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# The Securities Act of 1933 after SLUSA: Federal Class Actions Belong in Federal Court

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## The Securities Act of 1933 After SLUSA: Federal Class Actions Belong in Federal Court

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### INTRODUCTION

“The great thing about human language is that it prevents us from sticking to the matter at hand.”<sup>1</sup>

During the debate on the Securities Litigation Uniform Standards Act (“SLUSA”),<sup>2</sup> Representative Tom Bliley echoed the prevailing sentiment<sup>3</sup> that “lawsuits alleging violations that involve securities that are offered nationally belong in Federal Court.”<sup>4</sup> Despite this seemingly clear congressional intent, however, inartful drafting has allowed certain securities class actions to escape federal court. For example, in *In re Tyco International, Limited Multidistrict Litigation*,<sup>5</sup> Tyco was subject to forty-seven separate lawsuits in several different states for a variety of securities violations.<sup>6</sup> The

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1. LEWIS THOMAS, THE LIVES OF A CELL: NOTES OF A BIOLOGY WATCHER 112 (1974).

2. Securities Litigation Uniform Standards Act of 1998, Pub. L. No. 105-353, 112 Stat. 3227 (codified as amended at 15 U.S.C. §§ 77p, 77v, 77z-1, 78-4, and 78bb (2000)).

3. See *infra* Part III.

4. 144 CONG. REC. 26,537, 26,537 (1998) (emphasis added).

5. 322 F. Supp. 2d 116 (D.N.H. 2004).

6. *Id.* at 117.

defendants consolidated many of the cases and removed them to federal court in New Hampshire.<sup>7</sup> The District of New Hampshire, however, remanded seven of these cases because they only alleged violations of the Securities Act of 1933 (the "Securities Act").<sup>8</sup> The district court reasoned that the wording of the removal provision in the Securities Act, as modified by SLUSA, only granted defendants the right to remove state claims to federal court,<sup>9</sup> thus forcing Tyco to defend the federal claims in multiple state courts.

Remanding cases to state court prejudices defendant corporations because the requirements of the Private Securities Litigation Reform Act ("PSLRA"),<sup>10</sup> which were designed to reduce unmeritorious class action litigation,<sup>11</sup> apply only in federal court.<sup>12</sup> Leaving corporations vulnerable to unmeritorious suits compromises the integrity of the securities market and ultimately harms investors.<sup>13</sup> Although Congress enacted SLUSA to move most securities class actions to federal court, the wording of the removal provision seems to conflict with this intention.<sup>14</sup> Specifically, SLUSA fails to adequately address the nonremoval provision in the Securities Act, causing some federal courts to remand cases brought under the Securities Act that do not also include a state-law claim.<sup>15</sup> Indeed, dicta in a recent United States Supreme Court decision supports this construction of the statute.<sup>16</sup>

This Comment examines the statutory arguments, legislative history, and policy implications underlying the dispute over the scope of the Securities Act's removal provision and argues for a broad construction of the statute—one that extends removal authority to class actions alleging only Securities Act violations. Part I provides a general background of the federal securities laws and the conflict over removal. Part II first examines the language of the Securities Act and the source of the jurisdictional conflict, and then makes three

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7. *See id.*

8. *Id.* at 122; see 15 U.S.C. §§ 77a–77aa (2000) (regulating offerings of securities).

9. *In re Tyco Int'l*, 322 F. Supp. 2d at 122.

10. Private Securities Litigation Reform Act of 1995, Pub. L. No. 104-67, 109 Stat. 737 (codified as amended in scattered sections of 15 U.S.C.); see *infra* Part II.C (detailing Congress's motivation for the enactment of SLUSA).

11. See *infra* notes 47–57 and accompanying text.

12. See *infra* note 56.

13. H.R. REP. NO. 104-369, at 31–32 (1995) (Conf. Rep.), reprinted in 1995 U.S.C.C.A.N. 730, 730–31.

14. See *infra* Part II.A.

15. See *infra* note 87 and accompanying text.

16. See *Kircher v. Putnam Funds Trust*, 126 S. Ct. 2145, 2154–55 (2006); see also *infra* notes 163–64 and accompanying text.

arguments for a broad reading of removal authority. Part II also analyzes the Supreme Court's recent decisions in *Merrill Lynch, Pierce, Fenner & Smith, Inc. v. Dabit*<sup>17</sup> and *Kircher v. Putnam Funds Trust*<sup>18</sup> and attempts to reconcile the apparent inconsistency in the Supreme Court's guidance for interpreting the Securities Act's removal provision. Part III examines the legislative history of SLUSA, which demonstrates Congress's intent to permit removal of Securities Act class actions. Finally, Part IV analyzes the policy implications of such an outcome and argues that a broad reading comports with Congress's goal of improving market efficiency and protecting investors.

### I. BACKGROUND

Jurisdiction over Securities Act claims is best understood in the context of federal court jurisdiction generally. Federal question jurisdiction is set forth in 28 U.S.C. § 1331, which provides that "district courts shall have original jurisdiction of all civil actions arising under the Constitution, laws, or treaties of the United States."<sup>19</sup> However, plaintiffs can also file federal claims in state court.<sup>20</sup> To ensure that plaintiffs are not the ultimate arbiters of jurisdiction, title 28 of the United States Code authorizes defendants to remove most federal law claims brought in state court to federal court.<sup>21</sup> Specifically, § 1441(a) provides that "[e]xcept as otherwise expressly provided by Act of Congress, any civil action brought in a State court of which the district courts of the United States have original jurisdiction, may be removed . . . to the district court of the United States."<sup>22</sup> However, the Securities Act includes a provision that "expressly provide[s]" that actions brought under it cannot be

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17. 126 S. Ct. 1503 (2006).

18. 126 S. Ct. 2145 (2006).

19. 28 U.S.C. § 1331 (2000). The federal courts also have diversity jurisdiction. *See* § 1332. Furthermore, § 22 of the Securities Act explicitly gives federal courts original jurisdiction over claims arising under the Act. 15 U.S.C. § 77v(a) ("The district courts of the United States and United States courts of any Territory shall have jurisdiction of offenses and violations under this subchapter.").

20. 17A JAMES WM. MOORE ET AL., *MOORE'S FEDERAL PRACTICE* ¶ 120.10 (3d ed. 2006) (providing that most "state courts also have jurisdiction over most kinds of actions arising under federal law, and are competent to adjudicate federal claims pleaded in a state complaint"). Section 1441 suggests this result by giving the defendant the option of removal, thus implying that the action can remain in state court if not removed. *See* 28 U.S.C. § 1441.

21. § 1441.

22. *Id.* § 1441(a) (emphasis added).

removed to federal court.<sup>23</sup> Specifically, § 22 of the Securities Act provides concurrent, nonremovable jurisdiction by stating that “no case arising under this title and brought in any State court . . . shall be removed to any court of the United States.”<sup>24</sup> As one pre-SLUSA case noted, § 1441(a)’s “except” provision is “clearly a reference to statutes such as [the Securities Act].”<sup>25</sup> SLUSA, however, amended this provision.<sup>26</sup> This Comment examines SLUSA’s amendment to the Securities Act and argues that nonremovable jurisdiction no longer exists for Securities Act claims brought by large class actions.

Passed in the wake of the stock market crash in 1929, the Securities Act of 1933<sup>27</sup> provided the first comprehensive federal regulation of securities markets.<sup>28</sup> The Securities Act adopted the disclosure method of market regulation instead of a merit-based approach.<sup>29</sup> Under the merit-based approach, regulators assess the fairness of proposed transactions and have the authority to prevent economically disadvantageous securities from being traded.<sup>30</sup> The disclosure approach of the Securities Act, however, adopts the notion that “sunlight is . . . the best of disinfectants”<sup>31</sup> and attempts “to provide full and fair disclosure as to securities sold in interstate and foreign markets.”<sup>32</sup> The Securities Act accomplishes this by requiring companies to file a registration statement with the Securities and Exchange Commission (“SEC”)<sup>33</sup> and to furnish prospective investors

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23. 15 U.S.C. § 77v(a).

24. *Id.*

25. *Farmers & Merchs. Bank v. Hamilton Hotel Partners*, 702 F. Supp. 1417, 1419–20 (D. Ark. 1988) (“[S]ection [1441(a)] is inapplicable because Congress has explicitly prohibited removal of claims under the Securities Act of 1933.”).

26. Securities Litigation Uniform Standards Act of 1998, Pub. L. No. 105-353, § 101, 112 Stat. 3227, 3230 (codified at 15 U.S.C. § 77v (2000)).

27. Securities Act of 1933, ch. 38, 48 Stat. 74 (codified as amended at 15 U.S.C. §§ 77a–77aa (2000)).

28. 3 JAMES D. COX & THOMAS LEE HAZEN, COX & HAZEN ON CORPORATIONS § 27.09 (2d ed. 2003).

29. *Id.*

30. *See id.* § 27.10.

31. LOUIS D. BRANDEIS, OTHER PEOPLE’S MONEY AND HOW THE BANKERS USE IT 62 (1933) (discussing the ability of available public information to prevent social harms); *see also* COX & HAZEN, *supra* note 28, § 27.10 n.5 (using this quote to explain the disclosure approach of the Securities Act).

32. COX & HAZEN, *supra* note 28, § 27.10.

33. Note, however, that when the Securities Act was passed, the SEC did not exist. *Id.* § 27.09. Instead, the Federal Trade Commission performed these functions. *Id.* The SEC was substituted as the primary regulator of securities markets a year later by the Securities Exchange Act of 1934. *Id.*

with detailed information in a prospectus before issuing securities to the public.<sup>34</sup>

The Securities Act, however, only regulates “distributions of securities.”<sup>35</sup> A year after its enactment, Congress passed the Securities Exchange Act of 1934 (the “Exchange Act”),<sup>36</sup> which provided for much broader regulation of the securities markets. The Exchange Act allows for the regulation of the secondary market and “regulates all aspects of public trading of securities.”<sup>37</sup> Specifically, the Exchange Act extended federal regulation to “stock manipulation, insider trading, . . . [and] broker-dealer and stock exchanges as well as proxy solicitations.”<sup>38</sup>

In addition to the distinct substantive scopes of the Securities Act and the Exchange Act, each also provided different jurisdictional authority. As noted above, the Securities Act originally permitted plaintiffs to file their claim in either state or federal court and also prevented defendants from removing claims filed in state court to federal court.<sup>39</sup> In contrast to the concurrent, nonremovable jurisdiction of Securities Act claims, Exchange Act claims could be brought only in federal court.<sup>40</sup>

The reason for this abrupt shift remains unclear. As one commentator has pointed out:

[T]here is little—if any—legislative history underlying the non-removal provision of the 1933 Act. The grant of exclusive federal jurisdiction for 1934 Act claims just one year later casts an even darker shadow. Indeed, in 1934, Congress acknowledged the conflict between the non-removal provision

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34. *Id.* § 27.10. For a more thorough discussion of the scope and operation of the Securities Act, see *id.* §§ 27.09–27.16 (discussing the general application and function of the Securities Act).

35. *Id.* § 27.09; see also 1 LOUIS LOSS & JOEL SELIGMAN, *SECURITIES REGULATION* 225 (3d ed. 1989) (noting that the Securities Act “is concerned by and large with the initial distribution of securities rather than with their subsequent trading”).

36. Securities Exchange Act of 1934, ch. 404, 48 Stat. 881 (codified as amended at 15 U.S.C. §§ 78a–78mm (2000)). For a more thorough discussion of the scope of the Exchange Act, see COX & HAZEN, *supra* note 28, §§ 27.17–27.19; 1 LOSS & SELIGMAN, *supra* note 35, at 226 (“The 1934 Act, as initially enacted, had four basic purposes: to afford a measure of disclosure to people who buy and sell securities; to prevent and afford remedies for fraud in securities trading and manipulation of the markets; to regulate the securities markets; and to control the amount of the Nation’s credit that goes into those markets.”).

