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Developing a Precise Definition: The Fifth Circuit Addresses the Scope of the "In Connection With" Requirement Under SLUSA

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DEVELOPING A PRECISE DEFINITION: THE FIFTH CIRCUIT ADDRESSES THE SCOPE OF THE "IN CONNECTION WITH" REQUIREMENT UNDER SLUSA

INTRODUCTION

Congress passed the Securities Litigation Uniform Standards Act (SLUSA) in 1998 as an effort to close a loophole from the 1995 enactment of the Private Securities Litigation Reform Act (PSLRA).[1] Under the PSLRA, plaintiffs filing class action securities fraud cases in federal court became subject to heightened pleading requirements and other procedural hurdles, thereby making it more difficult to bring such claims.[2] Plaintiffs' attorneys, however, circumvented the procedural obstacles simply by filing claims in state court, often alleging violations of state law.[3] Plaintiffs' ability to file these claims in state court undermined the strength and purpose of the PSLRA,[4] that is, to "weed out non-meritorious actions at the pleadings stage, [and] discourag[e] strike suits."[5] Congress became aware of this "unintended consequence"[6] of the PSLRA and in response, enacted SLUSA to preempt many state-law claims for securities fraud class actions.[7]

SLUSA closed the gap that the PSLRA inadvertently left open because it preempted many state-law claims for securities fraud litigation. Congress intended for SLUSA to help end abuses in bringing class action suits that often targeted deep-pocketed defendants, were frivolous, and in the aggregate, threatened the United States securities markets.[8] Prior to SLUSA's enactment, the ever-increasing costs of defending class action suits led corporations to "[become] quick to settle rather than to fight

1. Rex M. Shannon III, *Securities Fraud-Federal Preemption-SLUSA Preempts State-Law Class Actions Brought by Holders of Covered Securities*, 76 MISS. L.J. 323, 331 (2006).

2. Jennifer O'Hare, *Preemption Under the Securities Litigation Uniform Standards Act: If it Looks Like a Securities Fraud Claim and Acts Like a Securities Fraud Claim, Is it a Securities Fraud Claim?*, 56 ALA. L. REV. 325, 335 (2004).

3. Roland v. Green, 675 F.3d 503, 507 (5th Cir. 2012), *cert. granted*, 133 S. Ct. 978 (U.S. Jan. 18, 2013) (No. 12–88); Jennifer J. Johnson, *Secondary Liability for Securities Fraud: Gatekeepers in State Court*, DEL. J. CORP. L. 463, 487 (2011).

4. *Roland,* 675 F.3d at 507.

5. O'Hare, *supra* note 2, at 336.

6. *Roland*, 675 F.3d at 507.

7. O'Hare, *supra* note 2, at 352–53 (internal quotation marks omitted) ("[C]ourts have had to determine what class actions are preempted by SLUSA. To answer this question, the great majority of courts have looked to the statute's plain language and adopted a four-part test. Under this test, SLUSA applies if the defendant can show that (1) the suit is a covered class action, (2) the plaintiff's claims are based on state law, (3) there has been a purchase or sale of a covered security, and (4) the plaintiff has alleged a misrepresentation or omission of material fact 'in connection with' the purchase or sale of such security.").

8. *Roland*, 675 F.3d at 507.

meritless claims and bear the expense of litigation."[9] Corporations faced a difficult predicament—they could spend an exorbitant amount of money defending a meritless suit or they could spend a somewhat less exorbitant amount of money settling the suit. Corporate defendants, concerned with their bottom lines, their shareholders, and maintaining their good names and reputations, often settled as the better of two poor alternatives.[10] SLUSA acted as a means to bolster the PSLRA's goal of protecting "the integrity of American capital markets" and preventing the system from being "undermined by those who seek to line their own pockets by bringing abusive and meritless suits."[11]

One of SLUSA's key provisions "prohibit[s] private parties from bringing covered class actions based on state law in either state or federal court when such actions allege fraud *in connection with* the purchase or sale of covered securities."[12] Thus, SLUSA effectively closes the loophole created by the PSLRA by prohibiting securities fraud class action litigation based on state law from proceeding in state or federal court. This forces the remaining, permissible securities class action litigation based on federal law to be subject to the heightened pleading standards required by the PSLRA. The statute's "in connection with" language "serves as the essential nexus between the fraud and the securities transaction."[13] As such, plaintiffs must allege that the particular fraud at hand was connected on a certain level to the purchase or sale of the securities. When the alleged fraud is "sufficiently detached" from a securities transaction, the requirement is not met and the class action may survive dismissal at the pleadings stage and proceed as a state-law claim.[14] The relevant inquiry in these cases is assessing "deception in connection with the purchase or sale of any security, not deception of an identifiable purchaser or seller."[15] The "in connection with" requirement

9. Ethan H. Townsend, *One Nation, Under Securities Fraud? The Third Circuit Notches a Win for Federalism in* In re Lord Abbett Mutual Funds Fee Litigation, 55 VILL. L. REV. 1059, 1064 (2010).

10. *See, e.g.*, Diana B. Henriques, *INVESTING IT; Making it Harder for Investors to Sue*, N.Y. TIMES, Sept. 10, 1995, http://www.nytimes.com/1995/09/10/business/investing-it-making-it-harder-for-investors-to-sue.html?pagewanted=all&src=pm; Leslie Eaton, *Class-Action Lawsuits by Investors Are Not Turning out Exactly as Congress Planned.*, N.Y. TIMES, Feb. 27, 1997, http://www.nytimes.com/1997/02/27/business/class-action-lawsuits-investors-are-not-turning-exactly-congress-planned.html.

11. Townsend, *supra* note 9, at 1065 n.37 (citing H.R. REP. NO. 104-369, at 31–32 (1995)); *see also* Jeffrey W. Apel, *Eliminating Claims That Jeopardize the Stature of American Capital Markets*, 5 DEPAUL BUS. & COM. L.J. 605, 607 (2007). There is certainly some inherent risk to investing in companies listed on the American stock exchanges, but the added risk of corporations having to defend strike suits should not be added to the already complex mix of risks that investors consider when deciding to invest in those particular companies. *Id.*

12. Shannon, *supra* note 1, at 323 (emphasis added) (internal quotation marks omitted) (citing Securities Litigation Uniform Standards Act of 1998, 15 U.S.C. § 78bb(f)(1) (1998)).

13. Apel, *supra* note 11, at 609.

14. United States v. O'Hagan, 521 U.S. 642, 657 (1997).

15. *Id.* at 658 (internal quotation marks omitted).

ensures that the relationship between the fraud and the securities transaction is not too attenuated, as is often the case in strike suits.[16] SLUSA thus makes it more difficult for the plaintiffs' bar to bring class action securities fraud claims because the statute contains a parallel provision,[17] stating, "Any covered class action brought in any State court involving a covered security . . . shall be removable to the Federal district court."[18] Once removed, it is consequently subject to dismissal under the PSLRA.[19]

The remainder of this note will trace the legislation leading up to the passage of SLUSA and subsequently will evaluate the Fifth Circuit's application in *Roland v. Green* of the key SLUSA provision—that the alleged fraud be "in connection with" the securities transaction.[20] Part II describes the history and background leading to Congress' 1998 enactment of SLUSA. Part III explains that, because the question of determining the scope of the "in connection with" requirement and the "coincide" language found in *SEC v. Zandford*[21] and in *Merrill Lynch, Pierce, Fenner & Smith v. Dabit*[22] was a matter of first impression for the Fifth Circuit, the court necessarily had to develop a test to apply the standard. Part III further analyzes how other circuit courts have tried to give dimension to the "coincide" requirement. Part IV of this note argues that the Fifth Circuit's adoption of the Ninth Circuit's interpretation supports both legislative intent and the Supreme Court's broad reading of the "in connection with" language and consequently offers the intended protection to corporate defendants in securities fraud class action litigation.

I. HISTORY AND BACKGROUND OF SLUSA

Following the stock market crash of 1929, Congress sought to strengthen investor confidence in the national securities markets[23] and to protect such markets through the Securities Act of 1933 and the Securities Exchange Act of 1934.[24] The Securities and Exchange Commission (SEC),

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16. A strike suit is one in which plaintiffs file a frivolous or non-meritorious suit for the purpose of extracting a high settlement from the corporate defendants. *See* O'Hare, *supra* note 2, at 338–39 (citing H.R. CONF. REP. NO. 105-803, at 13 (1998)). Plaintiffs' attorneys file suit knowing their claim is not particularly strong, yet the massive costs of discovery and defending the suit coerces defendants into quickly settling to get rid of the suit and to avoid potentially massive adverse financial consequences. *See id*.

17. Madden v. Cowen & Co., 576 F.3d 957, 965 (9th Cir. 2009) (citing Spielman v. Merrill Lynch, Pierce, Fenner & Smith, Inc., 332 F.3d 116, 131 (2d Cir. 2003) (Newman, J., concurring)) "Any suit removable under SLUSA's removal provision . . . is precluded under SLUSA's preclusion provision . . . and any suit not precluded is not removable." *Id*. This is illustrative of the fact that "SLUSA's removal and preclusion provisions are 'opposite sides of the same coin.'" *Id*.

