ALERT MEMORANDUM

Third Circuit Holds That SLUSA Preclusion of State Law Claims in Opt-Out Action Requires Actual Coordination With Class Action

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The Securities Litigation Uniform Standards Act ("SLUSA") generally precludes the assertion of claims under state law in securities class actions, as well as in individual actions that proceed together with such class actions. In securities class actions that have generated opt-out litigation, this provision has provided a powerful tool for defendants to seek the dismissal of individual plaintiffs' state law claims, which may not require allegations of intentional wrongdoing and can be subject to longer statutes of limitations and/or repose than claims under the federal securities laws. Last week, however, a divided panel of the Third Circuit held that individual actions filed after the settlement of the related class action had not "proceed[ed] as a single action for any purpose" with the class action, and that therefore SLUSA did not preclude the state-law claims in those individual actions.

The majority based its conclusion on its construction of the statute, Congress's intent in enacting the securities laws, and constitutional concerns about due process for plaintiffs who opt out of a class action settlement. The decision highlights the significance of class action settlement timing, as well as the potentially complex and fact-intensive nature of the question of whether multiple actions proceeded as a single action within the meaning of SLUSA.

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Background

In response to the perceived abusiveness of securities class action lawsuits in the 1990s, Congress enacted the Private Securities Litigation Reform Act of 1995 ("PSLRA"), which introduced a number of reforms in securities litigation, including a process for appointing lead plaintiffs in class actions, an automatic stay of discovery until a motion to dismiss is decided, and heightened pleading standards for securities fraud claims.[1] In an attempt to circumvent the PSLRA's requirements, class action plaintiffs began bringing similar claims under state law and arguing that the PSLRA's protections did not apply. In an effort to prevent the circumvention of the PSLRA, Congress enacted SLUSA in 1998, which precludes the assertion of securities law claims under state law in "covered class actions."[2] SLUSA defines "covered class actions" to include traditional class actions, as well as any group of lawsuits "filed in or pending in the same court and involving common questions of law or fact," "in which . . . damages are sought on behalf of more than 50 persons" and "in which . . . the lawsuits are joined, consolidated, or otherwise proceed as a single action for any purpose."[3]

District Court Proceedings

The *North Sound* case arose from plaintiffs' allegations that two pharmaceutical companies concealed damaging clinical trial results, which allegedly caused a drop in the companies' stock prices when they were revealed. Investors filed putative class actions in the District of New Jersey, alleging that the companies made material misstatements regarding the drugs that were the subject of the clinical trials. The actions survived the defendants' motions to dismiss and the district court subsequently granted class certification.[4]

Following class certification, the district court approved notices advising class members that if they opted out of the class they would be able to "individually pursue any legal rights [they] have against any Defendants."[5] The class action subsequently settled, and the district court granted final approval of the settlement in October 2013.[6]

Certain investors who had opted out of the class action, and declined to opt back into the class after the settlement, filed individual actions alleging federal securities claims and state common law fraud claims in November 2013 and January 2014. Only those opt-out plaintiffs' state law claim survived defendants' initial motions to dismiss and a subsequent appeal.[7]

On remand to the district court, defendants again moved to dismiss the lawsuits, arguing that SLUSA barred plaintiffs' common law fraud claim.[8] Finding that SLUSA's legislative history, text and purpose mandated an "expansive construction" of the relevant statutory provision,[9] the district court held that "based on the procedural history of, and degree of informal coordination between" the individual actions and the class action, they had "proceeded as a single action" and SLUSA barred the state law claims, notwithstanding that the related class action had settled before the individual actions were filed.[10] Accordingly, the district court granted defendants' motion to dismiss the remaining state law claims.[11]

Third Circuit

On appeal, the Third Circuit considered the question of "whether the Securities Litigation Uniform Standards

[1] 15 U.S.C. § 78u-4.
[2] 15 U.S.C. § 78bb.
[3] 15 U.S.C. § 78bb(f)(5)(B)(ii).
[4] *N. Sound Capital LLC v. Merck & Co.*, No. 18-2317, 2019 WL 4309663, at *1 (3d Cir. Sept. 12, 2019).
[5] *In re Merck & Co., Inc. Vytorin/ZETIA Sec. Litig.*, No. 2:08-cv-02177, ECF No. 266–1 at 11 (Dec. 19, 2012); *In re Schering-Plough Corp. / ENHANCE Sec. Litig.*, No. 2:08-cv-00397, ECF No. 331–1 at 11 (Dec. 19, 2012).
[6] *N. Sound Capital*, 2019 WL 4309663 at *2.
[7] *See N. Sound Capital LLC v. Merck & Co. Inc.*, 702 F. App'x 75, 81 (3d Cir. 2017) (holding plaintiffs' federal claims were untimely under statute of repose).
[8] *N. Sound Capital LLC v. Merck & Co.*, 314 F. Supp. 3d 589, 599 (D.N.J. 2018), rev'd and remanded, No. 18-2317, 2019 WL 4309663 (3d Cir. Sept. 12, 2019).
[9] *N. Sound Capital*, 314 F. Supp. 3d at 606, 617-18.
[10] *Id.* at 610.
[11] *Id.* at 619.

