

CLASS ACTION BLOG

National Securities Class Action Suits Based on Fraud Cannot Hide behind State Claims

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In the 1990's, Congress sought more stringent standards for filing securities class-action litigation. The Private Securities Litigation Reform Act (PSLRA) was passed in 1995 followed by the Securities Litigation Uniform Standards Act of 1998 (SLUSA). These reforms were aimed at preventing frivolous lawsuits in the sale of national securities and apply to both federal and state class-actions alleging fraudulent sales conduct. At issue in *Zola v. TD Ameritrade, Inc.* 889 F.3d 920 (8th Cir. (Neb.) 2018), was whether claims pled under the theory of a state-law contract claim were preempted by the SLUSA.

In *Zola*, investors filed a class-action against a brokerage firm alleging various state-law claims to avoid the restrictions of the PSLRA. The lawsuit included allegations of choosing trade venues favorable to the brokerage firm as opposed to venues providing customers with the best value. Also alleged was that the defendant breached a uniform client agreement by ignoring certain factors in venue determination and considering only the venues that would pay defendant the most. Hence, plaintiffs alleged their claim was based on breach of contract and governed by state law since SLUSA prohibits state common law claims alleging material misrepresentations or omissions made in connection with the purchase or sale of securities.

A Nebraska district court found the state-law claims were preempted by SLUSA and dismissed the lawsuit for failure to state a claim. On appeal, the United States Court of Appeals for the Eighth Circuit affirmed, and, in so doing, disregarded the title of the cause of action and looked instead to the substance of the state law claims asserted. The court found that even though plaintiffs alleged a breach of contract – the uniform client agreement – the claims were actually based on the defendant's "failure to disclose the fact that it was selling its order flow to the highest bidder." *Id.* At 924. Thus, the claims involved a misrepresentation or omission of a material fact in connection with the purchase of a sale of a covered security and, thus, were really alleging fraud such that they were subject to the preemption of the SLUSA, citing to another recent, similar opinion of the Eighth Circuit in *Lewis v. Scottrade, Inc.*, 879 F.3d 850, 851 (8th Cir. (Mo.) 2018).

The court's opinion in *Zola* reinforces the preeminence of federal law over state law claims when used as a weapon to try to avoid the restrictions against securities companies under both the PLSRA and the SLUSA. It also reinforces the general law in most jurisdictions that it is the substance of what is pled – and not the purported legal theory or cause of action asserted – that determines whether or not a claim is stated, or, in this case, whether a lawsuit is subject to federal preemption.