18. 15 U.S.C. § 77bb(f)(2) (1998); Roland v. Green, 675 F.3d 503, 507 (5th Cir. 2012).

19. *Roland*, 675 F.3d at 507–08.

20. *Id.* at 503.

21. SEC v. Zandford, 535 U.S. 813 (2002).

22. Merrill Lynch, Pierce, Fenner & Smith Inc. v. Dabit, 547 U.S. 71 (2006).

23. *Zandford*, 535 U.S. at 819.

24. *See Dabit*, 547 U.S. at 78; Shannon, *supra* note 1, at 326.

acting through the power that the 1934 Act granted to it,[25] promulgated Rule 10b-5, which expressly prohibited "fraud and deceit 'in connection with the purchase or sale of any security.'"[26] Specifically, Rule 10b-5 states,

> It shall be unlawful for any person, directly or indirectly, by the use of any means or instrumentality of interstate commerce, or of the mails or of any facility of any national securities exchange,
>
> (a) To employ any device, scheme, or artifice to defraud,
>
> (b) To make any untrue statement of a material fact or to omit to state a material fact necessary in order to make the statements made, in the light of the circumstances under which they were made, not misleading, or
>
> (c) To engage in any act, practice, or course of business which operates or would operate as a fraud or deceit upon any person,
>
> in connection with the purchase or sale of any security.[27]

By empowering the SEC to promulgate such a rule, Congress intended to promote investor confidence by requiring, among other things, disclosure and truthfulness in securities transactions.[28] Decades later in 1995, though the 1934 Act and Rule 10b-5 still governed modern securities transactions, Congress addressed a new challenge. It sought to find a balance between potentially frivolous lawsuits alleging federal securities fraud and protecting the securities market and its investors.[29]

Congress had become increasingly aware of "perceived abuses of the class-action vehicle in litigation involving nationally traded securities"[30] and passed the PSLRA as an effort to curb these practices.[31] The goal of the PSLRA was to ensure that securities fraud cases were proper and not merely "frivolous litigation."[32] Such frivolous litigation would likely cause excessive, inappropriate, or unwarranted harm to corporate defendants in the form of exceedingly high litigation or settlement costs.[33] Congress'

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25. 15 U.S.C. § 78j(b) (1998); *Dabit*, 547 U.S. at 78–79.

26. Shannon, *supra* note 1, at 327; *see also* 17 C.F.R. § 240.10b-5 (2012).

27. 17 C.F.R. § 240.10b–5.

28. Shannon, *supra* note 1, at 336.

29. *See* William B. Snyder, Jr., *The Securities Act of 1933 After SLUSA: Federal Class Actions Belong in Federal Court*, 85 N.C. L. REV. 669, 696–97 (2007).

30. Roland v. Green, 675 F.3d 503, 507 (5th Cir. 2012) (quoting *Dabit*, 547 U.S. at 81); *see also* Apel, *supra* note 11, at 616 (explaining that Congress relied "heavily on a study published by Stanford law professor Michael Perino, [and] took notice of the shift of plaintiffs beginning to file their securities suits in state court as opposed to federal court"); Michael A. Perino, *Fraud and Federalism: Preempting Private State Securities Fraud Causes of Action*, 50 STAN. L. REV. 273, 274 (1998).

31. Shannon, *supra* note 1.

32. *See* O'Hare, *supra* note 2, at 337.

33. *See* Townsend, *supra* note 9, at 1065 n.37. Another critical feature of the PSLRA that aimed to protect corporate defendants from strike suits is the stay on discovery that attaches once defendants file a motion to dismiss. O'Hare, *supra* note 2, at 335.

enactment of securities fraud legislation targeted the "tension between the federal interest of protecting investors in nationally traded securities and the practical need to protect normal business activity from vexatious litigation."[34] Thus, the PSLRA came into being.

Congress had a strong interest in ensuring that securities fraud class actions were brought in federal court because, among other reasons, corporations were unable to detect where their securities were being traded after the initial public offering.[35] When a corporation does not know in which states its securities are trading, it in turn does not know in which and in how many states it will be subject to litigation should a plaintiff file suit under state law. If plaintiffs were able to bring state-law claims, corporations could be subject to litigation in all fifty states according to fifty different sets of laws.[36] If any one state were particularly hostile to corporate defendants and strongly favored plaintiffs, it could "impose the risks and costs of its peculiar litigation system on all national issuers."[37] Ultimately, these suits could topple corporations as they would be forced to engage in extensive discovery for duplicative lawsuits in numerous states or risk a large adverse judgment.[38] With an eye toward allowing meritorious litigation to proceed but preventing strike suits, Congress sought to enact legislation that would balance these two competing, and often intertwined, interests via heightened procedural requirements. Such legislation revealed Congress' "preference for national standards for securities class action lawsuits involving *nationally* traded securities"[39] as emphasized in SLUSA.

A. PLAINTIFF CIRCUMVENTION OF THE PSLRA

The heightened pleading requirements and other procedural hurdles central to the PSLRA[40] worked to prevent, or alternatively to dismiss, frivolous cases filed in federal court. The language of the PSLRA, however, had inadvertently created a means for plaintiffs to circumvent the tough procedural requirements simply by filing state-law securities fraud claims in state courts.[41] Congress took note that plaintiffs' ability to bring state-law actions in state court "frustrate[d] the objectives of the PLSRA"[42] merely by

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34. Siepel v. Bank of America, N.A., 526 F.3d 1122, 1125 (8th Cir. 2008).
35. *Roland*, 675 F.3d at 517 (citing H.R.REP. NO. 105-803, at 15 (1998)).
36. O'Hare, *supra* note 2, at 339.
37. *Roland*, 675 F.3d at 517 (citing H.R.REP. NO. 105-803, at 15 (1998)). In addition to the possibility of corporate defendants becoming subject to litigation in all fifty states, Congress was particularly concerned that federal law should govern securities traded on the national markets because investors, buying and selling securities in every state, "rely on information distributed on a national basis." *Id.* at 517–18 (citing 144 Cong. Rec. 4799 (1998) (statement of Sen. Joseph Lieberman)).
38. *See Siepel*, 526 F.3d at 1126.
39. *Roland*, 675 F.3d at 517.
40. *See* Romano v. Kazacos, 609 F.3d 512, 517 (2d Cir. 2010).
41. *See id.*
42. *Roland*, 675 F.3d at 507.

plaintiffs' choice of forum.[43] SLUSA was enacted as a remedy to ensure that plaintiffs could not escape the PSLRA merely by forum selection[44] and a well-pleaded complaint.[45] Consequently, it became more difficult for plaintiffs to bring state-law securities fraud cases under the new statute.[46]

SLUSA was to be a remedy for cases in which plaintiffs frustrated the purpose of the PSLRA by avoiding federal court and choosing instead to bring actions in state court. SLUSA provides, in relevant part:

> No covered class action 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 a misrepresentation or omission of a material fact *in connection with* the purchase or sale of a covered security.[47]

SLUSA ensured that most securities fraud class actions would be brought in federal court and therefore "subject to the jurisprudence of Rule 10b-5 and the procedural requirements of the PSLRA."[48] While Congress and the SEC had recognized the need for plaintiffs to vindicate their rights in court, they were also seriously concerned about plaintiffs abusing the class action system.[49] Congress' concern that "private securities fraud class actions were injur[ing] the entire U.S. economy by rewarding nuisance filings, targeting . . . deep-pocket defendants, [and facilitating] vexatious discovery requests"[50] led to the enactment of SLUSA.[51]

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43. *Id.*

44. *See* Melanie P. Goolsby, *Merrill Lynch v. Dabit: The Case of the Scorned Broker and the Death of the State Securities Fraud Class Action Suit*, 67 LA. L. REV. 227, 235 (2006); Shannon, *supra* note 1; Perino, *supra* note 30, at 309.

45. *Roland*, 675 F.3d at 520–21 (citing Segal v. Fifth Third Bank, N.A., 581 F.3d 305, 308 (6th Cir. 2009)). It is well established that, although the plaintiff is the master of his complaint and he may specifically engineer the language to avoid a claim that would lead to dismissal under SLUSA, "[c]ourts may look to—they must look to—the substance of a complaint's allegations in applying SLUSA. Otherwise, SLUSA enforcement would reduce to a formalistic search through the pages of the complaint for magic words . . . and nothing more." *Id.*; *see also* O'Hare, *supra* note 2, at 344–45; *Romano*, 609 F.3d at 523 ("SLUSA requires our attention to both the pleadings and the realities underlying the claims.").