37. COX & HAZEN, *supra* note 28, § 27.09.

38. *Id.*

39. Securities Act of 1933, ch. 38, § 22, 48 Stat. 74, 86 (codified as amended at 15 U.S.C. § 77v(a) (2000)).

40. 15 U.S.C. § 78aa (2000).

of the 1933 Act and the exclusive federal jurisdiction provision of the 1934 Act, and even considered an amendment to grant exclusive federal jurisdiction over 1933 Act claims. . . . “So far as the legislative history shows, the difference in these two related statutes is pure happenstance.”<sup>41</sup>

The conflict over federal court jurisdiction, however, involves more than simply the courthouse in which to file. More importantly, the conflict involves the application of the procedural obligations imposed on class actions by PSLRA.<sup>42</sup> PSLRA imposes additional requirements on class actions that allege violations of the securities laws, but its requirements apply only in federal court.<sup>43</sup>

During the twentieth century, private securities litigation became an increasingly important component of securities regulation. Further, the class action’s ability to aggregate many relatively small claims was “particularly suitable in securities fraud cases, where the damages to each individual investor may not be substantial enough to justify incurring the costs of litigation.”<sup>44</sup> Successful class action litigants may also receive reasonable attorneys’ fees.<sup>45</sup> As such, class actions have become a popular vehicle for asserting violations of the securities acts.<sup>46</sup>

However, the class action mechanism is susceptible to abuse,<sup>47</sup> and prior to PSLRA, “plaintiffs’ law firms filing securities fraud class actions [had been] accused of a whole host of dubious practices, including using professional plaintiffs in their cases, filing carbon copy

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41. Jeffrey T. Cook, *Recrafting the Jurisdictional Framework for Private Rights of Action Under the Federal Securities Laws*, 55 AM. U. L. REV. 621, 632–33 (2006) (citations omitted) (quoting AM. LAW INST., *STUDY OF THE DIVISION OF JURISDICTION BETWEEN STATE AND FEDERAL COURTS* 183 (1969)). Note that Cook’s research addresses the issues raised by this Comment, namely the removal authority of Securities Act claims after SLUSA. See *id.* at 623–24. Unlike this Comment, which argues for a broad reading of removal authority, Cook’s article advocates congressional amendment of the removal provision. See *id.* at 664–65.

42. Private Securities Litigation Reform Act of 1995, Pub. L. No. 104-67, 109 Stat. 737 (codified as amended in scattered sections of 15 U.S.C.); see also Part III (detailing Congress’s motivation for the enactment of SLUSA).

43. See *infra* note 56 and accompanying text.

44. *In re VMS Sec. Litig.*, 136 F.R.D. 466, 473 (N.D. Ill. 1991).

45. See 15 U.S.C. §§ 77z-1(a)(6), 78u-4(a)(6).

46. See James D. Cox, *Making Securities Fraud Class Actions Virtuous*, 39 ARIZ. L. REV. 497, 497–98 (1997) (noting the growth of class actions in securities litigation); Richard H. Walker & J. Gordon Seymour, *Recent Judicial and Legislative Developments Affecting the Private Securities Fraud Class Action*, 40 ARIZ. L. REV. 1003, 1005–06 (1998) (noting some reasons for the “increased use of class action[s]” in securities litigation).

47. Evan A. Davis et al., *Class Actions*, in 7 SECURITIES LAW TECHNIQUES: TRANSACTIONS AND LITIGATION § 92.01 (A.A. Sommer, Jr. ed., 2006).

complaints, and racing to the courthouse to be the first to file a case before the ink was dry on a company's press release of unexpectedly weak earnings."<sup>48</sup> Further, plaintiffs often filed class action lawsuits, which, though based on inadequate evidence, were so expensive to defend that defendant corporations would often settle.<sup>49</sup>

Worried about the effect these "strike suits"<sup>50</sup> have on corporations and the investing public, Congress enacted PSLRA.<sup>51</sup> PSLRA attempted to curb strike suits by enacting heightened procedural requirements for private class action suits claiming violations of the securities acts.<sup>52</sup> These heightened procedural requirements include "restrictions on the class representative . . . [and] pretrial discovery."<sup>53</sup> In addition, PSLRA established mandatory Federal Rule of Civil Procedure 11(b)<sup>54</sup> review of dismissed claims.<sup>55</sup> The restrictions added by PSLRA, however, apply only to claims brought in federal court,<sup>56</sup> which allowed class actions

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48. Robert B. Thompson & Randall S. Thomas, *The New Look of Shareholder Litigation: Acquisition-Oriented Class Actions*, 57 VAND. L. REV. 133, 136 (2004). Interestingly, this article assumes the conclusion argued for in this Comment, noting in a footnote that SLUSA "wipe[d] out states' concurrent jurisdiction to hear securities fraud class action suits." *Id.* at 137 n.10.

49. See *Blue Chip Stamps v. Manor Drug Stores*, 421 U.S. 723, 739 (1975).

50. Strike suits are suits brought to "extract a sizable settlement from companies that are forced to settle, regardless of the lack of merits of the suit, simply to avoid the potentially bankrupting expense of litigation." H.R. REP. NO. 105-803, at 13 (1998) (Conf. Rep.).

51. The PSLRA Conference Committee report noted that securities litigation reforms were "prompted by significant evidence of abuse in private securities lawsuits." H.R. REP. NO. 104-369, at 31 (1995) (Conf. Rep.), reprinted in 1995 U.S.C.C.A.N. 730, 730 (noting specifically "(1) the routine filing of lawsuits against issuers of securities . . . whenever there is a significant change in an issuer's stock price, without regard to any underlying culpability . . . ; (2) the targeting of deep pocket defendants . . . ; [and] (3) the abuse of the discovery process to impose costs" as examples of abuses of private securities lawsuits). The Conference Committee report also noted that "the investing public and the entire U.S. economy have been injured by the unwillingness of the best qualified persons to serve on boards of directors and of issuers to discuss publicly their future prospects, because of fear of baseless and extortionate securities lawsuits." *Id.* at 31-32.

52. 2 THOMAS LEE HAZEN, TREATISE ON THE LAW OF SECURITIES REGULATION § 7.17[1] (5th ed. 2005); see also 15 U.S.C. § 77z-1 (2000).

53. See 2 HAZEN, *supra* note 52, § 7.17[1].

54. FED. R. CIV. P. 11(b) (requiring an attorney or unrepresented party to make certain certifications when filing a document with the court that, if violated, will subject the certifying party to sanctions).

55. 2 HAZEN, *supra* note 52, § 7.17[1][F].

56. 15 U.S.C. § 77z-1(a)(1) ("The provisions of this subsection [the requirements added by PSLRA] shall apply to each private action arising under this sub-chapter that is brought as a plaintiff class action pursuant to the *Federal Rules of Civil Procedure*." (emphasis added)); see *Lowinger v. Johnston*, No. 3:05CV316-H, 2005 WL 2592229, at \*3 (W.D.N.C. Oct. 13, 2005) ("PSLRA applies to all securities actions pending in federal court, whether originally filed there or upon removal from state court."); 2 HAZEN, *supra*



to avoid PSLRA's requirements by bringing securities claims in state court.<sup>57</sup>

Because federal courts have exclusive jurisdiction over claims alleging Exchange Act violations, plaintiffs could no longer bring Exchange Act claims without complying with the requirements of PSLRA.<sup>58</sup> However, in many instances, state securities law and common law fraud provide remedies similar to those offered under the Exchange Act.<sup>59</sup> Therefore, class action plaintiffs with Exchange Act claims could avoid PSLRA's restrictions by filing similar state securities law or common law fraud claims in state courts.<sup>60</sup> PSLRA posed even less of an obstacle to class actions asserting Securities Act violations because—in contrast to the Exchange Act's grant of exclusive federal court jurisdiction<sup>61</sup>—the Securities Act gave concurrent, nonremovable jurisdiction to state and federal courts.<sup>62</sup> Further, because Securities Act claims were expressly nonremovable, plaintiffs asserting violations of the Securities Act could avoid the requirements of PSLRA by simply filing their federal claims in state court.<sup>63</sup>

These two alternatives to federal court threatened to undermine the effectiveness of PSLRA. Indeed, reports issued after the enactment of PSLRA showed that “class action securities fraud litigation . . . declined by about a third in federal courts, but . . . [t]here [was] an almost equal increase in the level of state court” securities fraud actions.<sup>64</sup> To prevent plaintiffs from circumventing

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note 52, § 7.17[2] (“The class action procedural reforms of [PSLRA] appl[y] only to class actions . . . in federal court.”).

57. 2 HAZEN, *supra* note 52, § 7.17[2].

58. 15 U.S.C. § 78aa.

59. 2 HAZEN, *supra* note 52, § 7.17[2] (noting the overlapping remedies provided by state law and federal law).

60. *See Dabit v. Merrill Lynch, Pierce, Fenner & Smith, Inc.*, 395 F.3d 25, 32–33 (2d Cir. 2005), *rev'd*, 126 S. Ct. 1503 (2006).

61. 15 U.S.C. § 78aa.

62. *Id.* § 77v(a). For a more thorough discussion of concurrent jurisdiction, see generally Thomas Lee Hazen, *Allocation of Jurisdiction Between the State and Federal Courts for Private Remedies Under the Federal Securities Laws*, 60 N.C. L. REV. 707 (1982).

63. *See Dabit*, 395 F.3d at 32–33; 2 HAZEN, *supra* note 52, § 7.17[2].

64. *See* H.R. REP. NO. 105-803, at 14 (1998) (Conf. Rep.) (quoting Joseph A. Grundfest & Michael A. Perino, *Securities Litigation Reform: The First Year's Experience* (Stan. L. Sch. Sec. Class Action Clearinghouse, Release No. 97-1, Feb. 27, 1997), [http://securities.stanford.edu/research/studies/19970227firstyr\\_firstyr.html](http://securities.stanford.edu/research/studies/19970227firstyr_firstyr.html)). For a more thorough account of “federal flight,” including a discussion of critics of this theory, see *infra* note 183.

PSLRA, Congress enacted SLUSA,<sup>65</sup> which attempted to move most class actions alleging securities fraud to the federal courts, where PSLRA applies.<sup>66</sup>

To make federal court the primary venue for securities fraud class actions, SLUSA first precluded,<sup>67</sup> in § 16(b), “covered class actions”<sup>68</sup> that allege state-law claims based on securities fraud, thus forcing plaintiffs to allege federal claims.<sup>69</sup> Second, SLUSA amended both the Securities Act and the Exchange Act by including a grant of removal authority.<sup>70</sup> However, some courts have read the removal authority to extend only to those state-law claims that are precluded by § 16(b).<sup>71</sup> Such an interpretation makes sense in the context of Exchange Act claims because of the exclusive federal court jurisdiction over such claims.<sup>72</sup> However, in the context of Securities Act claims with concurrent, nonremovable jurisdiction, limiting removal authority to precluded state-law claims creates the “upside-down effect”<sup>73</sup> where judges remand class actions alleging federal Securities Act violations back to state courts.<sup>74</sup> This narrow interpretation of removal authority contradicts the stated intent of Congress to subject securities fraud class actions to PSLRA.<sup>75</sup>

Three factors magnify the importance of such a result. First, federal law prevents appellate review of district court decisions to

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65. See *infra* Part III.

66. See 2 HAZEN, *supra* note 52, § 7.17[1][F].

67. *Kircher v. Putnam Funds Trust*, 126 S. Ct. 2145, 2150 n.1 (2006) (“The preclusion provision is often called a preemption provision; the Act, however, does not itself displace state law with federal law but makes some state-law claims nonactionable through the class action device in federal as well as state court.” (citing *Merrill Lynch, Pierce, Fenner & Smith, Inc. v. Dabit*, 126 S. Ct. 1503, 1514 (2006))).

68. 15 U.S.C. § 77p(f)(2)(A) (2000) (defining a “covered class action” as a lawsuit with more than “50 prospective class members”). For a thorough discussion of “covered class actions” under SLUSA and the relationship with Federal Rule of Civil Procedure 23, see 9 LOSS & SELIGMAN, *supra* note 35, at 4166–73.

69. 15 U.S.C. §§ 77p(b), 78bb(f)(1). Note that SLUSA’s preclusion and removal provisions also apply only to suits involving “covered securities.” *Id.* §§ 77p, 78bb(f). Stated broadly, “covered securities” are those which are “nationally traded.” 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, 341 (2004); see also § 77r.

70. See *infra* note 127.

71. See *infra* note 87 and accompanying text.

72. 15 U.S.C. § 78aa.

73. Andrew J. Morris & Fatima A. Goss, *Why Claims Under the Securities Act of 1933 Are Removable to Federal Court*, 36 Sec. Reg. & L. Rep. (BNA) 626, 626 (Apr. 5, 2004).

