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HIGH COURT RULES ON AVAILABILITY OF STATE SECURITIES CLASS ACTIONS

(Merrill Lynch, Pierce, Fenner & Smith v. Dabit)

The U.S. Supreme Court today found a broad range of state securities class actions to be preempted by the Securities Litigation Uniform Standards Act of 1998, or "SLUSA." The Court's decision reversed a restrictive interpretation of SLUSA by a federal appeals court. The Washington Legal Foundation (WLF) had filed a brief on November 14, 2005, supporting a broad reading of the law.

In the statute, Congress acted to curb abusive class action claims for securities fraud. SLUSA expressly preempts any class action based upon state law concerning a material misrepresentation or omission "in connection with the purchase or sale of a covered security." The U.S. Court of Appeals for the Second Circuit in this case read a restriction into the statute's preemption provision, holding that it allows suits to proceed in state court on behalf of persons who merely hold, rather than purchase or sell, securities.

The Court's unanimous opinion today noted that if owners of securities who did not buy or sell stock in response to the alleged securities fraud were able to bring suit for fraud, the result would be vexatious litigation that could "frustrate or delay normal business activity." The Court noted that Congress enacted SLUSA in response to efforts by the plaintiffs' bar to sidestep earlier federal reform litigation by shifting securities class actions from federal courts to state courts. The text and policy rationale of SLUSA, the Court found, applied in the context of holders no less than in the case of purchasers and sellers.

In its brief, WLF argued that the statute's language broadly preempts holder claims as well as purchaser and seller claims. WLF further argued that this plain-language interpretation of SLUSA is the only reading of SLUSA consistent with sound policy and common sense. Finally, WLF's brief argued that a broad reading of SLUSA is consistent with principles of federalism, noting that the Framers granted Congress the power to prescribe uniform national rules when necessary to promote the flourishing of interstate commerce, and that the flow of capital manifested in the trading of securities on national exchanges is interstate (and increasingly international) in character.

Donald B. Verrilli, Jr. of the Washington, D.C. office of Jenner & Block represented WLF on a *pro bono* basis.

WLF is a nonprofit, nonpartisan public interest law and policy center based in Washington, D.C., with supporters nationwide. WLF engages in litigation and participates in administrative proceedings to defend free enterprise, individual rights, and a balanced civil justice system. To that end, WLF has frequently appeared in federal and state courts to address the proper scope of federal preemption. In addition, WLF frequently publishes policy papers and takes part in litigation and agency proceedings to promote and defend legal rules that protect employees, pensioners, and investors from stock losses caused by abusive securities litigation. Among WLF's recent papers on this topic are James Maloney, *Strict Standing Requirement For Securities Fraud Suits Upheld* (2005); Lyle Roberts & Paul Chalmers, *Lower Courts Will Determine Impact Of Supreme Court's Securities Fraud Suit Ruling* (2005); and Neil M. Gorsuch & Paul B. Matey, *Settlements In Securities Fraud Class Actions: Improving Investor Protection* (2005).

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For further information, contact WLF Senior Vice President for Legal Affairs David Price, (202) 588-0302. A copy of the brief is posted on WLF's web site, www.wlf.org.