46. Instituto de Prevision Militar v. Merrill Lynch, 546 F.3d 1340, 1345 (11th Cir. 2008).

47. 15 U.S.C. § 78bb (1998) (emphasis added); *see also* Merrill Lynch, Pierce, Fenner & Smith Inc. v. Dabit, 547 U.S. 71, 83–84 (2006) ("A 'covered class action' is a lawsuit in which damages are sought on behalf of more than 50 people. A 'covered security' is one traded nationally and listed on a regulated national exchange.").

48. Johnson, *supra* note 3, at 488.

49. *The Securities Litigation Uniform Standards Act of 1997: Hearing on S. 1260 Before the Subcomm. on Secs. of the S. Comm. on Banking, Hous., and Urban Affairs*, 105th Cong. 4 (1997) [hereinafter SEC Testimony], *available at* http://www.sec.gov/news/testimony/testarchive/1997/tsty1997.txt ("Although the Commission staunchly defends the right of defrauded investors to seek meaningful relief, we are sensitive to the burdens imposed on corporations by abusive litigation, which increases the cost of capital formation.").

50. *Instituto de Prevision Militar*, 546 F.3d at 1344 (internal quotations marks omitted) (citing *Dabit*, 547 U.S. at 81).

51. O'Hare, *supra* note 2, at 338.

Both Congress and the courts have noted that nuisance filings were dangerous because "the costs of discovery and the risk of a massive judgment" meant that "even a meritless lawsuit could extract a sizeable settlement from a defendant,"[52] when no such settlement may have been warranted. Congress determined, through its passage of the PSLRA and SLUSA, that plaintiffs seeking to line their pockets via strike suits[53] against corporations in the national securities market abused the class action system in a way that was never intended and that ought to be curbed to prevent unnecessary risk and harm to issuers of securities.[54] Both Congress and the courts have understood the "widespread recognition that 'litigation under Rule 10b-5 presents a danger of vexatiousness different in degree and in kind from that which accompanies litigation in general.'"[55] As a result of this unique aspect of Rule 10b-5 litigation, Congress and the courts felt corporate defendants were entitled to greater protection, a result Congress sought to attain by enacting SLUSA's heightened pleading requirements for plaintiffs.

B. THE BROAD SCOPE OF THE "IN CONNECTION WITH" LANGUAGE

The Supreme Court has held that the "in connection with" language found in both SLUSA and in Rule 10b-5 should be "construed flexibly, not technically or restrictively."[56] As the exact same language found in Rule 10b-5 is also present in both the PSLRA and SLUSA,[57] Congress was "hardly . . . unaware of the broad construction adopted by [the Supreme Court] and the SEC."[58] It therefore intended for the language to have the same meaning and broad scope it had in both statutes.[59] While plaintiffs seeking to recover in securities fraud class actions have often argued that

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52. Siepel v. Bank of America, N.A., 526 F.3d 1122, 1126 (8th Cir. 2008); *see e.g.*, Henriques, *supra* note 10.

53. *See* Merrill Lynch, Pierce, Fenner & Smith Inc. v. Dabit, 547 U.S. 71, 78 (2006) ("The magnitude of the federal interest in protecting the integrity and efficient operation of the market for nationally traded securities cannot be overstated.").

54. *See* James D. Cox, Randall S. Thomas, & Lynn Bai, *There are Plaintiffs and…There are Plaintiffs: An Empirical Analysis of Securities Class Action Settlements*, 61 VAND. L. REV. 355, 357 (2008); Snyder, *supra* note 29, at 670.

55. *Dabit*, 547 U.S. at 80 (citing Blue Chip Stamps v. Manor Drug Stores, 421 U.S. 723, 739 (1975)).

56. *Siepel*, 526 F.3d at 1127 (citing SEC v. Zandford, 535 U.S. 813, 819 (2002)); *see also Dabit*, 547 U.S. at 85.

57. 15 U.S.C. § 78bb (1998). SLUSA provides that private parties are prohibited from bringing securities fraud class actions whereupon the defendant deceived the plaintiff "in connection with the purchase or sale" of a covered security. *Id.* Rule 10b-5 prohibits fraud and deceit "in connection with the purchase or sale" of any security. 17 C.F.R. § 240.10b–5 (2012). Section 10(b) of the 1934 Act, too, prohibits manipulation or deception "in connection with the purchase or sale" of securities. 15 U.S.C. § 78j (2012).

58. Roland v. Green, 675 F.3d 503, 512 (5th Cir. 2012); *see also* SEC Testimony, *supra* note 49, at 13 ("The fraud language of [SLUSA] tracks the antifraud provisions of the securities laws Section 17(a) of the Securities Act . . . and Section 10(b) of the Exchange Act.").

59. *Roland*, 675 F.3d at 512.

the SLUSA language should be interpreted narrowly and restrictively,[60] particularly when interpreting the meaning of "in connection with," courts have consistently held otherwise.[61] When Congress enacted SLUSA, it recognized that it employed the exact same language as in Rule 10b-5. Congress had done this intentionally to ensure that SLUSA would have the same meaning, depth, and breadth as the identical language found in Rule 10b-5.[62] The Supreme Court's "express reliance" on policy considerations[63] has provided the general backdrop from which the Fifth Circuit later formulated its standard.

The Supreme Court held in *Zandford* and *Dabit*, as did numerous circuit courts, that Congress was "aware of the terminology and meaning attached"[64] to the language when it drafted SLUSA, and thus the language's broad scope[65] found in Section 10(b) should apply. Such a broad reading of the language reflects both legislative intent and policy considerations, namely, to provide a strong bulwark against abuses of class action suits and to protect the national securities markets.[66] When "in connection with" is read broadly in the statute, it preempts more allegations of fraud based on state law and funnels the remaining claims based on federal law through the PSLRA's heightened pleading standards in federal court. Conversely, when interpreted narrowly, the statutory language is a weak defense against frivolous suits[67] because it allows a greater range of cases to properly be brought and survive dismissal at the pleadings stage.

As a matter of policy, the drafters of the legislation and the courts hearing securities fraud class actions have generally decided that it is of primary importance to protect defendant corporations from meritless suits. This goal is achieved by interpreting the statutory language to cast a wide net over the alleged fraud covered by SLUSA's "preemptive sweep."[68] Because "[t]he 'in connection with' requirement is a means of testing whether the connection between securities, or even securities markets generally, and the fraud alleged, is too attenuated,"[69] it is a critical component in determining and implementing the policy goals of the legislation. If SLUSA's key provisions were construed narrowly, plaintiffs would be able to meet the heightened pleading requirements with relative ease. Plaintiffs would properly be able to claim more instances of alleged

60. S*ee, e.g.*, *Siepel*, 526 F.3d at 1127.
61. S*ee, e.g.*, *id.*
62. Merrill Lynch, Pierce, Fenner & Smith Inc. v. Dabit, 547 U.S. 71, 85–86 (2006).
63. *Roland*, 675 F.3d at 517.
64. O'Hare, *supra* note 2, at 365.
65. SEC v. Zandford, 535 U.S. 813, 819 (2002).
66. *See* Apel, *supra* note 11, at 613.
67. *Dabit*, 547 U.S. at 86.
68. *Id.*
69. ARTHUR R. PINTO & DOUGLAS M. BRANSON, UNDERSTANDING CORPORATE LAW 420 (3d ed. 2009) (citing Ketchum v. Green, 557 F.2d 1022, 1029 (3d Cir. 1977).

fraud in connection with more securities transactions, and a greater degree of vexatious litigation would threaten corporate defendants. Such a result would make the key SLUSA provision rather inconsequential, even futile, in its goal of strengthening the PSLRA.

Allowing more cases to slip through SLUSA's grasp would do little to close the gap the PSLRA left open, and would not afford sufficient protection for securities markets. This potentially adverse consequence reveals the legislative intent behind SLUSA as well as the SEC's consistently broad reading of Rule 10b-5—both Congress and the SEC sought to protect against undermining the purpose of the statute through their broad interpretations of the language.[70] These logical inferences about SLUSA's underlying policy goals should be given a certain degree of deference when courts interpret the statutory language to apply SLUSA preclusions. A broad construction of "in connection with" serves not only to protect individual corporate defendants from the major risk of litigating or settling frivolous suits, but also to protect the national securities markets as the cornerstone of the American economy.[71]

II. THE FIFTH CIRCUIT ADDRESSES THE "COINCIDE" LANGUAGE AS A MATTER OF FIRST IMPRESSION

The Fifth Circuit had not determined "what connection between a fraud and transactions in covered securities is required for SLUSA preclusion to apply,"[72] and correspondingly, the meaning of the "in connection with" and "coincide" language, until its 2012 decision of *Roland v. Green*.[73] The *Roland* court addressed a "consolidated appeal aris[ing] out of an alleged multi-billion dollar Ponzi scheme."[74] The SEC and different groups of investors alleged that defendants misrepresented the value and stability of securities they sold to plaintiffs, resulting in staggering financial losses.[75] Employing the state class action vehicle, plaintiffs sought to recover for their losses.[76] As such, the court addressed the issue of "the scope of the 'in connection with' language under SLUSA [as] one of first impression."[77] The process of developing and applying a standard to interpret the statutory language called upon the court to explore other circuit courts' interpretations of the same language and to use those findings to inform its analysis.