74. Indeed, the theory has been called the “paradox theory” because it is based on “the theory that SLUSA moved state-law cases to federal court but left federal-law cases in state court.” *Id.*

75. See *infra* note 171 and accompanying text.

grant motions to remand.<sup>76</sup> This removes PSLRA's protections without immediate review by a higher court.<sup>77</sup> Second, a district court split, which is unlikely to be resolved due to lack of appellate review, may encourage forum shopping. For example, the Southern District of Texas disagrees with the Northern District of Texas on whether to remand class actions alleging pure Securities Act claims.<sup>78</sup> The Northern District of Texas denied a motion to remand a case alleging only Securities Act violations, thus permitting the case to remain in federal court where it would be subject to PSLRA. However, the Southern District remanded a similar Securities Act claim. Without the higher appellate authority to unify these decisions, future plaintiffs would simply file in a state court where remand would be to the Southern District. Extending this concept on a national scale, once plaintiffs determine which district courts remand and which do not, plaintiffs will simply file in the district courts that will remand Securities Act cases to state courts. Contrary to the goals of SLUSA,<sup>79</sup> this would ultimately provide plaintiffs with the sole choice of whether PSLRA's limitations will apply. Finally, the increasing scrutiny of publicly held companies after the failures of Enron<sup>80</sup> and WorldCom<sup>81</sup>—and the corresponding increases both in number of

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76. 28 U.S.C. § 1447(d) (stating that “an order remanding a case to the State court from which it was removed is not reviewable on appeal or otherwise”); *Kircher v. Putnam Trust Funds*, 126 S. Ct. 2145, 2153 (2006); *Thermtron Prods., Inc. v. Hermansdorfer*, 423 U.S. 336, 343 (1976).

77. The federal court's decision is not given preclusive effect as to the merits of the case. *Kircher*, 126 S. Ct. at 2157. The Court in *Kircher* held that even though the decision to remand by the federal district court “coincide[d] entirely with the merits of the federal question[,] it is only the forum designation that is conclusive.” *Id.* Thus, after remand by the federal court, the state court could dismiss the case for lack of jurisdiction even though the federal court had previously held that the state court had exclusive jurisdiction. As the Court in *Kircher* explained: “[C]ontemporary principles of collateral estoppel . . . strongly militat[e] against giving a [non-reviewable judgment] preclusive effect.” *Id.* (alteration in original) (quoting *Standefer v. United States*, 447 U.S. 10, 23 (1980)). Despite this, PSLRA's protections, such as mandatory rule 11(b) review, do not apply in state court, and corporate defendants might feel pressure to settle, thereby sustaining the evil that Congress sought to cure through SLUSA.

78. *Alkow v. TXU Corp.*, No. 3:02-CV-2378-K, 2003 WL 21056750, at \*1 (N.D. Tex. May 8, 2003) (denying the motion to remand a Securities Act class action); *In re Waste Mgmt., Inc. Sec. Litig.*, 194 F. Supp. 2d 590, 595 (S.D. Tex. 2002) (granting the motion to remand a Securities Act class action).

79. See *infra* note 171 and accompanying text.

80. Richard A. Opper, Jr. & Andrew Ross Sorkin, *Enron's Collapse: The Overview; Enron Corp. Files Largest U.S. Claim for Bankruptcy*, N.Y. TIMES, Dec. 3, 2001, at A1.

81. Simon Romero & Riva D. Atlas, *Worldcom's Collapse: The Overview; Worldcom Files for Bankruptcy; Largest U.S. Case*, N.Y. TIMES, July 22, 2002, at A1.

claims brought and the settlement amounts of those claims<sup>82</sup>—heightens the urgency of finding SLUSA’s proper interpretation so that judicial resources can focus on meritorious cases.

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82. Michael C. Tu, *Ten Years After the Reform Act: Trends in Securities Class Action Trials*, 19 Sec. Reform Act Litig. Rep. (Computer Law Reporter, Inc.) 475, 478 (July 2005); Sheri Qualters, *Shareholder Suits Down, But a New Wave May Be Near*, BOSTON BUS. J., Jan. 20, 2006, <http://albany.bizjournals.com/boston/stories/2006/01/23/news.column3.html> (noting a decrease in suits in 2005, but citing one securities lawyer as saying that “case filings aren’t driven by the amount of actual fraud”). Qualters’ article suggests that a securities lawsuit may be provoked simply by the filing of an earnings restatement. *Id.*; see also Rudolph F. Pierce & Richard J. Rosensweig, *The “Other” Costs of Securities Class Action Settlements*, <http://library.findlaw.com/2004/Oct/27/133622.html> (last visited Dec. 13, 2006) (“It is no secret that the costs of settling securities class actions are high and continue to rise . . . . [I]n 1995, the average class action settlement was under \$7 million; by 2003 the average exceeded \$25 million.”). Pierce and Rosensweig also note that the financial costs “represent only part of the equation,” explaining that recent settlements have been imposing nonmonetary penalties as well that may be “equally or more disruptive,” like compulsory “changes in the board of directors.” *Id.* Specifically, they argue that “[t]he result of these new governance focused settlements may be that the costs associated with class action settlements—long perceived as exorbitant [sic] in and of themselves will be only part of the overall expense for companies that get sued in securities class actions.” *Id.*; see also John E. Black, Jr. & David T. Burrowes, *D&O Litigation Trends in 2004*, IRMI.COM, Feb. 2004, <http://www.irmi.com/expert/Articles/2004/Black02.aspx#8> (noting that “securities fraud suits . . . [increased] from 122 in 1996 to 224 in 2003” and that “the average settlement increased from \$7.0 million in 1996 to \$24.3 million in 2002 and the median settlement increased from \$3.5 million to \$6 million” (footnotes omitted)). Although settlement costs seem to be consistently rising in the long-term, some research suggests that 2006 may see fewer claims and smaller settlement costs per filing than recent years:

Securities class action has decreased noticeably in the first half of 2006 . . . . Total market capitalization losses associated with filings in the first half of 2006 also decreased substantially from the already reduced levels observed in 2005. . . . The annualized Maximum Dollar Losses (MDL) in the first half of 2006 amounted to \$255 billion, a 44 percent decline from 2005, and the annualized Disclosure Dollar Losses (DDL) amounted to \$45 billion, a 55 percent decline from 2005. . . . In our 2005 *Year in Review* publication, we suggested that the lower level of litigation activity in 2005 could be related to a combination of three factors. First, the dramatic boom and bust of U.S. equities in late 1990s–early 2000s is now sufficiently far in the past that the large majority of lawsuits relating to fraud during that period are behind us. Second, it is also possible that improvements in corporate governance following high publicity filings and settlements such as Enron and WorldCom, along with the passage of the Sarbanes Oxley Act of 2002, have influenced the number of filings. Third, the U.S. stock market became less volatile in 2005 than at any time since 1996. Because volatility is an important determinant of the likelihood of securities litigation, lower volatility tends to be associated with lower number of filings. With the exception of a modest pickup in volatility in May and June 2006, these three factors remained in place in the first half of 2006.

CORNERSTONE RESEARCH, SECURITIES CLASS ACTION CASE FILINGS: 2006 MID-YEAR ASSESSMENT 2 (2006), [http://securities.stanford.edu/clearinghouse\\_research/2005\\_YIR/2006FilingsMidYearRelease.pdf](http://securities.stanford.edu/clearinghouse_research/2005_YIR/2006FilingsMidYearRelease.pdf); see also Alan B. Krueger, *Accounting for Bad Apples*:

## II. THE LANGUAGE OF THE STATUTE

A. *SLUSA's Removal Authority and the District Court Split*

The district courts disagree over the relationship between the nonremoval provision of the Securities Act and the removal provision added by SLUSA. Section 22, the nonremoval provision, provides that “no case arising under this title and brought in any State court . . . shall be removed to any court of the United States.”<sup>83</sup> SLUSA, however, modified § 22’s prohibition against removal by adding the following italicized text: “*except as provided in section 16* no case arising under this title and brought in any State court . . . shall be removed”<sup>84</sup> to federal court.<sup>85</sup> SLUSA also added the following provisions to § 16 of the Securities Act:

(b) Class action limitations. 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—

(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.

(c) Removal of covered class actions. Any covered class action brought in any State court involving a covered security, *as set forth in subsection (b)*, shall be removable to the Federal district court for the district in which the action is pending, and shall be subject to subsection (b).<sup>86</sup>

The conflict over the scope of SLUSA’s removal authority arises from the ambiguity of the above language in § 16. Specifically, the removal provision, § 16(c), cites the preclusion provision, § 16(b). Thus, because § 16(c) allows removal of securities “as set forth in subsection (b),” and because § 16(b) addresses only class actions

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*Investors in the Stock Market Render Their Verdicts*, N.Y. TIMES, July 25, 2002, at C2 (noting investor reaction to accounting scandals); *S.E.C. to Consider Disclosure of Mutual Funds' Proxy Votes*, N.Y. TIMES, Sept. 17, 2002, at C15 (noting that “investor confidence [was] shaken” by accounting scandals like Enron and Worldcom).

83. 15 U.S.C. § 77v(a) (2000).

84. *Id.* (emphasis added).

85. Securities Litigation Uniform Standards Act of 1998, Pub. L. No. 105-353, § 101, 112 Stat. 3227, 3230 (codified as amended at 15 U.S.C. § 77v(a) (2000)).

86. § 101, 112 Stat. at 3228 (codified as amended at 15 U.S.C. § 77(p) (2000)) (emphasis added).

“based upon the statutory or common law of any State,” some district courts have held that § 16(c) only authorizes removal of class actions alleging a state-law claim, therefore, remanding the class actions alleging only Federal Securities Act claims to state court.<sup>87</sup>

On the surface, this argument seems very plausible. If § 16(b) modifies the entirety of § 16(c), then removal authority should not extend to Federal Securities Act claims. However, this Comment argues for an interpretation of § 16(c) that reads the reference to § 16(b) not as a limitation on the types of claims that may be removed, but as an express inclusion of state-law class actions in a larger category of claims that may be removed to federal court. This approach—similar to that reached by the District Court for the Northern District of Texas<sup>88</sup>—provides the reading of the statute most consistent with that intended by Congress and also reconciles otherwise conflicting subsections of the statute. Furthermore, a broad reading comports with the Supreme Court’s mandate that, in the area of statutory construction, courts should not proceed “by a single sentence, or member of a sentence, but look to the provisions of the whole law, and to its object.”<sup>89</sup>

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87. See, e.g., *Irta v. Lazard Ltd.*, No. 05 CV 3388 RJDRML, 2006 WL 2375472, at \*1 (E.D.N.Y. Aug. 15, 2006); *Zia v. Med. Staffing Network, Inc.*, 336 F. Supp. 2d 1306, 1309 (S.D. Fla. 2004); *In re Tyco Int’l, Ltd. Multidistrict Litig.*, 322 F. Supp. 2d 116, 119 (D.N.H. 2004); *Haw. Structural Ironworkers Pension Trust Fund v. Calpine Corp.*, No. 03cv0714 BTM(JFS), 2003 U.S. Dist. LEXIS 15832, at \*6 (S.D. Cal. Aug. 26, 2003); *Martin v. BellSouth Corp.*, No. 03-CV-728-WBH, slip op. at 5 (N.D. Ga. July 7, 2003); *Nauheim v. Interpublic Group of Cos.*, No. 02-C-9211, 2003 U.S. Dist. LEXIS 6266, at \*17 (N.D. Ill. Apr. 15, 2003); *In re Waste Mgmt., Inc. Sec. Litig.*, 194 F. Supp. 2d 590, 593 (S.D. Tex. 2002).

88. *Alkow v. TXU Corp.*, No. 3:02-CV-2738-K, 2003 U.S. Dist. LEXIS 7900, at \*1 (N.D. Tex. May 8, 2003) (stating that “the reference in [§ 16(c)] to subsection (b) includes state-law class actions among the cases that may be removed, but does not limit removal to just those cases”). The Western District of North Carolina reached the same conclusion that remand was improper, but noted that “[s]ection 16(b) does not narrow the scope of cases removable under section 16(c), except in its preemption of certain *state* law claims that might otherwise be removed.” *Lowinger v. Johnston*, No. 3:05CV316-H, 2005 WL 2592229, at \*4 (W.D.N.C. Oct. 13, 2005). Some defendants have also argued that the provision, “as set forth in subsection (b),” does not modify the phrase “covered class action,” but only the phrase “involving a covered security” in an effort to clarify that the provision only covers securities involving fraud. See *In re Tyco Int’l*, 322 F. Supp. 2d at 119 (summarizing the defendant’s argument); *In re Waste Mgmt.*, 194 F. Supp. 2d at 595 (noting that the defendants raised this argument).

