 2003) (motion to remand claims under New York statutory and common law for misrepresentations and omissions relating to investment firms' research reports denied; leave to amend denied); *see also In re Merrill Lynch & Co., Inc. Research Reports Sec. Litig.* Nos. 02 MDL 1484 (MP), 02 CV 0541 (MP), 02 CV 8472 (MP), 02 CV 4205 (MP), 02 CV 9487 (MP), 2003 WL 1872820 (S.D.N.Y. April 10, 2003) (same);
    - (4) *Shaw*, Fed. Sec. L. Rep. (CCH) ¶ 92,413, at 92,090-92,091 (Brokerage customer's claim that defendant misrepresented the commissions on its brokerage accounts was preempted. Citing *Zandford*, the court held that "in connection with" under SLUSA should have the same meaning as under § 10(b), *i.e.*, that it should be interpreted flexibly, and

should reach even transactions that merely coincide with alleged misconduct).

- b) Decisions holding that claims were not asserted in connection with the purchase or sale of securities and therefore SLUSA did not apply:
- (1) *Seaboard Secs.*, 241 F. Supp. 2d at 220-223 (Claims for fraud in the inducement under N.Y. Bus. Law § 349 and breach of contract were not preempted, because they asserted that plaintiffs contracted for services based on misrepresentations, rather than traded securities based on misrepresentations. Claims for fraud and misrepresentation were preempted, but claims for negligence and negligent supervision were not);
  - (2) *Burns*, 218 F. Supp. 2d at 915-16 (granting motion to remand complaint that asserted breach of fiduciary duty and misrepresentation based on broker's unauthorized liquidation of plaintiff's accounts and the brokerage firm's failure to disclose the liquidation. Held: any alleged misrepresentations occurred after the purchases or sales of securities and were therefore not in connection with them, *Zandford* distinguished on the basis that the sales and the representations did not coincide);
  - (3) *Dacey v. Morgan Stanley Dean Witter & Co.*, No. 02 CIV 4449 (LTS) (THK), \_\_ F. Supp. 2d \_\_ [2003 WL 21219841] (S.D.N.Y. May 22, 2003) (Motion to remand granted in part and denied in part. The plaintiff sued his investment advisor for failing to meet NASD standards, on the basis that the advisor's research reports were improperly influenced by investment banking relationships. The complaint asserted claims for breach of contract on behalf of both investors who purchased securities on the basis of the alleged reports and investors who were holding securities at the time the reports were issued. Held: the claims of the latter group did not arise in connection with the purchase or sale of securities and were not preempted);
  - (4) *Shen*, Fed. Sec. L. Rep. (CCH) ¶ 92,223, at 91,262-91,263 (claim for breach of fiduciary duty through dilution of voting rights arising out of merger did not state claim in connection with sale of securities).

## V. **“Covered Securities” Defined**

- A. SLUSA defines “covered securities” as including securities that meet the standards of Section 18(b)(1) or 18(b)(2) of the 1933 Act at the time of the alleged misrepresentation or omission, except debt securities that are exempt under § 4(2) of the 1933 Act.
1. Section 18(b)(1) applies to nationally traded securities, including those traded on any of the national exchanges as well as securities of these same issuers that are equal or senior to their listed securities.
  2. Section 18(b)(2) applies to the securities of registered investment companies, whether open or closed-end funds.
  3. Only those actions pertaining to the purchase or sale of the securities defined as “covered securities” by SLUSA are preempted.
  4. **Variable Annuities.** It is now widely recognized that variable annuities are covered securities under SLUSA. *See Herndon*, 253 F.Supp. at 1369 (fact that after complaint was filed, plaintiff reallocated premiums to a money market account did not change holding); *accord Dudek*, 295 F.3d at 878; *Patenaude v. Equitable Life Assurance Soc’y*, 290 F.3d 1020, 1025-26 (9th Cir. 2002).
  5. **Stock Options.** In *Falkowski*, 309 F.3d at 1129, the court held that alleged misrepresentations in connection with options to purchase stock that met the definition of a covered security fell within SLUSA.
  6. **Specific Securities.** In *Seaboard Secs.*, 241 F. Supp. 2d at 219, the plaintiffs, holders of accounts with a brokerage firm, asserted claims for breach of contract, fraud and negligence against the firm, based on its alleged representations about the extent to which its services were based on, and its commissions priced to include, proprietary research from another, larger firm, also named as a defendant. Plaintiffs asserted that because the complaint did not reference particular securities, the action did not involve covered securities. Held: because all of the securities at issue were listed on national exchanges, the action pertained to covered securities and was barred.

## VI. **Preserved Actions and the Delaware Carve-Out.**

- A. Four general categories of actions are preserved by SLUSA, including exclusively derivative actions, actions under contractual agreements between issuers and indenture trustees, actions by states or their subdivisions, and certain actions under the state law of an issuer’s state of incorporation.