70. *Zandford*, 535 U.S. at 819; *see Dabit*, 547 U.S. at 85.
71. *See* Apel, *supra* note 11, at 607.
72. Roland v. Green, 675 F.3d 503, 510 (5th Cir. 2012).
73. *Id.* at 511.
74. *Id.* at 506.
75. *See id.* at 508–09.
76. *Id.* at 506.
77. *Id.*

The Fifth Circuit analyzed how the Second, Sixth, Seventh, Eighth, Ninth, and Eleventh Circuits construed the "coincide" language that the *Dabit* court required for SLUSA preclusion to apply. It then credited or discredited varying analyses based upon whether that circuit's particular construction of the nexus requirement precisely met the "coincide" language, and consequently, the "in connection with" requirement.[78] The Supreme Court's test—whether the fraud *coincides* with a securities transaction—was "not particularly descriptive,"[79] and thus it rested upon the individual circuit courts to analyze and interpret the "coincide" requirement under SLUSA. The Fifth Circuit's interpretation and application of the "coincide" language, though not a flawless one, best reflects the underlying considerations that Congress, the SEC, and the courts have taken into account since SLUSA was first enacted.[80]

A. SISTER CIRCUITS' INSUFFICIENT INTERPRETATIONS OF THE "COINCIDE" LANGUAGE: SIXTH, SEVENTH, AND EIGHTH CIRCUITS

The *Roland* court noted that the Sixth, Seventh, and Eighth Circuits did not define the "in connection with" and "coincide" language succinctly and precisely enough to assist the Fifth Circuit in developing its own standard. The subsequent analysis presents the ineffective tests by which courts have promulgated a meaning of the "in connection with" requirement. As will be shown, none illustrate what it truly means for an alleged fraud to coincide with a securities transaction.[81] The relevant facts and application of law from cases in each of the three above-mentioned circuits are discussed below.

1. A Nexus More Intimately Related to Fraud than "Coincide" and Failure to Define "Coincide" Itself: The Sixth and Eighth Circuits

A particular problem the Fifth Circuit faced when assessing the Sixth and Eighth Circuits' standards arose when those courts failed to establish precisely what nexus the alleged fraud and securities transaction must have to *coincide* with each other, and alternatively, when such nexus is *more* intimately related than *coincide* requires. In failing to address what it actually means for the fraud and transaction to coincide, these courts could not provide meaningful guidance to the Fifth Circuit, whose task was to formulate such a demarcation in applying the SLUSA language.

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78. *Id.* at 512.
79. *Id.*
80. *See* SEC Testimony, *supra* note 49, at 2 ("We commend the Subcommittee for its continuing efforts to focus on the question of whether frivolous securities litigation threatens to inhibit capital formation and harm investors.").
81. *Roland*, 675 F.3d at 513.

a. The Sixth Circuit: Segal v. Fifth Third Bank

In 2009, the Sixth Circuit in *Segal v. Fifth Third Bank, N.A.* addressed the "in connection with" requirement that must be met to preclude securities fraud class actions based on state law under SLUSA. In *Segal*, plaintiff was a beneficiary of trust accounts administered by defendant Fifth Third Bank.[82] In bringing a class action suit on behalf of "himself, his children, and all beneficiaries of trust, estate, or other fiduciary accounts for which the Bank . . . acted as a . . . corporate fiduciary,"[83] plaintiff alleged that Fifth Third breached its fiduciary and contractual duties to the class. The district court, applying SLUSA, dismissed the action for failure to state a claim because the action involved "fifty or more people seeking to vindicate state-law securities-related claims," which constituted a class action.[84] On appeal, the Sixth Circuit affirmed.

The Sixth Circuit noted that the SLUSA language was to be interpreted broadly, as the Supreme Court recognized in *Zandford* and in *Dabit*,[85] and as Congress had intended when it drafted the legislation.[86] Understanding the Supreme Court's use of "coincide" to be tantamount to "in connection with," the court held that "All of Segal's counts—breach of fiduciary duty, unjust enrichment, breach of contract—*revolve around* Fifth Third's decision to buy mutual fund shares. Segal's allegations do not *merely coincide* with securities transactions; they *depend on them*."[87] The court's analysis clearly shows that it believed that *depended on* represented a much closer nexus than did *coincide*. In holding that the fraud *depended on* the securities transaction, the Sixth Circuit did not establish a clear standard of what it meant for an alleged fraud and a securities transaction to *coincide*. It did not draw a bright line showing the precise point where the fraud and transaction meet the coincide test, and where such fraud and where they escape SLUSA preclusion.

Because the court in *Segal* believed that the allegations did not *merely* coincide with the transactions, the court did not actually define what it means to *coincide* in its opinion. Rather, the court explained what it meant for such a transaction to have a nexus to the fraud that goes *beyond* coincide. Hence, the Fifth Circuit justifiably gave minimal weight to the Sixth Circuit's discussion of the "in connection with" requirement when developing its own standard. *Segal* described only a nexus that was more intimately related than one in which the fraud and securities transaction coincide.

82. Segal v. Fifth Third Bank, N.A., 581 F.3d 305, 308 (6th Cir. 2009).
83. *Id.* (internal quotation marks omitted).
84. *Id.*
85. *Id.* at 309–10.
86. *Id.* at 310.
87. *Id.* (emphasis added) (internal quotation marks omitted).

b. The Eighth Circuit: Siepel v. Bank of America

In *Siepel v. Bank of America, N.A.*,[88] the Eighth Circuit did not apply a definition that precisely interpreted the coincide standard established by the Supreme Court. Rather, the court applied a standard that most certainly required a much closer nexus than "coincide."[89] In *Siepel*, the court addressed whether SLUSA preempted "state-law claims that a trustee breached its fiduciary duty by failing to disclose conflicts of interest in its selection of nationally-traded investment securities."[90] Plaintiffs, beneficiaries of trust accounts that Bank of America maintained, alleged, inter alia, state-law claims in a class action suit.[91] In Bank of America's plan to consolidate its trust management activities, its clients were

> led to believe that their assets were being managed on an individualized basis, when in fact the assets were being invested in shares of the Nations Funds mutual fund, managed by an investment company substantially owned by the Bank.[92]

Plaintiffs claimed that Bank of America had invested the assets in this fashion to "indirectly extract additional fees and profits."[93] Further, Bank of America sent "misleading letters to co-trustees and beneficiaries touting the advantages of . . . Nations Funds and threatening adverse tax consequences if the recipients objected."[94] At this time, the Bank failed to disclose the "conflict of interest, higher expenses, and increased tax liability that would result from Bank of America's diversion of trust assets to Nations Funds."[95]

Plaintiffs brought suit in district court, where the court dismissed the federal claims on the merits and held the state-law claims to be precluded by SLUSA's reach.[96] The district court found that the alleged misrepresentations and omissions of material facts were "central"[97] to plaintiffs' state-law claims and therefore were "in connection with" the securities transaction.[98] Because the court found the alleged fraud to be

88. Siepel v. Bank of America, N.A., 526 F.3d 1122 (8th Cir. 2008).
89. *See id.* at 1125.
90. *Id.* at 1124.
91. *Id.*
92. *Id.*
93. *Id.*
94. *Id.* (internal quotation marks omitted).
95. *Id.*
96. *Id.*
97. *Id.* at 1125. "Central" is defined as "containing or constituting a center . . . relevant or pertinent to a center . . . belonging to the center as [the] most important part." WEBSTER'S THIRD NEW INTERNATIONAL DICTIONARY 363 (1993). "Coincide" is defined as "to occupy the same place in space . . . to occur at the same time or occupy the same period of time." WEBSTER'S THIRD NEW INTERNATIONAL DICTIONARY 441 (1993).
98. The Supreme Court has never interpreted "in connection with" to mean something that is so essential to a claim of fraud as the Eighth Circuit did when it affirmed the district court's interpretation of the nexus between the fraud and transaction as "central." *See* Merrill Lynch, Pierce, Fenner & Smith Inc. v. Dabit, 547 U.S. 71 (2006); SEC v. Zandford, 535 U.S. 813 (2002).

"central" to the transactions, SLUSA mandated dismissal.[99] Fraud that is *central* to a securities transaction necessarily *coincides* with such a transaction because *coincide* encompasses a much broader array of relationships than does *central*. It follows then, that if an alleged fraud is central to a securities transaction, it must also coincide with that transaction. The Fifth Circuit certainly did not express any doubt as to whether the preceding logic is true; it did, however, doubt that such logic was useful when the court needed to employ an exact definition of coincide.[100] The Eight Circuit did not entertain the idea that "central" goes far beyond "coincide" and therefore is not a precise enough match in terms of defining the necessary nexus between the alleged fraud and the purchase or sale of the securities in question.