89. *Massachusetts v. Morash*, 490 U.S. 107, 115 (1990) (quoting *Pilot Life Ins. Co. v. Dedeaux*, 481 U.S. 41, 51 (1987)).

### B. Plain Language?

Although the difficulty of interpreting the statute is implicit in the growing district court split<sup>90</sup> over the issue, courts and commentators on both sides explicitly note the difficulty of ascertaining an accurate interpretation.<sup>91</sup> In *Brody v. Homestore, Inc.*,<sup>92</sup> the District Court for the Central District of California stated that the statute was “inartfully (or even inaccurately) worded,” but refused to grant a motion to remand a Securities Act claim to state court.<sup>93</sup>

The Southern District of California<sup>94</sup> also acknowledged the “seeming inconsistency between the plain language of [§ 16(c)] and [§ 22(a)],” but remanded the case to state court.<sup>95</sup> Ironically, the Southern District of California remanded the case to state court because it determined that the “language of the statute is clear.”<sup>96</sup> Other cases, while not explicitly noting the statute’s ambiguity, implicitly do so by using two to three pages to interpret the “plain meaning” of the statute.<sup>97</sup> One commentator, arguing for removal of pure Securities Act claims, noted that “the removal provision’s reference to the preemption provision is not a model of clarity.”<sup>98</sup> Another commentator, arguing for nonremoval, noted the ambiguity

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90. See *supra* notes 87–88 and accompanying text.

91. Note that the party arguing that removal jurisdiction is appropriate has the burden of proving it. *Wilson v. Republic Iron & Steel Co.*, 257 U.S. 92, 97 (1921). Additionally, removal jurisdiction is strictly construed against the party arguing for removal. *Shamrock Oil & Gas Corp. v. Sheets*, 313 U.S. 100, 108 (1921).

92. 240 F. Supp. 2d 1122 (C.D. Cal. 2003).

93. *Id.* at 1123. This interpretation was criticized by the district court in *Nauheim*. *Nauheim v. Interpublic Group of Cos.*, No. 02-C-9211, 2003 U.S. Dist. LEXIS 6266, at \*14 (N.D. Ill. Apr. 15, 2003). The court in *Nauheim* stated that “[u]nder the clear and unambiguous language of the statute, as amended by SLUSA, such an action [based solely on federal law] cannot be removed from state court.” *Id.* at \*17. The Eastern District of Tennessee agreed with the *Brody* court’s description of the statute. *In re King Pharm., Inc.*, 230 F.R.D. 503, 505 (E.D. Tenn. 2004) (“The *Brody* court recognized that SLUSA, although inartfully worded, was enacted to ensure that securities class litigation would be conducted in federal court.”).

94. *Haw. Structural Ironworkers Pension Trust Fund v. Calpine Corp.*, No. 03cv0714 BTM(JFS), 2003 U.S. Dist. LEXIS 15832, at \*7 (S.D. Cal. Aug. 23, 2003).

95. *Id.* at \*6. Another commentator has also noted the seeming contradiction. Jordan A. Costa, Note, *Removal of Securities Act of 1933 Claims After SLUSA: What Congress Changed, and What it Left Alone*, 78 ST. JOHN’S L. REV. 1193, 1211 (2004) (“[T]he court directly contradicted itself by calling the statute ‘clear’ and by simultaneously recognizing the ‘inconsistency’ in its language.”). For a more thorough discussion of the inconsistency between § 22(a) and § 16(c), see *infra* notes 104–15 and accompanying text.

96. *Haw. Structural Ironworkers*, 2003 U.S. Dist. LEXIS 15832, at \*6.

97. See, e.g., *In re Tyco Int’l, Ltd. Multidistrict Litig.*, 322 F. Supp. 2d 116, 121 (D.N.H. 2004).

98. Morris & Goss, *supra* note 73, at 626.

of the statute in nearly identical terms, stating that “the provisions are far from a model of legislative clarity.”<sup>99</sup> Thus, the confusion in the district courts is understandable. However, as demonstrated in the following Section, the language of the statute supports the broad reading of § 16(c)’s removal authority.

### C. *The Statutory Argument*

The broad reading of the removal authority is internally consistent with the statute as a whole, creating a result closer to that envisioned by Congress.<sup>100</sup> Three primary statutory arguments support the broad reading. The first two arguments examine specific provisions of the statute, and the third demonstrates that only the broad reading explains SLUSA’s amendment to both the Securities Act and the Exchange Act. First, the narrow reading ignores the “except” clause that SLUSA added to § 22 of the Securities Act.<sup>101</sup> Second, the narrow reading creates redundancy in the use of the term “covered class action” in both § 16(c) and § 16(b).<sup>102</sup> Finally, Congress could have achieved the narrow reading without amending the Securities Act at all; the broad reading, however, gives meaning to this amendment.

First, the broad reading explains the meaning of the “except” clause in § 22. Section 22(a) of the Securities Act confers concurrent jurisdiction to state and federal courts and further provides that “no case arising under this title and brought in any State court of competent jurisdiction shall be removed to any court of the United

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99. Costa, *supra* note 95, at 629.

100. See *infra* Part III.

101. See Brody v. Homestore, Inc., 240 F. Supp. 2d 1122, 1124 (C.D. Cal. 2003); Alkow v. TXU Corp., No. 3:02-CV-2738-K, 2003 U.S. Dist. LEXIS 7900, at \*1 (N.D. Tex. May 8, 2003) (“In other words, claims arising under the [Securities] Act are removable as provided in [§ 16(c)]. If [§ 16(c)] applies only to state-law claims as the Alkows claim, then no claims arising under the 1933 Act would be removable, and the exception language in [§ 22(a)] would be meaningless.”). But see *In re Tyco Int’l*, 322 F. Supp. 2d at 120 (rejecting the argument that if § 16(c) “authorizes the removal only of cases that are based on state law, Congress would not have needed to amend [§ 22(a)] to create an exception for cases that are removable under [§ 16(c)] because [§ 22(a)] applies only to claims that arise under the Securities Act”); *In re Waste Mgmt., Inc. Sec. Litig.*, 194 F. Supp. 2d 590, 595–96 (S.D. Tex. 2002) (rejecting the argument that applying the removal clause to state-law claims *only* would make the except clause in § 22(a) pointless).

102. See *In re Tyco Int’l*, 322 F. Supp. 2d at 120 n.8 (noting that the defendants raised this argument, but stating that “[w]hile . . . § 77p(c) could have been drafted without these terms because they are already included in § 77p(b), it is understandable that Congress would have wanted to emphasize that, like the rest of SLUSA, § 77p(c) was intended to apply only to covered class actions that involve covered securities”).



States.”<sup>103</sup> SLUSA amended § 22(a) by adding the phrase “except as provided in section 16(c)”<sup>104</sup> to qualify both the concurrent jurisdiction and nonremovability of claims.<sup>105</sup> However, § 22(a) applies only to “offenses and violations under [the Securities Act].”<sup>106</sup> Thus, the “except” clause is unnecessary to create removal authority for state-law claims. To put it another way, if § 16(c) were truly meant to permit the removal of only state-law claims, then it would be illogical for the jurisdictional provision of the Securities Act, which applies only to federal claims, to contain an exception for state-law claims that would never come under the scope of the Act.<sup>107</sup> Thus, the narrow reading, which allows removal of only the precluded state-law claims, would create inconsistency between § 16(c) and § 22(a) of the Securities Act and would impute to Congress the intent to draft an unneeded amendment to § 22(a). Indeed, the absence of any explanation of such an awkward result in the legislative history makes the narrow reading even more doubtful.

The broad reading of § 16(c) eliminates this confusion and provides a more intelligible explanation of the “except” clause. Specifically, under the broad reading, individual claims alleging violations of the Securities Act would continue to enjoy concurrent, nonremovable jurisdiction.<sup>108</sup> However, the “except” clause in § 22(a) would allow defendants to remove a subset of those claims—those brought by “covered class actions”—to federal court. Because PSLRA’s procedural requirements apply only in federal court, only the broad reading of removal authority is consistent with the legislative intent to revitalize PSLRA’s restrictions on class actions. Thus, the broad reading gives meaning to Congress’s amendment to the nonremoval clause of § 22(a)—a meaning that reflects the intent to revitalize PSLRA.

One court “reject[ed] this argument [for the broad reading] because it is based on the mistaken premise that a case cannot both arise under the Securities Act *and* be based on state law.”<sup>109</sup> The court in *In re Tyco International* argued that a claim may arise

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103. 15 U.S.C. § 77v(a) (2000).

104. Securities Litigation Uniform Standards Act of 1998, Pub. L. No. 105-353, § 101, 112 Stat. 3227, 3230 (codified as amended at 15 U.S.C. § 77v(a)).

105. *Id.*

106. § 77v(a).

107. *See supra* note 103 and accompanying text.

108. § 77p(c) (extending removal authority only to “covered class actions”).

109. *In re Tyco Int’l, Ltd. Multidistrict Litig.*, 322 F. Supp. 2d 116, 120 (D.N.H. 2004) (emphasis added).

simultaneously under both the Securities Act and state law.<sup>110</sup> The possibility of overlapping federal and state claims, the court argued, explains the purpose of the “except” clause for state-law claims.<sup>111</sup> This reading suggests that the “except” clause of § 22(a) merely ensures removal of those state claims that may overlap with an otherwise nonremovable Securities Act claim.

However, careful examination of this argument reveals fundamental flaws. The argument recognizes that claims can arise under both federal and state law, but would allow defendants to remove the complaint only when the plaintiff expressly pleads the state claim.<sup>112</sup> Under this interpretation, the class action plaintiff has two overlapping remedies—one under federal law and one under state law—but the removal provision of § 16(c) applies only if the plaintiff explicitly alleges the state-law claim. In direct contradiction to the stated purpose of SLUSA,<sup>113</sup> this would give plaintiffs sole choice of forum, and, thus, choice of whether PSLRA’s restrictions apply.

To put it another way, if § 16(c)’s removal authority extends only to state claims—those which are immediately precluded by § 16(b)—plaintiffs would have no incentive to include such claims. Plaintiffs suffer no loss by excluding precluded claims. Thus, plaintiffs could choose the forum with impunity. Congress enacted SLUSA with the explicit purpose of preventing class action plaintiffs from circumventing PSLRA.<sup>114</sup> An interpretation of SLUSA that would allow class action plaintiffs claiming violations of the Securities Act to avoid PSLRA by simply excluding a precluded claim conflicts with Congress’s intent.<sup>115</sup> Further, nothing in the legislative history

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110. *Id.* at 120 nn.6–7.

111. *Id.*

112. A contrary interpretation would require courts, when hearing a motion to remand, to perform a searching inquiry into state law to determine whether an overlapping state-law claim exists. Such an interpretation would create two separate subsets of class action claims: (1) those alleging violations of the Securities Act that also could be brought under an applicable state law; and (2) those alleging violations of the Securities Act that could not also be brought under an applicable state law. This interpretation would then apply § 16(c) only to the first subset of claims—those Securities Act claims that could potentially have an overlapping state-law claim. No court or commentator suggests that this could be the correct interpretation of the statute.

113. Securities Litigation Uniform Standards Act of 1998, Pub. L. No. 105-353, § 2, 112 Stat. 3227, 3227 (codified as amended at 15 U.S.C. § 78a (2000)) (stating that one of the purposes of SLUSA was “to prevent certain State private securities class action lawsuits alleging fraud from being used to frustrate the objectives of the Private Securities Litigation Reform Act of 1995”).

114. *See infra* note 171 and accompanying text.

115. *See infra* Part III.

indicates the intent to create an exception to SLUSA for a subset of class actions that are based on Securities Act claims.