Act (SLUSA) prohibits investors from bringing individual actions under state law if they exercise their constitutionally protected right to opt out of a class action."[12] A divided court held that the plaintiffs' individual actions were not "joined, consolidated, or otherwise proceed[ing] as a single action for any purpose" with the previously settled class action, and thus their state law claims were not barred by SLUSA.[13]

Majority Opinion

The majority opinion held that the single-action requirement of SLUSA requires "actual coordination" of the related actions. Applying the canon of *ejusdem generis*—which instructs that where two or more words that "share a common attribute" appear, successive words refer "only to persons or things of the same general kind or class specifically mentioned"—the majority reasoned that the words "joined" and "consolidated" illuminated what Congress meant by "otherwise proceed as a single action."[14] The court therefore held that for two actions to be a "single action" within the meaning of SLUSA, they must be "somehow combined, in whole or in part, for case management or for resolution of at least one common issue."[15]

Significantly, the court opined that actions are highly unlikely to be so combined when one was filed after the settlement of the other, such that they were never pending at the same time. In that circumstance, "a court cannot combine them for management of a common stage of the proceedings or for resolution of a common question."[16] On the other hand, the court clarified that cases need not be "coextensive with one another" to meet the single-action requirement of SLUSA, but they must be at least "partially coordinated."[17]

In reaching this result, the majority stated that a broader reading would raise constitutional concerns by "burden[ing]" putative class members' opt-out right, "or worse yet sap[ping] it of any meaning."[18] The court also rejected defendants' suggestion that any benefit the individual plaintiffs received from the existence of a class action based on the same allegations would satisfy the single-action requirement, remarking that "only a hermetically sealed opt-out investor could possibly escape the all-encompassing sweep of [this] proposed atextual rule."[19]

Having thus defined the single-action requirement, the court reversed the district court's conclusion that the actions proceeded as a single action for the purposes of SLUSA preclusion.

Dissenting Opinion

Judge Shwartz dissented from the majority opinion, providing an alternative textual analysis of the single-action requirement focusing on the distinctions between the words "joined" and "consolidated" on the one hand and the phrase "otherwise proceed as a single action for any purpose" on the other.[20] In particular, Judge Shwartz reasoned that Congress included the latter "otherwise proceed . . . for any purpose" language to "capture actions other than those that have been actually associated via formal invocation of the Federal Rules of Civil Procedure."[21] Judge Shwartz further concluded that the text of the statute did not impose a simultaneity requirement.[22]

As Judge Shwartz did not consider the lack of simultaneity to be an obstacle to fulfilling the single-action requirement, she then turned to evaluating the indicia of coordination that the district court had considered. Based on the similarity of the class action and individual action complaints, the filing of the

[12] *N. Sound Capital LLC v. Merck & Co.*, No. 18-2317, 2019 WL 4309663, at *1 (3d Cir. Sept. 12, 2019).
[13] *N. Sound Capital*, 314 F. Supp. 3d at *1. Judges Shwartz, Krause, and Bibas heard the appeal. Judge Shwartz dissented from the majority opinion authored by Judge Krause.
[14] *N. Sound Capital*, 2019 WL 4309663at *6.
[15] *Id.* at *8.
[16] *Id.* at *6.
[17] *Id.*
[18] *See id.* at *8.
[19] *Id.* at *9.
[20] *Id.* at *12 (Shwartz, J., dissenting).
[21] *Id.*
[22] *Id.* at *13.

individual actions as related to the class action, and the benefits individual plaintiffs obtained from class action discovery and pretrial proceedings, Judge Shwartz concluded that the district court did not err in holding that the individual suits were precluded by SLUSA.[23]

Implications

While the *North Sound* decision places a limit on SLUSA preclusion by requiring as a condition for its application individual actions to proceed at the same time as the related class action, the ruling does not otherwise question the propriety of applying SLUSA to opt-out actions that are coordinated with securities class actions, as has been done in many prior securities litigations.[24]

However, the decision leaves unanswered the precise degree of coordination required to trigger SLUSA preclusion, as well as whether state law claims should be dismissed where an opt-out action is consolidated with a class action "over an opt-out plaintiff's objection."[25] Defendants facing securities class actions with significant numbers of opt outs should consider these issues in deciding whether to stay any opt-out actions during the pendency of the class action, the degree to which to coordinate discovery across the actions, and in considering the timing and scope of any class action settlement.

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[23] *Id.*, at *16.

[24] *See, e.g., Central States Southeast and Southwest Areas Pension Fund v. Petróleo Brasileiro S.A.—Petrobras, et al.*, No. 15–cv–3911 (S.D.N.Y. Oct. 19, 2015);, *In re Lehman Bros. Sec. & ERISA Litig.*, 131 F. Supp. 3d 241, 266–68 (S.D.N.Y. Sept. 18, 2015); *Kuwait Investment Office, et al. v. American International Group, Inc., et al.*, No. 11-cv-8403 (S.D.N.Y. Sept. 10, 2015).

[25] *N. Sound Capital*, 2019 WL 4309663 at *8 n.7.

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