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Sixth Circuit Reinforces Limits on Class Action Securities Litigation

June 2, 2010

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In a recently issued opinion, Associate Justice Sandra Day O'Connor, sitting by designation on the Sixth Circuit, issued an opinion reinforcing the statutory restrictions designed to prevent abusive class action securities litigation. *Jerry L. Demings¸ et al., v. Nationwide Life Insurance, et al.*, 6th Cir. Nos. 08-4476 (Feb. 3, 2010). Discussing the Securities Litigation Uniform Standards Act of 1988 ("SLUSA"), the Court ruled that a sheriff's class action suit filed on behalf of all public employers who sponsor § 457 deferred compensation plans was precluded by SLUSA. Justice O'Connor noted that this conclusion "is bolstered by the fact that Congress meant SLUSA's preclusive effect to be broad and far reaching."

The case involved Sheriff Jerry L. Demings of Orange County, Florida, bringing a class action lawsuit against Nationwide Life Insurance Company and related entities. Nationwide had provided certain mutual funds and other products in which plan participants could invest their money. The claims arose out of the Sheriff's allegation that Nationwide received revenue-sharing payments from the mutual funds in which participants' funds were invested. He argued that Nationwide should have provided any revenue-sharing payments to the plan participants, instead of retaining those for itself.

The District Court ruled that the Sheriff's claim was precluded by SLUSA, since it was a class action suit alleging Nationwide's misrepresentation with respect to certain mutual funds. SLUSA precludes certain class actions from being brought in "any state or federal court alleging either "(1) an untrue statement or omission of 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 in such a purchase or sale."

On appeal, the Sheriff did not dispute SLUSA's preclusive reach, but cited an express exception written into the law, the so-called "state-actions exception." This exception states "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."

The Sixth Circuit ruled that a sheriff is certainly not a state or a state pension plan. The Court then examined whether he could arguably be a "political subdivision," but rejected that argument since the sheriff clearly brought the suit "on behalf of the plan," not on behalf of any political subdivision. The Court found Congressional intent for SLUSA's preclusive effect to be broad, counseling in favor of interpreting any exceptions narrowly.

In its ruling, the Sixth Circuit followed a similar interpretation by the Supreme Court in *Merrill Lynch, Pearce, Fenner and Smith, Inc. v. Dabut*, 547 U.S. 71 (2006). The *Dabut* decision discusses the history and purpose of SLUSA in light of prior case law, statutes, and regulations. SLUSA is simply one of the latest refinements of the Securities Act of 1933, the Securities Exchange Act of 1934, and SEC Rule 10b-5. Rule 10b-5 broadly prohibits deception, misrepresentation, and fraud in connection with the purchase or sale of any security. U.S. Courts have recognized that "litigation under Rule 10b-5 presents a danger of vexatiousness different in degree and in kind from that which accompanies litigation in general." *Blue Chip Stamps v. Manor Drug Stores*, 421 U.S. 723, 739 (1975). Even weak cases can have substantial settlement value because the "very pendency of the lawsuit may frustrate or delay normal business activity." *Id.* at 740.

These policy considerations lead Congress in 1995 to adopt the Private Securities Litigation Reform Act ("PSLRA"), aimed at class action suits. The PSLRA imposed certain limits on damages and attorney fees, provided a safe harbor for forward-looking statements, imposed restrictions on selection of lead plaintiffs, and mandated imposition of sanctions for frivolous litigation, among other provisions. The effort had an unintended consequence in that it prompted some plaintiffs attorneys to avoid the federal forum altogether, and file instead under state law, often in state court. This reality lead Congress to adopt SLUSA, which precluded certain class action suits from being "maintained in any state or federal court."

Against this background of Congressional intent, Justice O'Connor issued her decision, sitting by designation on the Sixth Circuit. Her decision shows that counsel seeking to bring class action securities litigation are finding their options to be limited. Unless the complaint clearly invokes some of the statutory safe harbors or exceptions, Courts can easily find basis to dismiss the suit. In dismissing a sheriff's securities-related class action in this case, Justice O'Connor has further reinforced SLUSA's broad preclusive effect.