The second argument for the broad reading examines the inconsistency that the narrow reading creates between §§ 16(c) and 16(b). Under the narrow reading, the phrase in § 16(c), “[a]ny covered class action brought in any State court involving a covered security, *as set forth in subsection (b)*,” incorporates *all* of the terms of § 16(b).<sup>116</sup> Indeed, the premise of the narrow reading is that § 16(c) incorporates the phrase, “[n]o covered class action *based upon the statutory or common law of any State*.”<sup>117</sup> However, both § 16(c) and § 16(b) have clauses limiting their scope to “covered class actions”; thus, under the narrow reading, the inclusion of “covered class action” again in § 16(c) is unnecessary.<sup>118</sup> To put it another way, because § 16(b) includes the phrase “covered class action,” the narrow reading of the statute could be achieved more concisely if § 16(c) simply read, “Any claim involving a covered security, as set forth in subsection (b), brought in State court shall be removable,” instead of the existing text, “Any *covered class action* brought in any State court involving a covered security.”<sup>119</sup>

The broad reading avoids this redundancy.<sup>120</sup> Specifically, the broad reading suggests two independent provisions: § 16(c) sets forth the requirements for removal while § 16(b) sets forth the requirements for preclusion. As such, the two sections begin with the parallel language<sup>121</sup> that one would expect from independent provisions, each separately including covered class actions. Under the broad reading, the use of the phrase “as set forth in subsection (b)” ensures that federal courts determine which actions are precluded by subsection (b) but does not limit removal to those claims. Instead, the broad reading would extend removal authority to any covered class action involving a covered security that alleged violations of the Securities Act and also those claims precluded by subsection (b). Only this reading comports with Congress’s clear

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116. See *In re Tyco Int’l, Ltd. Multidistrict Litig.*, 322 F. Supp. 2d 116, 119 (D.N.H. 2004) (noting that defendants raised this argument, but finding it unpersuasive); *In re Waste Mgmt., Inc. Sec. Litig.*, 194 F. Supp. 2d 590, 595–96 (S.D. Tex. 2002) (rejecting this argument).

117. 15 U.S.C. § 77p(b) (2000) (emphasis added).

118. See *In re Tyco Int’l*, 322 F. Supp. 2d at 120 n.8.

119. § 77p(c) (emphasis added).

120. *Id.* (rejecting this argument).

121. *Id.* § 77p(b) (“No covered class action . . . .”); *Id.* § 77p(c) (“Any covered class action . . . .”).

intent to grant federal courts broad authority over securities class actions.<sup>122</sup>

The final statutory argument examines SLUSA's amendments to both the Securities Act and the Exchange Act and demonstrates that only the broad reading gives purpose to both sets of amendments. This argument, however, must be viewed in the context of SLUSA's goal to prevent circumvention of PSLRA. Plaintiffs wishing to circumvent PSLRA used different methods to avoid federal court depending on which Act provided the remedy they sought.<sup>123</sup> Specifically, federal courts have exclusive jurisdiction over Exchange Act claims; however, many state securities laws and common law fraud provide similar remedies.<sup>124</sup> Thus, plaintiffs wishing to allege Exchange Act violations could often avoid federal court and PSLRA by filing similar state-law or common law fraud claims.<sup>125</sup> However, plaintiffs wanting to file Securities Act claims could take advantage of the concurrent, nonremovable jurisdiction and simply file their Federal Securities Act claim in state court,<sup>126</sup> thus getting around PSLRA's restrictions. Despite the two different means of avoiding federal court, Congress amended the two statutes with almost identical language.<sup>127</sup>

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122. See *supra* note 121 and accompanying text.

123. See *supra* notes 58–63 and accompanying text.

124. See *supra* note 59 and accompanying text.

125. See *supra* note 60 and accompanying text.

126. See *supra* note 63 and accompanying text.

127. Section 16 of the Securities Act states that:

(b) Class action limitations[:] 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—

(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;

(c) Removal of covered class actions[:] Any covered class action brought in any State court involving a covered security, as set forth in subsection (b), shall be removable to the Federal district court for the district in which the action is pending, and shall be subject to subsection (b).

15 U.S.C. § 77p (2000).

Section 29(f) of the Exchange Act states that:

(1) Class action limitations[:]

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—

To prevent plaintiffs from filing substitute state claims to avoid the Exchange Act's exclusive federal jurisdiction, SLUSA added a provision which precludes "covered class actions" alleging state-law and common law securities fraud.<sup>128</sup> Thus, plaintiffs could no longer file a state-law claim in state court for securities fraud similar to that provided by the Exchange Act and thereby circumvent PSLRA.<sup>129</sup> However, even though plaintiffs alleging Securities Act violations could avoid federal court due to the grant of concurrent, nonremovable jurisdiction and simply file their federal claim in state court,<sup>130</sup> SLUSA amended the Securities Act and the Exchange Act in an almost identical fashion by providing a clause precluding state-law securities fraud claims.<sup>131</sup>

Congress recognized that class actions could avoid PSLRA in the context of both Exchange Act and Securities Act claims.<sup>132</sup> However, SLUSA—enacted to solve this problem—clearly addressed only the method that plaintiffs used to avoid PSLRA's amendment to the Exchange Act; namely, it precluded class actions based on state-law

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(A) a misrepresentation or omission of a material fact in connection with the purchase or sale of a covered security; or

(B) that the defendant used or employed any manipulative or deceptive device or contrivance in connection with the purchase or sale of a covered security.

(2) Removal of covered class actions[;] Any covered class action brought in any State court involving a covered security, as set forth in paragraph (1), shall be removable to the Federal district court for the district in which the action is pending, and shall be subject to paragraph (1)).

15 U.S.C. § 78bb(f).

128. § 77p(b) (preclusion provision in the Securities Act); § 78bb(f)(1) (preclusion provision in the Exchange Act); *see also* 2 HAZEN, *supra* note 52, § 7.17[2] ("Under the 1933 Act's general jurisdiction provision, private actions under sections 11 and 12 of the Securities Act can be brought in either federal or state court. Additionally, state securities law and common law fraud were able to provide alternative state court forums for class action plaintiffs who could thereby avoid the provisions of [PSLRA]. Congress largely eliminated these alternatives in the Securities Litigation Uniform Standards Act of 1998." (footnotes omitted)). However, SLUSA did provide a few exceptions to this general rule. For instance, "class actions concerning privately traded securities are not covered by SLUSA's removal and preclusion provisions." *Id.* § 7.17[2]. In addition, "derivative suits and suits by individuals" may remain in state court. *Id.* State class actions are not precluded, and neither are class actions "seeking to enforce a contractual agreement under a trust indenture for a debt security." *Id.* § 7.17[2][A] (citations omitted).

129. *See* 2 HAZEN, *supra* note 52, § 7.17[2].

130. 15 U.S.C. § 77v(a).

131. *See supra* note 127.

132. SLUSA, designed to prevent plaintiff circumvention of PSLRA, amended both the Securities Act and the Exchange Act. *See* Securities Litigation Uniform Standards Act of 1998, Pub. L. No. 105-353, 112 Stat. 3227 (codified as amended in scattered sections of 15 U.S.C.).

securities fraud.<sup>133</sup> PSLRA also applied to Securities Act class actions brought in federal court,<sup>134</sup> but plaintiffs wishing to bring these claims did not have to find a similar state-law claim to avoid federal court. Instead, class action plaintiffs could file the Securities Act claim in state court.<sup>135</sup> Despite this different method of avoiding federal court, SLUSA added nearly the same language to the Securities Act as it added to the Exchange Act.<sup>136</sup> The narrow reading suggests that this language only allows removal of precluded state-law claims and thus fails to address the method by which class action plaintiffs avoided PSLRA in the context of Securities Act claims. However, SLUSA also amended the concurrent, nonremovable jurisdiction provision of the Securities Act with an “except” clause that references the removal provision.<sup>137</sup>

Further, Congress intentionally amended the Securities Act. The narrow reading suggests that Congress intended to prevent class action plaintiffs from circumventing PSLRA only in the context of Exchange Act claims; however, this reading fails to properly account for the fact that Congress also amended the Securities Act with the express intention of preventing circumvention of PSLRA by “private securities class action[s].”<sup>138</sup> Ascertaining whether Congress addressed both *causes* of this problem—(1) filing state claims and (2) filing Securities Act claims in state court—depends on one’s reading of SLUSA. The narrow reading suggests that Congress addressed only the first cause of this problem.

In the context of Securities Act claims, reading SLUSA’s removal authority narrowly leaves the amendment to the Securities Act superfluous. Under the narrow reading, § 16(b) of the Securities Act precludes state-law claims based on securities fraud, and § 16(c) grants removal authority only to those precluded state-law claims. However, after amendment, § 28(f)(1) of the Exchange Act precludes state-law claims,<sup>139</sup> and § 28(f)(2) grants removal authority to those precluded claims.<sup>140</sup> Thus, the narrow reading suggests that Congress provided for the removal and preclusion of state-law securities fraud claims *twice*.

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133. 15 U.S.C. § 78bb(f)(1).

134. *Id.* § 77z-1.

135. *Id.* § 77v(a).

136. *See supra* note 127.

137. *See supra* notes 84–85, 104–05 and accompanying text.

138. Securities Litigation Uniform Standards Act of 1998, Pub. L. No. 105-353, § 2, 112 Stat. 3227, 3227 (codified as amended at 15 U.S.C. § 78a (2000)).

139. 15 U.S.C. § 78bb(f)(1).

140. *Id.* § 78bb(f)(2).

Thus, a reading of the removal provision that does not allow removal of Securities Act claims leaves SLUSA's amendment to the Securities Act completely unnecessary and ineffectual. The broad reading, however, gives purpose to the amendment to the Securities Act by interpreting it to extend removal authority to Securities Act claims through the "except" clause that it added to the general nonremoval provision. Thus, the narrow reading creates a redundant statutory amendment, while the broad reading prevents both Securities Act class actions and Exchange Act class actions<sup>141</sup> from circumventing PSLRA, providing an interpretation more consistent with congressional intent.

Reading SLUSA's removal provision in the Securities Act to extend to Securities Act class actions avoids many illogical results that follow from the narrow reading. As such, this broad reading provides the most logical and internally consistent interpretation of the statute as a whole. The district court split, however, demonstrates the continuing disagreement over the scope of removal authority. The Supreme Court's decisions also fail to provide a clear answer.

#### D. *The Supreme Court's Conflicting Guidance*

Dicta in *Kircher v. Putnam Funds Trust*<sup>142</sup> suggest that the Supreme Court supports the narrow reading of the removal statute,<sup>143</sup> but the Court's dicta in *Merrill Lynch, Pierce, Fenner & Smith, Inc. v. Dabit*<sup>144</sup> indicate support for broad removal authority and uniform national standards.<sup>145</sup> Although *Dabit* specifically addressed whether SLUSA's amendment precludes state-law holder claims,<sup>146</sup> language in the opinion suggests that the Court would support the broad reading of § 16(c) and extend removal authority to Securities Act claims. *Dabit* read SLUSA's preclusion provision broadly by refusing to interpret the "in connection with a purchase or sale" requirement<sup>147</sup> to limit preclusion to claims involving a "purchase or sale."<sup>148</sup> The Court took this approach despite its decision in *Blue*

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141. Note that the phrasing here may be somewhat misleading as class actions with Exchange Act violations avoid PSLRA by filing a similar state-law claim, i.e., not the actual Exchange Act claim. See *supra* notes 58–60 and accompanying text.

142. 126 S. Ct. 2145 (2006).

143. See *infra* notes 163–64 and accompanying text.

144. 126 S. Ct. 1503 (2006).

145. *Id.* at 1514.

146. *Id.* at 1515.

147. Securities Litigation Uniform Standards Act of 1998, Pub. L. No. 105-353, § 101(b), 112 Stat. 3227, 3230 (codified as amended at 15 U.S.C. § 78bb(f) (2000)).

148. *Dabit*, 126 S. Ct. at 1515 (quoting 15 U.S.C. § 78bb(f)).