Such a narrow reading is contrary to the legislative history and purpose of the SLUSA preclusion, and as such, the definition was of little use to the Fifth Circuit in *Roland*.[101] Because *central* is a much closer nexus than is *coincide*, the court did not promulgate a standard to best determine the meaning of coincide. *Central* fits within the much broader net of *coincide*, and per the Eighth Circuit, claims central to securities transactions meet the "in connection with" standard. However, the court does not actually explain what it means to merely *coincide*, which is the necessary inquiry.

2. A Standard Too Attenuated to Satisfy the "Coincide" Language: The Seventh Circuit's *Gavin v. AT&T Corp.*

The 2006 decision of *Gavin v. AT&T Corp.*[102] presents a case where the plaintiff, on behalf of a class of shareholders of MediaOne Group, sued defendants in state court after the completion of a June 2000 MediaOne and AT&T merger. The terms of the merger entitled MediaOne shareholders to a "Standard Election" share-cash package or other combination of "shares and cash that would be equal in value" to the Standard Election if they preferred.[103] In three letters dated June 15, 2000, August 1, 2000, and December 15, 2000, AT&T notified shareholders of their options to obtain the cash or shares packages they selected.[104] The final letter of December 15, which was sent to shareholders who had not responded to either of the previous letters, reiterated that there was no deadline to exercise the Standard Election, but that the July 14 deadline to exercise any other options had passed. Further, though the first two letters noted that shareholders could use the exchange service at no fee, the third reminder

99. *Siepel*, 526 F.3d at 1125.
100. *See* Roland v. Green, 675 F.3d 503, 513 (5th Cir. 2012).
101. *Id.*
102. Gavin v. AT&T Corp., 464 F.3d 634 (7th Cir. 2006).
103. *Id.* at 637.
104. *Id.*

letter did not reiterate that term of the agreement.[105] Plaintiffs claimed that the failure to mention the no-charge option in the third letter constituted the alleged fraud in question.[106]

The Seventh Circuit, employing several colorful analogies[107] to illustrate its point, determined that the alleged fraud "happened afterwards and had nothing . . . to do with federal securities law."[108] Instead, such allegations dealt with "garden-variety issues of state-law consumer fraud."[109] The test that the Seventh Circuit appears to have applied was one that asked whether the alleged material omission of the term in the letter *involved* the securities transaction.[110] While the Supreme Court had used the *involving* language in *Dabit* to provide another linguistic explanation of what it means to be "in connection with," the Seventh Circuit provided minimal explanation of what it means to *coincide*. That *involving* and *coincide* both explain the *in connection with* requirement does not automatically mean that *involving* and *coincide* are synonymous. Here, the court did not address what it means for the fraud and the transaction to meet the threshold *coincide* test. It did, however, note that a mere but-for relationship was insufficient.[111] Hence, the Fifth Circuit justifiably dismissed[112] the Seventh Circuit's test because the latter's definition offered no guidance about how to accurately interpret the key "coincide" language.

B. SISTER CIRCUITS' MERITORIOUS TESTS: THE SECOND, NINTH, AND ELEVENTH CIRCUITS EVALUATE THE MEANING OF THE "COINCIDE" LANGUAGE

The Fifth Circuit found most persuasive the interpretations applied by the Second, Ninth, and Eleventh Circuits in determining the meaning of the "coincide" language as expressed by the Supreme Court in the *Zandford* and *Dabit* cases.[113] Believing these analyses to be helpful in providing guidance for establishing its own test, the court looked to the other circuits' tests to determine whether they appropriately circumscribed the requirement

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105. *Id.*

106. *Id.* at 638.

107. *See, e.g.*, *id.* at 639 ("Of course there is a literal sense in which anything that happens that would not have happened but for some prior event is connected to that event. In that sense the fraud of which the plaintiff complains is connected to the merger, without which there would not have been such a fraud against the plaintiff and her class. But in the same sense the fraud is connected to the Big Bang, without which there would never have been a MediaOne or even an AT&T.").

108. *Id.* at 638.

109. *Id.* at 640.

110. *Id.* at 639 (emphasis added).

111. *Id.*

112. *Id.* at 641. Defendants could have litigated their claim in federal court had they suggested diversity as a basis for jurisdiction; rather they "instead . . . plac[ed] all their jurisdictional eggs in the SLUSA basket, and there [the court left] them." *Id.*

113. Roland v. Green, 675 F.3d 503, 512 (5th Cir. 2012).

of the "in connection with" language based on the complex facts of the *Roland* case.

1. Stringent Standards: The Second and Eleventh Circuits

a. The Eleventh Circuit: Instituto de Prevision Militar v. Merrill Lynch

Instituto de Prevision Militar v. Merrill Lynch evaluated the "in connection with" and "coincide" language in 2008.[114] The court addressed consolidated cases on appeal from the Southern District of Florida in which the plaintiff, Instituto de Prevision Militar (IPM) sued Merrill Lynch alleging state-law claims of negligence, breach of fiduciary duty, and fraud,[115] as well as federal securities fraud.[116] IPM claimed that Pension Fund of America (PFA), a non-party, had defrauded Latin American Investors, itself included, by self dealing. PFA held itself out as an agent of Merrill Lynch,[117] and "[r]elying upon Merrill Lynch's reputation," IPM invested.[118] Pursuant to the trust agreement, IPM wired over $7.7 million to Merrill Lynch, which placed the money in an account named Pension Fund of America.[119] Subsequently, Merrill Lynch "allowed PFA to transfer more than $3 million" from the IPM account "for its own benefit and for its principal's personal use."[120]

In order to determine whether the misrepresentation was "in connection with" the purchase or sale of securities, the court applied the following standard: "[F]raud that *induced* IPM to invest with PFA" or "a fraudulent scheme that . . . *depended upon* the purchase or sale of securities"[121] satisfied the "coincide" language. The Second Circuit applied a similar analysis in interpreting the relevant language. In both instances, the courts employed a heightened, stringent standard, which led the circuit courts to interpret the "in connection with" and "coincide" language of SLUSA and the Supreme Court in *Dabit* and *Zandford* more narrowly. The policy considerations and results of a stricter test in *Instituto de Prevision Militar* mirror those that resulted from the Second Circuit's interpretation in *Romano v. Kazacos*[122] as well. When the court reads the language narrowly, there are fewer cases that can be precluded under SLUSA and subject to dismissal. Such a result could lead to corporate defendants potentially facing a greater risk of strike suits and meritless litigation.

114. Instituto de Prevision Militar v. Merrill Lynch, 546 F.3d 1340, 1347–48 (11th Cir. 2008).
115. *Id.* at 1343.
116. *Id.* at 1342.
117. *Id.*
118. *Id.* (citations omitted).
119. *Id.* at 1343.
120. *Id.*
121. *Id.* at 1349 (emphasis added).
122. Romano v. Kazacoz, 609 F.3d 512 (2d Cir. 2010).

Fraud that *depends upon* the securities transaction in question raises a similar inquiry when determining how intimate the nexus truly is when the fraud and the securities transaction are considered to coincide with each other. A transaction that *depends upon* fraud has a tighter relationship to the misrepresentation or omission than does a transaction that merely *coincides* with the fraud. When a securities transaction depends upon a fraud, or when fraud induced the transaction, the two are inextricably linked. Without the fraud, the securities transaction in question would never and could never happen. Under this linguistic analysis, the fraud appears to be absolutely necessary in producing the securities transaction in question. Congress did not contemplate such a stringent standard when drafting SLUSA.[123] The Eleventh Circuit standard blunts the congressional intent behind SLUSA and provides plaintiffs a greater ability to bring meritless suits. As such, the Fifth Circuit properly rejected it.

b. The Second Circuit: Romano v. Kazacos

The Second Circuit addressed the "in connection with" requirement in 2010 in *Romano v. Kazacos* and held that, where plaintiff's claims "turn on injuries caused by acting on misleading investment advice," or where the claims "necessarily allege," "necessarily involve," or "rest on" the purchase or sale of securities, such alleged fraud coincides with, and therefore is in connection with, the securities transaction.[124]

In *Romano*, the court heard consolidated appeals from plaintiff-appellants, Xerox and Kodak retirees, who filed class action complaints in state court alleging state-law claims.[125] They claimed that Morgan Stanley employees had misrepresented that the retirees' investments would provide sufficient income should they choose to retire early.[126] Plaintiffs elected to receive a lump sum retirement package and subsequently left their employment after being advised by their Morgan Stanley consultants.[127] Appellants' retirement accounts then "suffered 'disastrous' declines in value" and their standard of living plummeted due to the increased financial hardship they faced.[128]

Appellants filed a class action claim against Morgan Stanley and its Senior Vice President, Kazacos, alleging "common law claims of negligence, breach of fiduciary duty, negligent misrepresentation, breach of contract,"[129] and a host of other state-law claims. Upon removal to federal court, appellants' motion to remand for lack of federal jurisdiction was

123. *See* Roland v. Green, 675 F.3d 503, 507 (5th Cir. 2012).
124. *Id.* at 522.
125. *Id.* at 515.
126. *Id.*
127. *Id.* at 515–16.
128. *Id.* at 516.
129. *Id.*

denied and the court determined that "defendants' alleged misconduct 'coincided' with appellants' securities purchases."[130] The district court held that SLUSA preempted the state-law class action and dismissed the claim.[131]

On appeal, the Second Circuit looked "beyond the face of the amended complaints to determine whether they allege securities fraud in connection with the purchase or sale of covered securities."[132] The court noted that *Zandford* interpreted "in connection with" to also mean "coincide," which is to be construed broadly in scope.[133] Because the Supreme Court never explicitly defined "coincide," the circuit courts have used interpretive techniques to give dimension to the term.