- B. **Derivative Actions Excluded**. Actions that are exclusively derivative in nature are excluded from the definition of “covered class actions”, whereas three other categories of actions are explicitly “preserved” by SLUSA. 15 U.S.C. § 77p(f)(2)(B); 15 U.S.C. § 78bb(f)(5)(c).
1. **Deference to Characterization of Derivative Action**. Under the plain meaning of the statute, if plaintiff labels the claim derivative, the court will consider it not preempted. In *Arlia v. Blankenship*, 234 F. Supp. 2d 606, 612-613 (S.D. W.Va. 2002), the complaint asserted a derivative claim for breach of fiduciary duty, including a misappropriation theory of insider trading. Defendants argued that the complaint essentially asserted a class action claim for insider trading, which could not recover for harm to the corporation, but only to shareholders. Held: the plain meaning of the statute exempted the claim under the Delaware carve out, despite the fact that West Virginia law may not recognize a derivative cause of action for insider trading.
- C. **State Actions**. “State actions” are one category of preserved actions. SLUSA provides that “Notwithstanding any other provision of this section, nothing in this section may be construed to preclude a State or political subdivision thereof or a State pension plan from bringing an action involving a covered security on its own behalf, or as a member of a class comprised solely of other States, political subdivisions, or State pension plans that are named plaintiffs, and that have authorized participation, in such action.” 15 U.S.C. § 77p(f)(d)(2); 15 U.S.C. § 78bb(f)(3)(B).
- D. **Trustee Actions**. Also preserved are actions under contractual agreements between issuers and indenture trustees. Specifically, SLUSA provides that covered class actions that “seek to enforce a contractual agreement between an issuer and an indenture trustee” can be brought in federal or state court “by a party to the agreement or a successor to such party.” 15 U.S.C. § 77p(f)(d)(3); 15 U.S.C. § 78bb(f)(3)(C).
- E. **Delaware Carve-Out**. Actions based on the law of the state of incorporation, along with the exception for derivative actions, are known as “the “Delaware carve-outs.”
1. For a non-derivative action based on the law of the state of incorporation to fall within the Delaware carve-out, it must involve either: (1) the purchase or sale of securities by the issuer or an affiliate of the issuer exclusively from or to holders of equity securities of the issuer; or (2) a recommendation, position, or other communication with respect to the sale of the issuer’s securities that is made by or on behalf of the issuer or its affiliate to equity holders, and concerns the equity holders’ decisions with respect to voting their securities, responding to a tender or exchange offer, or exercising dissenters’ or appraisal rights.

2. Several cases have now interpreted the scope of the Delaware carve-out.
  - a) *See Alessi v. Beracha*, 244 F. Supp. 2d 354 (D. Del. 2003) (Plaintiff alleged that company failed to disclose ongoing merger discussions during a stockholder buyback, thereby purchasing shares for less than their value. Held: action was subject to Delaware carve out and SLUSA did not apply. Court rejected a narrow reading of “tender or exchange offer,” finding that where gravamen of claim was breach of duty of disclosure, matters were intended to be entrusted to Delaware state court);
  - b) *Greaves v. McAuley*, No. CIV A 1:03-CV-0207-B, \_ F. Supp. 2d \_ [2003 WL 21277274] (N.D. Ga. Feb. 7, 2003) (Plaintiff, a shareholder of the defendant company, challenged the company’s announced plan to merge, asserting breach of fiduciary duty based on inadequate consideration to the public shareholders. The amended complaint included class and derivative claims, among them a claim for misrepresentations in the proxy statement regarding the consideration and the process of considering the merger. On receipt of the amended complaint, defendants removed under SLUSA. Held: the majority of the claims were excluded from SLUSA under the Delaware carve-out because they involved communications to shareholders under the law of the state of incorporation concerning decisions whether or not to vote for the merger).

## VII. The SLUSA Discovery Stay.

- A. One of the key elements of the PSLRA is the stay of discovery pending a court’s determination on a motion to dismiss the complaint. After the PSLRA’s enactment, plaintiffs would frequently file parallel federal and state proceedings in order to circumvent the discovery stay by obtaining discovery in the state court actions. By restricting plaintiffs’ ability to file in state court, SLUSA was intended to close this loophole. *See* Report of the House Committee on Commerce, H.R. 105-640, July 21, 1998, at 9.
- B. In addition to generally augmenting the reach of the PSLRA’s federal discovery stay through its preemptive effect, SLUSA also expressly provides that “upon a proper showing, a court may stay” discovery in a state action, “as necessary in aid of its jurisdiction, or to protect or effectuate judgments.” 15 U.S.C. § 77z-1(b)(4); 15 U.S.C. § 78u-4(b)(3)(D).
- C. **Derivative Actions.** The SLUSA discovery stay may be invoked to stay discovery in a state court derivative action. *See In re DPL Inc. Sec. Litig.*, 247 F. Supp. 2d 946, 949 (S.D. Ohio 2003).

1. Defendants in a federal securities action moved to invoke the SLUSA discovery stay as to four state court derivative actions based on similar allegations. The court rejected the argument that because derivative actions are themselves exempt from SLUSA, discovery may not be stayed, noting that the stay may extend to “any private action in a state court,” not only to “covered class actions.”
2. In so holding, the court disagreed with *In re Transcript Int’l Sec. Litig.*, 57 F. Supp. 2d 836 (D. Neb. 1999), which had held that only discovery in state class actions could be stayed. *Id.* at 948 n.6.
3. In granting the stay, the court applied the two-part test previously set forth in *Lapicola v. Alternative Dual Fuels, Inc.*, Fed. Sec. L. Rep. (CCH) ¶ 91,765, at 98,653 (N.D. Tex. Apr. 5, 2002), which requires that the stay be necessary both to: (1) prevent an unreasonable burden on defendants before the disposition of a motion to dismiss; and (2) avoid allowing plaintiffs to use discovery to support claims that do not meet the PSLRA pleading requirements. *DPL*, 247 F. Supp. 2d at 950.

D. **Third Party Standing to Invoke Stay**. In addition to litigants, third parties also have standing to invoke the discovery stay. *See In re Adelpia Communications Corp.*, 294 B.R. 39, 42-45 (S.D.N.Y. June 12, 2003) (Third party accounting firm sought to object to the form of proposed order on motion staying discovery, to the extent that it permitted third party document discovery in a related state court action. Held: while the auditor had standing to object, the court declined to exercise its discretion to stay document discovery where no discovery against the third party was presently sought and the issue could be decided by the state or federal trial courts).

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