*Chip Stamps v. Manor Drug Stores*,<sup>149</sup> interpreting almost identical language to impose such a requirement on rule 10b-5 claims.<sup>150</sup>

The reasoning in *Dabit* also suggests support for the broad reading of § 16(c)'s removal authority. *Dabit* purported to follow congressional intent and noted the "congressional preference for 'national standards for securities class action lawsuits.'" <sup>151</sup> The Court also noted that "[t]he magnitude of the federal interest in protecting the integrity and efficient operation of the market for nationally traded securities cannot be overstated."<sup>152</sup>

The presumption that Congress envisioned a broad construction [of preclusion authority] follows not only from ordinary principles of statutory construction but also from the particular concerns that culminated in SLUSA's enactment. A narrow reading of the statute would undercut the effectiveness of [PSLRA] and thus run contrary to SLUSA's stated purpose, viz., "to prevent certain State private securities class action lawsuits alleging fraud from being used to frustrate the objectives" of the [PSLRA].<sup>153</sup>

The congressional language quoted in *Dabit* also supports the broad reading of § 16(c)'s removal authority. Indeed, the same concern, namely the circumvention of PSLRA, demands that Securities Act claims be litigated in federal court.

In *Dabit*, the Court also appeared comfortable allowing policy to dictate statutory interpretation in this area of law, noting that the Court had previously done so in *Blue Chip Stamps*.<sup>154</sup> Indeed, the Court highlighted that in *Blue Chip Stamps*, a seminal rule 10b-5 case, it had "relied chiefly and candidly, on 'policy considerations.'" <sup>155</sup> As noted later, in Part IV, policy also supports a broad reading of § 16(c).

The Court's decision in *Kircher*, handed down just four months later, seems to conflict both with *Dabit*'s reliance on congressional intent as an interpretive tool in construing SLUSA and its endorsement of a federal system of securities regulation. *Kircher*, like *Dabit*, involved a class action holder claim.<sup>156</sup> The plaintiffs in *Kircher*

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149. 421 U.S. 723 (1975).

150. *Id.* at 747-51 (interpreting rule 10b-5, 17 C.F.R. § 240.10b-5(c) (2006)). Rule 10b-5 and its statutory counterpart, 15 U.S.C. § 78j (2000), provide the basis for federal law claims alleging securities fraud.

151. *Dabit*, 126 S. Ct. at 1514 (quoting § 2(5), 112 Stat. at 3227).

152. *Id.* at 1509.

153. *Id.* at 1513 (quoting § 2(5), 112 Stat. at 3227).

154. *See id.* at 1510, 1512 (citing *Blue Chip Stamps*, 421 U.S. 723).

155. *Id.* at 1512.

156. *See Kircher v. Putnam Funds Trust*, 126 S. Ct. 2145, 2150 (2006).



had received a favorable decision from the district court, which ruled that SLUSA did not preclude holder claims. The defendants filed a notice of appeal and the Court of Appeals for the Seventh Circuit overturned the district court's decision and precluded the claim.<sup>157</sup> The plaintiffs appealed to the Supreme Court.

However, before the plaintiffs reached the Supreme Court, the Court handed down its decision in *Dabit*, which—unlike the district court in *Kircher*—held that SLUSA's preclusion provision applies to holder claims.<sup>158</sup> Defeated substantively, the plaintiffs argued that, regardless of whether the district court misinterpreted the law, the defendants had no right to appeal the decision.<sup>159</sup> The Supreme Court agreed, holding that decisions to remand cannot be appealed, even if, as in *Kircher*, the district court misinterprets the statute.<sup>160</sup>

Contrary to *Dabit*, language in *Kircher* suggests that the Court would adopt the narrow reading of SLUSA's removal provision in the context of federal claims brought under the Securities Act. Specifically, the Court in *Kircher* noted that its decision in *Dabit* suggested "that a 'key provision of the [Act] makes all "covered class actions" filed in state court removable.'"<sup>161</sup> However, the Court clarified this language in *Kircher* by stating, "We sketched the removal provisions in broad strokes then because the question of its scope was not before us. Now that it is, we speak more cautiously."<sup>162</sup> The Court further stated, "[W]e read authorization for the removal in [§ 16(c) as being] . . . confined to cases 'set forth in [§ 16(b)],' . . . namely those with claims of untruth, manipulation, and so on,"<sup>163</sup> and it specifically declared, "In sum, we see no reason to reject the straightforward reading: *removal and jurisdiction to deal with removed cases is limited to those precluded by the terms of subsection (b)*."<sup>164</sup> Thus, in *Kircher*, the Court seemed to read the amendment of the Securities Act narrowly to extend removal authority only to state-law claims.

As the Court noted, its reading in *Kircher* contradicts its reasoning in *Dabit*. If courts interpret SLUSA narrowly so as to

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157. *Id.* at 2151–52.

158. *Dabit*, 126 S. Ct. at 1515.

159. *Kircher*, 126 S. Ct. at 2151–52; see also *supra* note 76 and accompanying text (discussing 28 U.S.C. § 1447(d) (2000) and the general restriction against appealing decisions to remand).

160. *Kircher*, 126 S. Ct. at 2154.

161. *Id.* at 2154 n.11 (emphasis added) (quoting *Dabit*, 126 S. Ct. at 1512 n.7).

162. *Id.*

163. *Id.* at 2154.

164. *Id.* at 2155 (emphasis added).

remand Securities Act class actions to state court, then the federal statute will be subjected to conflicting state interpretations, thereby defeating the uniformity of “national standards” endorsed by *Dabit*.<sup>165</sup> However, because *Kircher* did not need to address the removal provision in the context of Securities Act claims, it did not fully explain its rationale and reconcile this patent conflict. Because policy favors a federal system of securities regulation and protection of corporations from strike suits,<sup>166</sup> the Court’s broad policy language in *Dabit*—supporting the broad reading of removal authority—may be more indicative of the Court’s view of securities laws generally than its specific statutory analysis in *Kircher*, which seems to support the narrow reading.<sup>167</sup> Thus, *Dabit* remains instructive to district courts addressing whether to remand Securities Act claims. In light of the statutory arguments supporting removal of federal claims,<sup>168</sup> the Court could conceivably abandon its dicta in *Kircher* and construe the removal provision in the Securities Act to cover Securities Act claims. Such a reading is also more consistent with the congressional intent of SLUSA.

### III. CONGRESSIONAL INTENT

The Supreme Court has noted for the past century that “‘nothing is better settled, than that statutes should receive a sensible construction, such as will effectuate the legislative intention, and . . . avoid an unjust or an absurd conclusion.’”<sup>169</sup> The legislative history of SLUSA indicates that Congress intended to enact a broad statute that provides for removal of pure Securities Act claims. The Central District of California, sensitive to the importance of legislative intent, noted that “‘[t]he purpose of [SLUSA] is to prevent plaintiffs from seeking to evade the protections that Federal law provides against abusive litigation by filing suit in State, rather than in Federal, court.’”<sup>170</sup> Indeed, Congress expressly set forth its goal in enacting SLUSA in the “Findings” section of the Act:

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165. See *Dabit*, 126 S. Ct. at 1509 (stating that “[t]he magnitude of the federal interest in protecting the integrity and efficient operation of the market for nationally traded securities cannot be overstated”); *supra* note 151 and accompanying text.

166. See *infra* Part IV.

167. *Kircher*, 126 S. Ct. at 2155.

168. See *supra* Part II.C.

169. *Johnson v. United States*, 529 U.S. 694, 707 n.9 (2000) (quoting *In re Chapman*, 166 U.S. 661, 667 (1897)).

170. *Brody v. Homestore, Inc.*, 240 F. Supp. 2d 1122, 1124 (C.D. Cal. 2003) (quoting 144 CONG. REC. H11,019, 11,020 (daily ed. Oct. 15, 1998) (Conference Report)).

[I]n order to prevent certain State private securities class action lawsuits alleging fraud from being used to frustrate the objectives of the Private Securities Litigation Reform Act of 1995, *it is appropriate to enact national standards for securities class action lawsuits* involving nationally traded securities, while preserving the appropriate enforcement powers of State securities regulators and not changing the current treatment of individual lawsuits.<sup>171</sup>

Thus, while Congress did intend to protect some enforcement powers of the states, the “Findings” section suggests that Congress’s primary concern was enacting national standards for class actions and preventing circumvention of PSLRA.<sup>172</sup>

The House Committee on Commerce specifically noted the problem of PSLRA circumvention in its report on the bill.<sup>173</sup> The Committee then added that “[t]he solution to this problem is to make Federal court the *exclusive venue* for securities fraud class action litigation.”<sup>174</sup> Indeed, the record is replete with references to the establishment of federal standards for subject securities.<sup>175</sup> Testifying before the Senate Committee on Banking, Housing, and Urban Affairs, Representative Anna G. Eshoo echoed this goal of establishing federal courts, with the procedural protections of PSLRA, as the exclusive venue for securities fraud cases: “Migration to State courts is not a minor problem. . . . This is because [PSLRA] relies on uniform application and enforcement of the law to be effective. Without this uniform standard, the law is undermined, the strike suits continue and companies and investors are held hostage.”<sup>176</sup>

Other congressional comments also suggest that Congress intended to enact an amendment granting broad removal authority. Senator Phil Gramm, a cosponsor of the bill, noted, “What our bill

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171. Securities Litigation Uniform Standards Act of 1998, Pub. L. No. 105-353, § 2, 112 Stat. 3227, 3227 (codified as amended at 15 U.S.C. § 78a (2000)) (emphasis added).

172. *Id.*

173. H.R. REP. NO. 105-640, at 10 (1998).

174. *Id.* (emphasis added).

175. *See, e.g.*, 144 CONG. REC. 8950, 8971 (1998) (statement of Sen. Dodd) (noting that SLUSA “is intended to create a uniform national standard for securities fraud class actions involving nationally-traded securities”); *id.* at 8987 (statement of Sen. Domenici) (stating that SLUSA “create[s] one set of rules for securities fraud cases”); *id.* at 8973 (statement of Senator Reed) (noting that “this Act will preempt this circumvention, creating a national standard for class action suits involving nationally traded securities”).

176. *Securities Litigation Uniform Standards Act of 1997: Hearings on S. 1260 Before the Subcomm. on Securities of the S. Comm. on Banking, Housing, & Urban Affairs*, 105th Cong. 7 (1997) (opening statement of Rep. Anna G. Eshoo).

does is very simply this. It sets *national standards* for stocks that are traded on the national markets. What it says is that in the case of class-action suits . . . if a stock is traded on the national market . . . then the . . . suit *has to be filed in Federal court.*<sup>177</sup> Speaking before the House of Representatives, Representative Tom Bliley noted that “lawsuits alleging violations that involve securities that are offered nationally *belong in Federal court.*”<sup>178</sup> Representative Bliley also noted that “[t]his legislation . . . will eliminate State court as a venue for meritless securities litigation.”<sup>179</sup>

Voicing his opposition to the bill, Senator Tim Johnson also indicated that he read the legislation consistently with the broad reading, which forces class action plaintiffs to meet PSLRA’s requirements; specifically, Senator Johnson argued that “[p]reempting state remedies now—and requiring fraud victims to seek relief *solely under the federal standards promulgated in 1995*—could leave investors with severely limited ability to protect themselves against fraud.”<sup>180</sup> Interestingly, nowhere did a Senator note an exemption from the removal authority for class actions alleging violations of only the Securities Act. Such an awkward exception to the implementation of “federal standards” would surely have been mentioned.

Senator Feinstein’s comments, however, may provide the most explicit congressional endorsement for the broad reading of SLUSA which extends removal authority to federal claims. She noted that SLUSA would create “uniform national standards in securities fraud class action suits.”<sup>181</sup> More importantly, Senator Feinstein directly alludes to the fact that the removal authority created by the Act extends to federal (i.e., Securities Act) claims and not just state-law claims. Specifically, she stated that without the authority to remove claims to federal court, corporations “whose securities are traded throughout the fifty states could face liability under *federal securities laws* in fifty state courts.”<sup>182</sup>

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177. 143 CONG. REC. 21,354, 21,355 (1997) (emphasis added).

178. 144 CONG. REC. 26,537, 26,537 (1998) (emphasis added).

179. *Id.*

180. 144 CONG. REC. 8950, 8970 (1998) (emphasis added).

181. *Id.* at 8969.