The Second Circuit's standard was a more "exacting" one than that required by the Supreme Court's coincide test.[134] The more exacting standard would serve to weaken the effect of the PSLRA's heightened pleading requirements because fewer claims would be precluded when deemed not to have met the "in connection with" test. In those instances, fewer cases would be removable to federal court and subject to dismissal under SLUSA. The Fifth Circuit was concerned that the Second Circuit's standard was not entirely representative of Congress' purpose in enacting SLUSA[135] because, under the more exacting standard, corporate defendants are subject to a greater potential of frivolous litigation than would be the case if the standard precluded more cases.

2. The Ninth Circuit Promulgates the Best Test: *Madden v. Cowen & Co.*

The Ninth Circuit dealt with the "in connection with" and "coincide" language in its 2009 case of *Madden v. Cowen & Co.*[136] In *Madden*, sixty-three shareholders sued an investment bank alleging state-law claims for "misleading them in connection with the sale of their closely held corporation to a publicly traded acquiring corporation."[137] When the case was removed to federal court, the district court held that the suit was "properly removed and precluded under SLUSA."[138] On appeal to the Ninth Circuit, the court reversed, holding that the district court had employed the

130. *Id.* at 517.
131. *Id.*
132. *Id.* at 519 (citing Rowinski v. Salomon Smith Barney, Inc., 398 F.2d 294, 298 (3d Cir. 2005)).
133. *Id.* at 521.
134. Roland v. Green, 675 F.3d 503, 519 (5th Cir. 2012).
135. *Id.* at 519.
136. Madden v. Cowen & Co., 576 F.3d 957 (9th Cir. 2009).
137. *Id.* at 961.
138. *Id.* at 962.

wrong standard in making its determination that SLUSA preempted the claim.[139]

The class of plaintiffs in this case, mostly physicians who owned a majority share of St. Joseph's Medical Corporation (which in turn owned a majority share in Orange Coast Managed Care Services), brought suit in the disastrous wake of a merger with FPA Medical Management.[140] St. Joseph and Orange Coast's management retained Cowen, an investment bank, to "look for prospective buyers, give advice regarding the structure of any potential sale, and render a 'fairness opinion' regarding any proposed transaction."[141] After Cowen determined that the proposed merger would be "financially fair"[142] to St. Joseph and Orange Coast shareholders, the board of directors approved the merger and the transaction was soon completed. Shortly after closing, FPA "issued a calamitous first-quarter report" and two months later, "FPA declared bankruptcy, with a share price that was approximately 0.5% of its value at the time of the merger agreement."[143]

Madden thereafter sued Cowen in California state court alleging negligent misrepresentation and professional negligence under state law.[144] Cowen removed the case to federal court seeking to invoke SLUSA's preemption provision. The district court denied plaintiffs' motion to remand and dismissed the case applying the SLUSA preclusion.[145]

On appeal, the Ninth Circuit noted the significance of the SLUSA legislation in working toward Congress' intent to limit the potential liability of defendants and "deter or at least quickly dispose of" improper usage of the class action vehicle.[146] The Ninth Circuit held that a misrepresentation is "in connection with" the purchase or sale of securities when there is "a relationship in which the fraud and the stock sale *coincide* or *are more than tangentially related*."[147] The court found that Cowen's misrepresentations caused plaintiffs to vote in favor of the FPA merger and exchange their existing stock for that of FPA.[148] Further, the plaintiffs alleged that they "would not have done so absent Defendants' fairness opinion . . . that the transaction was fair, from a financial point of view."[149]

139. *Id.*
140. *Id.* at 963.
141. *Id.*
142. *Id.* ("Under the merger agreement, FPA would acquire all outstanding shares of St. Joseph and Orange Coast. In exchange, FPA would issue shares of its stock valued at $60 million to St. Joseph and Orange Coast shareholders.").
143. *Id.*
144. *Id.*
145. *Id.*
146. *Id.* at 964.
147. *Id.* at 966 (emphasis added) (citing Falkowski v. Imation Corp., 309 F.3d 1123 (9th Cir. 2002)).
148. *Id.*
149. *Id.*

The court held that the misrepresentations and omissions alleged were "more than tangentially related" to plaintiffs' purchase of the FPA securities in the merger transaction, and were therefore "in connection with the purchase or sale" of the securities.[150] A securities transaction that coincides with an alleged fraud when that transaction is more than tangentially related to the fraud is a broad, yet not over-inclusive, formulation of the nexus that satisfies the "in connection with" language. Such nexus reflects the proper balance of policy considerations and legislative intent that led to the enactment of SLUSA.

C. The Fifth Circuit adopts the Ninth Circuit's test

Interpreting the "coincide" language was a matter of first impression for the Fifth Circuit; therefore, it was necessary for the court to establish a standard to apply in *Roland* and in future cases brought under SLUSA. Looking to the Supreme Court's language in *Zandford* and *Dabit*, the Fifth Circuit noted that, despite an absence of controlling authority, it did not "write on a blank slate."[151] In *Dabit*, the Court looked to the language of Rule 10b-5 to assist it in determining the reach of the "in connection with" requirement. Employing traditional statutory interpretation methods, the Court noted that the SLUSA language exactly mirrored the Rule 10b-5 language. It therefore concluded that Congress, aware of the overlap in language, intended for it to have the same meaning in SLUSA as in Rule 10b-5.[152] The Fifth Circuit, in turn, evaluated and analyzed the language provided by the Supreme Court and looked to the varying interpretations its sister circuits employed to meet the required test.

The Fifth Circuit chose to adopt the standard promulgated by the Ninth Circuit when interpreting the "coincide" language found in the Supreme Court cases.[153] In making its decision to provide a precise interpretation, the court considered various circuit court cases that had already addressed the issue. Believing the Ninth Circuit's test—when the fraud and the purchase or sale of the security are more than tangentially related—to be the most compelling, the justices of the Fifth Circuit adopted that standard as the court's own.

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150. *Id.*
151. Roland v. Green, 675 F.3d 503, 511 (5th Cir. 2012).
152. Merrill Lynch, Pierce, Fenner & Smith Inc. v. Dabit, 547 U.S. 71, 85 (2006) (citing Bragdon v. Abbott, 524 U.S. 624, 645 (1998)).
153. *Roland*, 675 F.3d at 520.

III. WHY THE FIFTH CIRCUIT ADOPTED THE NINTH CIRCUIT'S TEST

A. THE FIFTH CIRCUIT: *ROLAND V. GREEN*

In 2012,[154] the Fifth Circuit in *Roland v. Green* heard a consolidated appeal of three cases[155] where plaintiffs sought to use the state class action vehicle to recover damages for "an alleged multi-billion dollar Ponzi scheme."[156] In the first case, the SEC sued the Stanford Group Company (SGC) and its corporate entities, including Stanford International Bank (SIB), for their alleged role in the Ponzi scheme.[157] The companies had sold certificates of deposit (CDs) issued by SIB, and SIB had represented for fifteen years that it "consistently earned high returns on its investment of CD sales proceeds."[158] In reality, however, SIB had to "use new CD sales proceeds to make interest and redemption payments on pre-existing CDs, because it did not have sufficient assets, reserves and investments to cover its liabilities."[159] Such misrepresentations were the key issue before the court when the SEC alleged fraud in violation of Rule 10b-5.

In the second suit, two groups of Louisiana investors "sued the SEI Investments Company ("SEI"), the Stanford Trust Company (the "Trust"), the Trust's employees, and the Trust's investment advisors (collectively, the "SEI Defendants") for their alleged role in the Stanford Ponzi scheme."[160] They alleged a multitude of state-law claims including "breach of contract, negligent representation, breach of fiduciary duty, unfair trade practices, and violations of the Louisiana Securities Act."[161] Specifically, they claimed that SEI made several misrepresentations, which "induced them into using their IRA funds to invest in the CDs."[162] Among the many representations that SEI made to plaintiffs were that the CDs were a good investment, that independent auditors verified the value of the SIB assets, and that the CDs would produce double-digit returns.[163] The SEI defendants

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154. The Supreme Court granted the *Roland* defendants' petition for certiorari on January 18, 2013 to address whether SLUSA precludes a securities fraud class action suit where plaintiffs purchase securities in reliance on material misrepresentations from financial advisors and other professionals. *See* Petition for Writ of Certiorari at i, Willis of Colorado, Inc. v. Troice, 133 S. Ct. 977 (2013) (No. 12-86); Petition for Writ of Certiorari at i, Proskauer Rose LLP v. Troice, 133 S. Ct. 978 (2013) (No. 12-88). Such an inquiry invariably leads to an analysis of the correct meaning of the "in connection with" and "coincide" language of SLUSA and Rule 10b-5.

155. *Roland*, 675 F.3d at 506. The district court in which the SEC action was filed ordered all suits against Stanford International Bank and related third parties to be filed as ancillary proceedings to the SEC action. *Id.* at 508.

156. *Id.* at 506.

157. *Id.* at 508.

158. *Id.*

159. *Id.*

160. *Id.*

161. *Id.*

162. *Id.*

163. *Id.* at 508–09.

sought removal to the district court claiming SLUSA precluded the claim, and after the action was consolidated with the others against SEI, plaintiffs made a motion to remand back to state court.[164]

The third case of the consolidated appeal involves a group of Latin American investors who sued SIB's insurance brokers and lawyers under Texas law in two separate class actions.[165] Plaintiffs alleged that SIB's insurance brokers represented to them that the CDs were a good investment for various reasons, including that "the CDs were safe and secure . . . SIB's portfolio produced consistent, double-digit returns . . . and the CDs' high return rates . . . greatly exceeded those offered by commercial banks in the United States."[166] After plaintiffs filed suit, defendants again claimed that SLUSA preclusion applied and moved to dismiss the class actions.

The question at issue in each of the above cases was whether "the plaintiff alleges the use of misrepresentations, omission, or deceptive devices 'in connection with the purchase or sale of a covered security.'"[167] When determining the strength of the nexus linking the alleged fraud to the securities transaction, the district court applied the Eleventh Circuit's test. SLUSA preclusion would apply if the defendants' misrepresentations regarding the supposedly highly profitable and safe CDs *induced* plaintiffs to purchase the financial products, or alternatively that the scheme *depended upon* the securities transaction.[168]

The district court found that SLUSA preclusion applied and dismissed the action.[169] The Fifth Circuit, however, reversed, finding that the district court had applied an improper standard for determining the "in connection with" requirement. Applying the correct legal standard, the Fifth Circuit determined that SLUSA did not preclude plaintiffs' claims.[170] The court held that "the purchase or sale of securities (or representations about the purchase or sale of securities) is only tangentially related to the fraudulent schemes alleged . . . [and therefore] that SLUSA does not preclude the Appellants from using state class actions to pursue their recovery."[171]

B. THE NEED FOR A PRECISE DEFINITION TO MEET THE "COINCIDE" THRESHOLD

The Fifth Circuit was not bound to employ any of its sister circuits' tests for determining the scope of the "in connection with" requirement.[172]

164. *Id.* at 509.
165. *Id.* Plaintiffs alleged only "civil conspiracy" rather than material misrepresentations or omissions against their attorneys, the Proskauer defendants. *Id.*
166. *Id.* at 508–09 (internal quotation marks omitted).
167. *Id.* at 510.
168. *Id.*
169. *Id.* at 511.
170. *Id.* at 522.
171. *Id.* at 506–07.
172. *Id.* at 512.

It could have simply chosen to establish its own test to define "in connection with" and "coincide." So why did the court elect to adopt the Ninth Circuit's test as its own? First, the Fifth Circuit noted that the Sixth, Seventh, and Eighth Circuits did not "attempt to define the 'coincide' requirement, but merely discuss[ed] what connection *above and beyond* 'coincide' is sufficient."[173] These tests insufficiently defined *coincide*. The respective definitions and analyses in each of those cases were of little help to the Fifth Circuit, and as such, it properly dismissed them as a guide to its decision.[174] To handle a matter of first impression, the Fifth Circuit aimed to more precisely define its test. The above-mentioned cases narrowly or insufficiently held what it meant for an alleged fraud to be "in connection with" a securities transaction[175] and thus provided minimal help in the Fifth Circuit's exercise of statutory interpretation.

Regarding the three remaining circuits[176] that the Fifth Circuit deemed relevant in steering it toward an understanding of the "coincide" language, it is not entirely obvious why the court adopted an existing standard rather than creating its own to add to the range of standards already in play. Arguably, the court did not want to add to the "melange" of tests[177] already applied by the circuit courts to maintain consistency in the application of federal securities law regarding covered and uncovered securities.[178] *Roland's* language reflects an admiration of how the Ninth Circuit adopted its test and determined its final result.[179] It is possible that, had the Fifth Circuit failed to look to its sister circuits for guidance, it would have proffered a *more than tangentially related* standard, or something nearly identical. While this note cannot determine how the justices of the court *actually* chose their coincide standard, the process outlined in *Roland* in coming to its conclusion expresses the justices' fundamental agreement with both the standard applied in the Ninth Circuit and the policy considerations bolstering such a standard.[180]

To avoid requiring completely new tests for each slight factual variation, future courts should be able to apply a standard in a consistent, yet flexible manner. Here, the Fifth Circuit used keen judgment and logic when it analyzed a precise and easy-to-apply standard for determining whether fraud exists in connection with the purchase or sale of securities.

173. *Id.* at 513 (emphasis added).

174. *See id.*

175. *Id.*

176. *Id.* The three remaining circuit courts the Fifth Circuit addressed were the Second, Ninth, and Eleventh. *Id.*

177. *Id.* at 510.

178. *See id.* at 517. *See generally* SEC Testimony, *supra* note 49, at 3 (noting one of SLUSA's goals was to "adopt a uniform standard for the prosecution of certain securities fraud class actions.").

179. *Roland*, 675 F.3d at 519–20.

180. *See id.*

The court did not want a definition that was so broadly construed that there was no clear line marking where a given instance of fraud went beyond the proposed test or whether it precisely met the court's threshold.[181] The Fifth Circuit sought an exacting definition in the *Roland* opinion, one with a clear demarcation of when a securities transaction coincides with an alleged fraud and when it does not. Such a definition was adopted in the *more than tangentially related* standard.

The district court in *Roland* had employed the Eleventh Circuit's test, which the Fifth Circuit found to be "too stringent a standard."[182] This standard would make it easier for plaintiffs to sue corporations than the court found necessary or appropriate if such fraud could be alleged under that standard.[183] If few nexuses satisfied the "in connection with" or "coincide" requirements, then the standard applied would allow for a significant amount of litigation and potential corporate liability. Had the court followed the Eleventh Circuit's approach, it, in essence, could have returned the state of securities fraud class action litigation to the same condition that led Congress to enact SLUSA to begin with.[184]

When considering the spectrum of possible standards to influence the development of its own, the Fifth Circuit intended to make it more difficult for plaintiffs to bring suit than what other circuits have found appropriate.[185] The court rightfully invoked a standard favorable to corporate defendants, and looked more skeptically at the plaintiffs' bar.[186] Protecting the national securities markets in the aggregate was a key goal in enacting SLUSA[187] and the Fifth Circuit supported that goal in reading the "in connection with" language broadly.

While this note argues that the Fifth Circuit properly rejected the Second Circuit's narrower construction of the "coincide" language, it is still rather curious that the Fifth Circuit expressly rejected the latter's interpretation, given the Second Circuit's influence on corporate and securities matters.[188] The Second Circuit's jurisdiction includes New York, the major center of corporate, financial, and business activity—potentially the largest amount of corporate liability in the United States. The Second

181. *Id.* at 518.

182. *Id.* at 519.

183. *See id.* at 517.

184. Such a result would be contrary to Congress' purpose in enacting SLUSA—that is, to close the loophole that the PSLRA left open. Shannon, *supra* note 1, at 331.

185. *Roland*, 675 F.3d at 520.

186. *Id.*; *see, e.g.*, Henriques, *supra* note 10.

187. *See* SEC Testimony, *supra* note 49, at 4.

188. *Roland*, 675 F.3d at 519; *see* Joshua L. Boehm, *Private Securities Fraud Litigation After* Morrison v. National Australia Bank*: Reconsidering a Reliance-Based Approach to Extraterritoriality*, 53 HARV. INT'L L.J. 249, 253 (2012) ("The U.S. Court of Appeals for the Second Circuit has played the principal role in shaping this [Section 10(b)]; because it encompasses New York City, it has had the opportunity to hear a disproportionate number of securities fraud cases.").

Circuit's test, as compared to that of the Ninth and now Fifth Circuits' tests, makes it comparatively easier for plaintiffs to bring securities fraud claims because of its stricter preclusion standard. Such a holding would appear to favor injured investors over defendants. By dissecting the language of the standard, fewer claims of fraud necessarily allege, necessarily involve, or rest on[189] the sale or purchase of securities than those that are more than tangentially related to each other. Therefore, there could be more instances where the claim continues past the pleadings under the Second Circuit's jurisprudence. The Fifth Circuit, alternatively, stressed the necessary protection of corporate defendants in adopting the *more than tangentially related* standard.