182. *Id.* (emphasis added). One student commentator brushed off the relevance of these statements, concluding that Senator Feinstein’s “reading of [SLUSA] . . . is erroneous.” Costa, *supra* note 95, at 1221. As a general matter, Costa argues that, despite repeated statements of members of Congress indicating the need for national standards in securities fraud litigation, and in a bill whose primary purpose was to remove most class actions to federal courts, the Republican Congress’s strong commitment to federalism

Congress enacted SLUSA to ensure compliance with PSLRA. Indeed, in enacting SLUSA, Congress specifically noted SLUSA's purpose "to prevent certain State private securities class action lawsuits alleging fraud from being used to frustrate the objectives of the Private Securities Litigation Reform Act of 1995."<sup>183</sup> As such, the goals of each are inextricably intertwined and the scope of SLUSA should be examined in light of PSLRA's reach. As noted in the "Findings" section of the Act,<sup>184</sup> Congress designed SLUSA to prevent class action plaintiffs from easily sidestepping PSLRA's restrictions by filing in state court. PSLRA attempted to prevent abusive strike suits by adding procedural limitations to both the

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prevented it from allowing removal of the small sliver of complaints comprised of pure Securities Act claims, and thus created an anomalous subset of claims which are unfavorable to big businesses. *Id.* at 1223 ("[The] Republican majority [in both houses] was generally concerned with federalism, and with 'returning authority to the states.' [And a]s a general proposition, proposed legislation which contracted the authority of state judiciary in favor of augmenting that of the federal judiciary was unpopular in this political climate." (citations omitted)).

183. Securities Litigation Uniform Standards Act of 1998, Pub. L. No. 105-353, § 2, 112 Stat. 3227, 3227 (codified as amended at 15 U.S.C. § 78a (2000)); see 144 CONG. REC. 16,425, 16,437 (1998) (noting a "6000 percent increase" in state securities class actions filings after the passage of the PSLRA); see also Grundfest & Perino, *supra* note 64 (noting an increase in state court cases that closely mirrors the decrease in federal cases brought following passage of PSLRA); Allan Horwich, *The Securities Litigation Uniform Standards Act Has Begun to Achieve Its Purpose*, WALLSTREETLAWYER.COM: SEC. ELEC. AGE 4, Nov. 1999, available at 3 No. 6 GLWSLAW 4 ("Some members of the plaintiffs' securities bar sought to avoid the burdens imposed by the PSLRA by shifting their focus, to the extent possible, to state-law claims in state courts."). The Conference report cited the findings of Joseph A. Grundfest and Michael A. Perino, which showed that after enactment of PSLRA, federal class actions alleging securities fraud were down by a third, while state fraud securities class actions increased proportionately. H.R. REP. NO. 105-803, at 14-15 (1998) (Conf. Rep.) (citing Grundfest & Perino, *supra* note 64). The Conference report referred to this as the "substitution effect." *Id.* It has also been referred to as "federal flight." See *Dabit v. Merrill Lynch, Pierce, Fenner & Smith, Inc.*, 395 F.3d 25, 32 (2d Cir. 2005), *rev'd*, 126 S. Ct. 1503 (2006); *Spielman v. Merrill Lynch, Pierce, Fenner & Smith, Inc.*, 332 F.3d 116, 123 (2d Cir. 2003). However, findings that PSLRA actually created "federal flight" are disputed. See 9 LOSS & SELIGMAN, *supra* note 35, 4167 n.117 ("The rationale for this legislation rests on a misconception of the facts. . . . In fact, every empirical study of securities fraud class actions filings reaches the same conclusion; while State court securities filings may have increased in 1996, they decreased in 1997." (quoting S. Rep. No. 105-182, at 12 (1997) (emphasis added))). For a thorough overview of the studies contradicting the findings cited before Congress regarding flight to state courts, see Richard W. Painter, *Responding to a False Alarm: Federal Preemption of State Securities Fraud Causes of Action*, 84 CORNELL L. REV. 1, 9 nn.31-33 (1998). Regardless of the accuracy of the studies detailing flight to state courts, the "Findings" section of the Act conclusively establishes that Congress relied on their accuracy in enacting SLUSA. § 2, 112 Stat. at 3227 (stating that "since enactment of that legislation, considerable evidence has been presented to Congress that a number of securities class action lawsuits have shifted from Federal to State courts").

184. § 2, 112 Stat. at 3227.

Securities Act and the Exchange Act.<sup>185</sup> Only an interpretation of SLUSA that provides for the removal of class actions alleging Securities Act violations prevents class actions from circumventing PSLRA and is, therefore, consistent with congressional intent. That is, because Congress enacted SLUSA to prevent circumvention of PSLRA, SLUSA should be interpreted in connection with PSLRA's intended reach. Because PSLRA applies to Securities Act claims only when brought in federal court, SLUSA only fully prevents PSLRA circumvention by class actions if the removal provision extends to federal claims.

The court in *Alkow v. TXU Corp.*<sup>186</sup> examined a class action plaintiff's argument that a pure Securities Act claim should be remanded and noted that SLUSA was "drafted precisely to prevent the[se] type[s] of tactics employed . . . to avoid federal court."<sup>187</sup> However, Judge Barbadoro, in *In re Tyco International*, reached a contrary conclusion but noted that he did not

attempt . . . to determine what Congress might have done if it had been asked to decide whether cases that are based exclusively on the Securities Act should be removable to federal court. Instead, . . . [he] made a contextual examination of the statutory language and a careful review of legislative history to determine the meaning of the statute that Congress actually passed.<sup>188</sup>

Contrary to Judge Barbadoro's opinion, reading the legislative history in combination with the statutory language of SLUSA reveals that Congress intended to pass, and did pass, a statute which allowed defendants to remove claims brought solely under the Securities Act. Congress enacted SLUSA to revitalize PSLRA, which it felt was necessary to protect investors and the integrity of the securities market.<sup>189</sup> Only a reading of SLUSA's removal authority that extends to claims alleging violations of the Securities Act achieves this objective.

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185. *Dabit* demonstrates the Supreme Court's sensitivity to congressional concerns regarding the circumvention of PSLRA, which motivated SLUSA's enactment. *Merrill Lynch, Pierce, Fenner & Smith, Inc. v. Dabit*, 126 S. Ct. 1503, 1513 (2006) ("A narrow reading of the statute[s] preclusion provision] would undercut the effectiveness of the 1995 Reform Act and thus run contrary to SLUSA's stated purpose, viz., 'to prevent certain State private securities class action lawsuits alleging fraud from being used to frustrate the objectives' of the 1995 Act.").

186. No. 3:02-CV-2738-K, 2003 WL 21056750 (N.D. Tex. May 18, 2003).

187. *Id.* at \*2.

188. *In re Tyco Int'l, Ltd. Multidistrict Litig.*, 322 F. Supp. 2d 116, 121 (D.N.H. 2004).

189. See *supra* notes 51, 171, 176 and accompanying text.

## IV. IMPLICATIONS OF A BROAD READING

Interpreting SLUSA in light of the legislative history suggests that the removal provision in § 16(c) applies to class actions alleging Securities Act claims. Not only is this an accurate reading, but it also furthers Congress's goal of protecting defendants by decreasing vexatious strike suits<sup>190</sup> and therefore protects investors. Furthermore, a broad reading helps protect market integrity, thereby advancing an efficient capital market.<sup>191</sup> Federal law "has long been the principal vehicle for asserting class-action securities fraud claims."<sup>192</sup> Only after the enactment of PSLRA did class actions alleging securities fraud appear with any regularity in state court.<sup>193</sup> "This is hardly a situation, then, in which a federal statute has eliminated a historically entrenched state-law remedy."<sup>194</sup> Moreover, a broad reading of § 16(c) has the secondary effect of encouraging independent claims by institutional investors.

A. *Preventing Strike Suits and Creating an Uniform Interpretation of Federal Securities Laws*

PSLRA increases "the cost and time associated with filing" class actions in federal court.<sup>195</sup> Indeed, one commentator noted that after PSLRA, a covered class action "may take . . . three years to arrive at a posture that exists for an individual state court case with state causes of action the day after it is filed."<sup>196</sup> Senator Pete Domenici, remarking on the move from federal to state courts, stated that PSLRA may have "worked too well."<sup>197</sup>

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190. *Dabit*, 126 S. Ct. at 1510–11.

191. H.R. REP. NO. 104-369, at 31 (1995), *reprinted in* 1995 U.S.C.C.A.N. 730, 730–31 (noting that PSLRA's protections help protect the integrity of the market).

192. *Dabit*, 126 S. Ct. at 1514 (citing H.R. REP. NO. 105-803, at 14 (1998) (Conf. Rep.)).

193. *Id.* at 1515.

194. *Id.*

195. Jonathan F. Mack, *PSLRA and SLUSA: Laws with Unintended Consequences*, WALLSTREETLAWYER.COM: SEC. ELEC. AGE 1, Nov. 2003, *available at* 7 No. 6 GLWSLAW 1.

196. *Id.* Mack's article specifically notes the following as contributors to the delay: "a 90-day notice period for class members to apply for status as a provisional class representative," the "selection process," "filing of the mass compliant," "motions to dismiss," frequent "repleading," "certification motions," and initial discovery. *Id.*

197. 144 CONG. REC. 8950, 8987 (1998). The Senator further stated that "because of [the] more stringent pleading requirements, plaintiffs' lawyers no longer 'race to the courthouse' to be the first to file securities class actions. . . . [W]e no longer have 'professional plaintiffs' . . . [and] the expensive and time consuming 'fishing expedition' discovery process." *Id.*

A narrow reading of SLUSA creates a loophole in PSLRA for Securities Act claims. Under the narrow reading, plaintiffs could continue to bring large class action strike suits alleging Securities Act violations. The broad reading of removal authority, however, allows defendants to remove class actions alleging federal claims to federal court where the procedural protections provided by PSLRA, such as the automatic stay of discovery<sup>198</sup> and requirement of a lead plaintiff,<sup>199</sup> apply. Thus, only the broad reading ensures the extension of PSLRA's restrictions to Securities Act claims and achieves the protection against strike suits intended by PSLRA and SLUSA.

The Supreme Court acknowledged the problem of strike suits as early as 1975 in *Blue Chip Stamps v. Manor Drug Stores*,<sup>200</sup> noting that "a plaintiff with a largely groundless claim [can] simply take up the time of a number of other people, with the right to do so representing an *in terrorem* increment of the settlement value."<sup>201</sup> According to one source, approximately "190 class-action lawsuits alleging securities fraud are filed each year. Because companies fear large judgments, many settle such lawsuits."<sup>202</sup> By one account, the average securities class action settlement in 2004 had risen to \$46.2 million.<sup>203</sup>

In enacting PSLRA, Congress reviewed reports of "abuse in private securities lawsuits."<sup>204</sup> The Conference report specifically noted "the routine filing of lawsuits . . . whenever there is a significant change in . . . stock price, without regard to any underlying culpability . . . [and] the targeting of deep pocket defendants . . . without regard to their actual culpability."<sup>205</sup> The PSLRA Conference Committee report noted that "the private securities litigation system is too important to the integrity of American capital markets to allow this

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198. 15 U.S.C. § 77z-1(b) (2000).

199. *Id.* § 77z-1(a)(3)(B).

200. 421 U.S. 723 (1975).

201. *Id.* at 741.

202. Hope Yen, *Court Affirms Fraud Standard: Justices Say Investors Must Prove Link to Stock Losses*, WASH. POST, Apr. 20, 2005, at E03. Cf. Tu, *supra* note 82, at 475, 478 (analyzing the seven cases asserting securities violations which have been litigated to a verdict since the passage of PSLRA and arguing that increasing settlement costs and recent favorable defense verdicts may create an "incentive for defendants in the right situation (with a good case) to take their case through trial").

203. Tu, *supra* note 82, at 478 (compiling the findings from several different economic analysis firms regarding average and total settlement amounts for securities class actions). This is up from an average of \$26 million from 1995 to 2003. *Id.*; see also *supra* note 82 (collecting research on settlement amounts).

204. H.R. REP. NO. 104-369, at 31 (1995) (Conf. Rep.), reprinted in 1995 U.S.C.C.A.N. 730, 730.

205. *Id.*; see also Qualters, *supra* note 82 (suggesting that a securities lawsuit may be provoked simply by the filing of an earnings restatement).



system to be undermined by those who seek to line their own pockets by bringing abusive and meritless suits.”<sup>206</sup> As Congress noted in passing PSLRA, without these protections, companies cannot attract talented and experienced directors, and the concern over meritless lawsuits may restrict dissemination of information.<sup>207</sup> As noted in Part II.D,<sup>208</sup> the Supreme Court recently endorsed these views in *Merrill Lynch, Pierce, Fenner & Smith, Inc. v. Dabit*.<sup>209</sup> The narrow reading allows plaintiffs to sidestep PSLRA’s heightened obligations for large class actions alleging Securities Act claims. As such, the narrow reading allows large class actions to continue, unrestrained by PSLRA, so long as the complaint only alleges violations of the Securities Act.