Similarly, looking to Delaware's prominence within the Third Circuit, it may be asked why the court never evaluated a Third Circuit case in making its decision.[190] It is possible that the Fifth Circuit foresaw itself acting to influence a future Third Circuit case in determining the nexus of a fraudulent scheme and a securities transaction. In securities law jurisprudence, both New York and Delaware—and more broadly, the Second and Third Circuits—have been highly influential and act as a guide to other courts in corporate securities matters.[191]

If, after *Roland*, the Third Circuit were to directly address the question posed in *Roland*, it may be that the Fifth Circuit wanted to persuade the Third Circuit to employ the *more than tangentially related* standard. Under such circumstances, three circuits would employ the same standard, which would provide more continuity regarding how federal securities fraud class action cases are decided. Such a result reflects the "congressional preference for national standards for securities class action lawsuits involving nationally traded securities."[192] Considering that the interpretation from the Fifth and Ninth Circuits protects corporate defendants more than the Second Circuit's interpretation, it would be a strong message in support of congressional intent and policy considerations should the Third Circuit accept the Fifth and Ninth Circuits' test rather than that of the Second.

C. A COMPARISON OF THE SECOND AND NINTH CIRCUITS' STANDARDS

The Fifth Circuit made it clear in *Roland* that the Second and Ninth Circuits' opinions were among the most important ones it considered when

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189. *Roland*, 675 F.3d at 522.

190. *See* Pinto & Branson, *supra* note 69, at 15. The outcome of SLUSA and Rule 10b-5 litigation may disproportionately affect states within the Third Circuit, Delaware in particular, as many public companies—and more than half of Fortune 500 companies—are Delaware companies. *Id.*

191. *Id.* at 17; *see also* Boehm, *supra* note 188, at 253.

192. *Roland*, 675 F.3d at 507 (citing *In re* Enron, 535 F.3d 325, 338 (5th Cir. 2008)); *see* Apel, *supra* note 11, at 631.

developing its standard. It employed the Eleventh Circuit's test only as a starting point[193] and subsequently rejected the Eleventh Circuit test when it reversed the district court.[194] The court then evaluated the remaining two circuits' tests in a fair amount of detail. The results of both tests, whether the alleged fraud *necessarily alleges, necessarily involves, or rests on* the securities transaction or whether the alleged fraud is *more than tangentially related to* the securities transaction, have the potential to provide rather different results in 10b-5 litigation.

In the case of the Second Circuit standard, the test for SLUSA preclusion is fairly strict and narrow. It follows logically that there would be relatively few instances where the alleged fraud and the securities transaction at hand actually meet the standard in which SLUSA would mandatorily bar the action. Because of its narrow reach, plaintiffs could allege a greater number of claims and defendants would be exposed to an increased risk of defending or settling these suits. This is not a welcome risk for corporate participants in the securities markets.[195] It is ironic that the Second Circuit, home to New York's incredibly important capital markets, subjects corporate defendants to more potentially frivolous lawsuits under this strict standard. The Fifth Circuit noted that such an approach was not the goal of Congress[196] and was not what the Supreme Court contemplated when it announced the "coincide" standard in *Zandford* and *Dabit*.

The Ninth Circuit, alternatively, provides corporate defendants greater protection against potentially frivolous lawsuits. Those states within the Ninth Circuit—Alaska, Arizona, California, Hawaii, Idaho, Montana, Nevada, Oregon, and Washington—though not widely regarded as major hubs of corporate and securities law, provide greater protection for corporate defendants and the national securities markets. Such protection aligns with the goals of federal securities law[197]—protection of investors and the national stock exchanges to promote efficient growth and stability.[198]

CONCLUSION

The Fifth Circuit's 2012 decision of *Roland v. Green* proscribed the meaning of the "in connection with" and "coincide" language the Supreme

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193. *Roland,* 675 F.3d at 518.

194. *Id.* at 522.

195. Cox et al., *supra* note 54, at 360; *see* Apel, *supra* note 11, at 631.

196. O'Hare, *supra* note 2, at 360 ("The legislative intent underlying SLUSA—foreclosing the circumvention of the procedural reforms contained in the Reform Act—is certainly an important reason why some courts have refused to allow plaintiffs to plead around SLUSA.").

197. *See* SEC Testimony, *supra* note 49, at 4. The federal securities laws and the SEC's "primary mission is investor protection." *Id.*

198. SEC v. Zandford, 535 U.S. 813, 819 (2002).

Court held as necessary to apply SLUSA preclusion.[199] In the process of carefully interpreting the meaning of *coincide*, the court evaluated other circuit court decisions and grappled with whether they provided persuasive guidance in its own decision.[200] The court first undertook an exercise in statutory interpretation, looking at the text[201] of SLUSA and the SEC's Rule 10b-5. It next looked to broader policy considerations, the protection of the national securities markets,[202] and legislative intent when establishing its standard.[203] From the Fifth Circuit's careful scrutiny of its sister circuits' tests determining the nexus connecting an alleged fraud to a securities transaction, the court reasoned that the Ninth Circuit's best reflected congressional intent.[204] The Ninth Circuit's test—whether the alleged fraud is *more than tangentially related* to the purchase or sale of a covered security—aimed to preclude much of the frivolous litigation that may stifle business activity and financially drain corporations. The Fifth Circuit rightly held that such a standard illuminates the truest meaning of the *coincide* nexus as expounded by key Supreme Court decisions.

The Fifth Circuit definition establishes where the SLUSA standard begins and the circumstances under which preclusion is met. It finds a crucial balance between the notion that "the statute must not be construed so broadly as to convert every common-law fraud that *happens to involve* [*covered*] *securities* into a violation of § 10(b),"[205] and that it must provide sufficient protection against the immense risk of frivolous lawsuits unique to Rule 10b-5 litigation.[206] Since Congress' enactment of the Securities Exchange Act of 1934 and the SEC's subsequent promulgation of Rule 10b-5, at issue has been, and will continue to be, maintaining the delicate balance between vindicating plaintiffs' rights and protecting corporate defendants from unwarranted liability. The Fifth Circuit's adoption of the *more than tangentially related* test furthers this goal.

The *more than tangentially related* test supports legislative intent to quell Congress' concerns about abuses in securities fraud class action litigation. The language is, and should continue to be, construed broadly to protect corporations from a wide range of potentially frivolous and meritless suits brought for the sole purpose of extracting a high settlement.[207] Yet, the standard is narrow enough in scope to allow plaintiffs to bring meritorious class actions to recover for legitimate losses sustained at the hand of corporate defendants. Recognizing the health of the national

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199. *See generally Roland*, 675 F.3d at 511–20.
200. *Id.* at 512–20.
201. *Id.* at 512.
202. *Id.* at 517.
203. *Id.*
204. *Id.* at 519–20.
205. *Id.* at 512 (citing SEC v. Zandford, 535 U.S. 813, 820 (2002) (emphasis added)).
206. Merrill Lynch, Pierce, Fenner & Smith Inc. v. Dabit, 547 U.S. 71, 81 (2006).
207. *See, e.g.*, Eaton, *supra* note 10.

securities markets as the backbone of the American economy, Congress prioritized their security in enacting SLUSA to close the loophole that the PSLRA inadvertently left open.[208] The Supreme Court has subsequently held that the legislative intent and policy considerations are crucial aspects of SLUSA that should be granted deference to ensure the legislation accomplishes its proffered goals.[209] The Fifth Circuit, in turn, properly interpreted the "in connection with" and "coincide" language[210] to support legislative intent and protect corporate defendants individually, and national securities markets generally, from the heightened risk of vexatious litigation in federal securities fraud class actions.

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208. *See Dabit*, 547 U.S. at 78.

209. *See* Blue Chip Stamps v. Manor Drug Stores, 421 U.S. 723, 737 (1975); O'Hare, *supra* note 2, at 338.

210. This note argues for the Fifth Circuit's *standard* in interpreting the *coincide* language of SLUSA, rather than for the Court's *application* of that standard to the facts in *Roland*. It is important to note that an arguably illogical tension now exists between the District Court and the Fifth Circuit in the proper *application* of the law. The District Court employed a stricter standard, but held that the alleged fraud fell within that nexus, yet the Fifth Circuit adopted a broader test and determined that the fraud fell outside of that nexus and that plaintiffs had met their burden to properly bring the claim. It is the Fifth Circuit's *standard* that the Supreme Court should adopt when the Court hears the case in the October Term 2013, not its application of that standard. *See Granted & Noted List: Cases for Argument in October Term 2013*, SUPREME COURT, (May 13, 2013), http://www.supremecourt.gov/orders/13grantednotedlist.pdf.

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