The broad reading, by contrast, shifts class actions alleging Securities Act violations to federal court where they are subject to PSLRA, thus avoiding the creation of a subcategory of class actions immune from PSLRA’s safeguards. By subjecting these claims to PSLRA, the broad reading makes it more difficult for plaintiffs to harass corporations with unmeritorious suits, thereby protecting investors, who are “always . . . the ultimate losers when extortionate ‘settlements’ are extracted from issuers.”<sup>210</sup>

### B. Encouraging Individual Actions by Institutional Investors

Congress passed PSLRA primarily to curb vexatious class action lawsuits, which they felt committed the gravest abuses of securities litigation.<sup>211</sup> However, as the Supreme Court noted in *Dabit*,

SLUSA does not actually pre-empt any state cause of action. It simply denies plaintiffs the right to use the class action device to vindicate certain claims. The Act does not deny any individual plaintiff, or indeed any group of fewer than 50 plaintiffs, the right to enforce any state-law cause of action that may exist.<sup>212</sup>

Thus, plaintiffs bringing individual lawsuits can avoid many of PSLRA’s restrictions<sup>213</sup> because SLUSA’s removal provision applies only to class actions.<sup>214</sup> Plaintiffs bringing individual suits may clearly

206. H.R. REP. NO. 104-369, at 31, *reprinted in* 1995 U.S.C.C.A.N. 730, 730–31.

207. *Id.* at 31–32, *reprinted in* 1995 U.S.C.C.A.N. 730, 730–31.

208. *See supra* notes 151–53 and accompanying text.

209. 126 S. Ct. 1503, 1514 (2006).

210. H.R. REP. NO. 104-369, at 31–32, *reprinted in* 1995 U.S.C.C.A.N. 730, 730–31.

211. *Dabit*, 126 S. Ct. at 1510–11.

212. *Id.* at 1514 (explaining SLUSA’s scope in relation to Exchange Act claims).

213. 2 HAZEN, *supra* note 52, § 7.17[2].

214. 15 U.S.C. § 77p(c) (2000).

maintain the suit in state court and avoid many of the heightened requirements of PSLRA. This distinction reflects Congress's additional concern for the class action's potential for abuse.<sup>215</sup>

The exception for individual actions indirectly encourages individual actions by large stakeholders, most commonly institutional investors.<sup>216</sup> Institutional investors, with the money to fund large individual suits, can file separate actions in state court and avoid the costly and time-consuming burdens of PSLRA.<sup>217</sup> Indeed, one commentator noted that the combined effect of PSLRA and SLUSA has been that "[n]early every major class action securities fraud case is now accompanied by intensely litigated individual actions by institutions that never brought such suits ten years ago."<sup>218</sup>

These individual actions are more likely to be meritorious because the investor bringing an individual claim bears the financial risk of losing the suit alone. Indeed, one court noted that "[i]f an institutional investor, which represents the long-term interests of many small investors, decides that a certain form of relief is appropriate, it is more likely superior for the majority of investors than the relief which would be sought by a 'professional plaintiff's' lawyer."<sup>219</sup>

Another commentator noted as follows:

It might be said that a leading role in enforcing the anti-fraud provisions of the securities laws in civil litigations was long overdue for sophisticated institutional investors who make markets and have large stakes. That the captains of the investment community should a [sic] play a role in checking fraud even beyond that anticipated by the promulgators of the PSLRA should be considered a welcome precipitate.<sup>220</sup>

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215. See 3 HAZEN, *supra* note 52, § 12.5[0].

216. Mack, *supra* note 195 (noting that the heightened requirements imposed by PSLRA and the complementary preclusion and removal provisions of subject class actions by SLUSA may "have had the intended consequence of awakening the sleeping giants of institutional investors and the unintended consequence of prompting them to file individual rather than class actions").

217. See *supra* note 128 and accompanying text; see also Mack, *supra* note 195 ("In short, the slower results and restriction to federal causes of action available in class actions are driving to the courthouse entities that once were satisfied to quietly wait on the sidelines and take a modest check as a class member.").

218. Mack, *supra* note 195.

219. Keith L. Johnson, *Deterrence of Corporate Fraud Through Securities Litigation: The Role of Institutional Investors*, LAW & CONTEMP. PROBS., Autumn 1997, at 155, 155 (quoting *Gluck v. CellStar Corp.*, 976 F. Supp. 542, 548 (N.D. Tex. 1997)).

220. Mack, *supra* note 195.

However, for complaints alleging pure Securities Act claims, the beneficial result of more individual actions by institutional investors can be fully achieved only under a broad reading of § 16(c). Under the narrow reading, courts remand pure Securities Act class actions to state courts, where PSLRA's restrictions do not apply. Because the narrow reading allows both individual actions and class actions to avoid PSLRA's requirements, the narrow reading provides no incentive for the individual actions. Thus, institutional investors may once again become "satisfied to quietly wait on the sidelines and take a modest check as a class member."<sup>221</sup> On the contrary, district courts which broadly interpret § 16(c)'s removal authority deny the class action plaintiff's motion to remand, allowing the case to remain in federal court and, thus, subject to PSLRA's restrictions.<sup>222</sup> This encourages institutional investors, eager to circumvent the longer waiting period created by PSLRA, to file individual actions in state court rather than undergo the more costly and time-consuming procedures imposed on class actions by PSLRA. Only the broad reading of § 16(c) applies PSLRA's restrictions in the Securities Act context, thus providing the incentive to file individual actions—and remain in state in court—when Securities Act violations are at stake. The narrow reading, on the other hand, would deprive the market of the benefit of more active participation of institutional investors.

Furthermore, PSLRA's restrictions encourage the appointment of institutional investors as lead plaintiff. Thus, even if the application of PSLRA does not result in more individual filings by institutional investors, it would still benefit the market to have these investors more involved in class actions as the lead plaintiff. One author notes several reasons why the market benefits from institutional investors acting as lead plaintiff:

Their repeat player status . . . causes institutions to bear a higher proportion of costs associated with inefficiencies in the securities litigation system, such as losses to legal fees that are not based on competitive market rates and costs associated with prosecuting and defending unnecessary cases. With this broad presence in the equity markets, their overwhelming interests in individual cases, and their fiduciary duty to act in the best interest of investors, institutions have incentives to pursue both of the competing interests involved in securities litigation. As the largest claimants, they have a strong interest in maximizing recoveries in class action lawsuits. However, they also have a

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221. Mack, *supra* note 195.

222. See *supra* note 56 and accompanying text.

direct incentive both to increase portfolio returns by taking actions to reduce losses to securities fraud through enhanced deterrence and to improve efficiency of the system.<sup>223</sup>

The narrow reading, however, allows class actions to circumvent PSLRA's requirements, including the lead plaintiff requirement.<sup>224</sup> Thus, the narrow reading would deprive the market of the benefit of more active participation of institutional investors.

#### CONCLUSION

Only a broad reading of § 16(c) accurately reflects the correct confluence of statutory language, legislative history, and policy. SLUSA amended both the Securities Act and Exchange Act to prevent class action lawyers from using state courts to circumvent PSLRA,<sup>225</sup> and the statute should be interpreted to effect that intention. Reading the amendment to allow only the removal of precluded state-law claims prevents those plaintiffs asserting Exchange Act violations from filing in state courts and avoiding PSLRA, but does not prevent similar gamesmanship by plaintiffs asserting Securities Act violations.<sup>226</sup> SLUSA should also prevent parties filing class actions for Securities Act violations from avoiding PSLRA; it should extend removal authority to Securities Act claims brought as class actions. Reading SLUSA to exempt Securities Act claims from PSLRA leaves its amendment to the Securities Act superfluous.<sup>227</sup> Specifically, because SLUSA amended the Exchange Act to provide for the removal and preclusion of state-law claims based on securities fraud, it would be unnecessary to amend the Securities Act again to provide for the removal and preclusion of state-law claims based on securities fraud. This is especially true in light of the amendment SLUSA made to the Securities Act's provision granting concurrent, nonremovable jurisdiction<sup>228</sup>—the provision relied on by proponents of the narrow reading to advocate for nonremoval. Thus, reading SLUSA's amendment to § 16(c) of the Securities Act broadly provides the most consistent interpretation of the statute as a whole and effects congressional intent.

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223. Johnson, *supra* note 219, at 158 (citations omitted).

224. 15 U.S.C. § 77z-1 (2000).

225. *See supra* Part III.

226. *See supra* notes 133–36 and accompanying text.

227. *See supra* notes 139–41 and accompanying text.

228. *See supra* notes 84, 104–05 and accompanying text (noting SLUSA's addition of an "except" clause in § 22).

The nonreviewable nature of orders to remand magnifies the negative effects of narrowly reading § 16(c). The ability to file suit in multiple localities allows plaintiffs the opportunity to avoid jurisdictions where federal district courts typically deny motions to remand class actions alleging only Securities Act violations. District courts in the same state have split on the issue of remand. The lack of appellate review<sup>229</sup> exacerbates such splits and creates incentives for plaintiffs to forum shop. Thus, district courts must uniformly refuse motions to remand pure Securities Act claims. If they do not, PSLRA's protections may be lost for defendants, as plaintiffs attempt to file in jurisdictions with a precedent of granting motions to remand. The application of PSLRA's provisions is too important for such inconsistency.

Only the broad reading of § 16(c) provides the adequate protection from strike suits that Congress intended. State courts do not provide the same procedural protection from vexatious litigation that federal courts provide to defendants. Indeed, this inadequate state protection provided the impetus for SLUSA.<sup>230</sup> Without the limitations imposed by PSLRA, state courts may permit the abuse of the discovery process that often forces defendants to settle unmeritorious claims.

As the average settlement cost rises,<sup>231</sup> broadly applying PSLRA's restrictions becomes increasingly important in order to curb nonmeritorious suits. Indeed, the scandals of Enron and WorldCom may make companies especially vulnerable to strike suits, as the public grows increasingly skeptical of big business.<sup>232</sup> As public scrutiny of publicly held companies increases, the plaintiff's leverage in settlement negotiations increases.<sup>233</sup> This heightens the need for a uniform application of PSLRA, and such an application can be achieved only through a broad reading of SLUSA's removal authority.

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229. *Kircher v. Putnam Funds Trust*, 126 S. Ct. 2145, 2153 (2006). The Court did note, however, that the issue could still potentially reach the Supreme Court through state channels. *See id.* However, in the absence of an order granting a motion for interlocutory appeal, the case would have to proceed through trial on the merits first. *See, e.g.*, 28 U.S.C. § 1292(b) (providing the authorization for an interlocutory appeal in federal courts).

230. *See Securities Litigation Uniform Standards Act of 1998*, Pub. L. No. 105-353, § 101, 112 Stat. 3227, 3227 (codified as amended at 15 U.S.C. § 77v(a) (2000)).

231. *See supra* notes 82, 203 and accompanying text.

232. *See Tu, supra* note 82, at 478.

233. *See id.*

Moreover, a uniform interpretation of SLUSA would help to unify the standards applied to securities fraud cases. Through SLUSA, Congress attempted to create a federal system of securities regulation.<sup>234</sup> Uniformity and consistency reduce uncertainty and create a more predictable market, thereby decreasing the operational risk of corporations and facilitating the development of a more efficient market.

The broad interpretation of § 16(c)—applying the removal provision to class action claims alleging solely Securities Act violations—accurately reflects the appropriate consistency across statutory language, legislative history, and policy considerations. Because orders to remand are not reviewable, uniform application of the broad reading can be achieved only if the federal district courts each independently adopt a consistent reading of the statute. The growing district court split creates uncertainty for plaintiffs and defendants alike, straining the efficient operation of capital markets. Only a broad interpretation of § 16(c) will achieve the safeguards intended by Congress: those safeguards necessary to protect the integrity of the market.

WILLIAM B. SNYDER, JR.

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234. See *Merrill Lynch, Pierce, Fenner & Smith, Inc. v. Dabit*, 126 S. Ct. 1503, 1514 (2006) (noting “the congressional preference for ‘national standards for securities class action lawsuits involving nationally traded securities’ ” (quoting § 2(5), 112 Stat. at 3227)); see also *supra* Part III.