MINTZ LEVIN

Class Action Newsletter

FALL 2002 www.mintz.com

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Recent Developments

Antitrust/Consumer Class Actions

2nd Circuit Permits Antitrust Consumer Class Actions Against Local Telephone Service Providers. The Second Circuit recently decided that the so-called "Baby Bells" — local telephone companies — are subject to class action antitrust claims brought by consumers challenging the companies' failure to open their local networks to competitors. Prior cases had found that similar suits brought by the Baby Bells' competitors were impermissible because they were "inextricably linked" to claims brought under Section 251 of the Telecommunications Act, which requires that local companies open their networks to competitors. The Court found that the class-action Complaint stated a claim under Section 2 of the Sherman Act because it did not merely allege that Bell Atlantic had violated Section 251 of the Telecommunications Act, but also stated a claim for antitrust violations, including a cause of action under the "essential facilities" doctrine and claims for monopoly leveraging. The Court therefore held that in the case of consumer claims, the antitrust laws "will be needed to supplement the regulatory scheme," thus opening the door for consumer class actions against Baby Bells. **Law Offices of Curtis V. Trinko, L.L.P., et al. v. Bell Atlantic Corp., 2002 WL 31015490* (2d Cir. Aug. 30, 2002)**

Antitrust/Class Certification

United States Supreme Court Denies Certiorari To Appeal Challenging Class Certification Based Upon Lenient Standard. The Supreme Court has refused to hear an appeal by Visa U.S.A and MasterCard International challenging a class certification decision in a major antitrust case brought against the credit card companies by Wal-Mart and other large and small retailers. Like many antitrust cases, the District Court's decision to certify the class rested heavily on expert economic testimony offered by both the purported class and the defendants. In upholding class certification, the Second Circuit adopted a remarkably lenient standard for class action plaintiffs, requiring that they merely show, "based on a methodology that [is] not fatally flawed," that their case meets the requirements of Rule 23. Because the plaintiffs' expert had presented a methodology for proving an antitrust violation, injury-in-fact, causation, and damages on a class-wide basis, and that methodology was not revealed as "fatally flawed" by defendants and their expert, class certification was appropriate. This relatively low burden on antitrust plaintiffs may result in the certification of more antitrust plaintiff classes and also highlights the importance of retaining a qualified expert economist in such cases. **In re Visa Check/ Mastermoney Antitrust Litigation, 280 F.3d 124 (2d Cir. 2001), cert. denied, 122 S. Ct. 2382 (2002).**

Features

Third Circuit Orders Hearing *En Banc* to Reconsider Ruling that an Offer of Judgement Providing Maximum Relief to a Named Plaintiff Moots Claims of Plaintiff Class.

In a significant and potentially far-reaching decision, a Third Circuit panel has ruled that an offer of judgment to a representative plaintiff providing the maximum relief to which the plaintiff is entitled, if made before a class is certified, moots the plaintiff's claim and precludes class certification. *Colbert v. Dymacol, Inc.,* 302 F.3d 155 (3d Cir. 2002). In a development that highlights the significance of this decision, the Third Circuit recently granted rehearing *en banc* to the plaintiffs, which will result in argument of the appeal to all 12 judges of the Third Circuit Court of Appeals. While the decision potentially would provide a powerful tool to permit defendants to achieve early resolution of some types of class action litigation, the order vacating the decision and granting rehearing suggests that the Third Circuit is likely to rule in the plaintiff's favor.

In *Colbert,* the plaintiff brought a claims under the federal Fair Debt Collection Practices Act (FDCPA). Before the plaintiff filed his class certification motion, the defendant Dymacol made an offer of judgment under to Fed. R. Civ. P. 68 offering the maximum statutory damages available under the FDCPA, plus attorneys' fees and costs. Despite that offer of judgment, the trial court granted plaintiff's motion for class certification. On appeal, the appellate panel reversed, holding that because this offer of judgment provided the maximum relief available to the plaintiff, the offer mooted the representative plaintiff's claim, thereby making class certification inappropriate.

In so ruling, the Third Circuit panel concluded that, prior to class certification, the interests of other class members are not at issue and the disposal of the named plaintiff's claim will not prejudice the rights of other such claimants to come forward and assert their claims. Conversely, the panel reasoned, to allow the class action to go forward despite the mooting of the individual plaintiff's claims would violate the Article III "case in controversy" requirement. According to the opinion, the only circumstances under which a case can go forward as a class action notwithstanding the named plaintiffs' claims being mooted before class certification are (i) if a certification motion was filed before the plaintiff's claims expired and the district court did not have a reasonable opportunity to decide or (ii) when the plaintiff's claims expire after a certification motion is denied, in which case the named plaintiff can appeal the denial of class certification. Otherwise, the court said that there is nothing inherently improper about "picking off" a named plaintiff, insofar as in "higher stake" contexts with large numbers of aggrieved class members, offering maximum relief to all putative representatives would be cost prohibitive.

Recent Developments

Class Certification/Choice of Law

7th Circuit Reverses Certification of Nationwide Class Action Because the Forum's Choice-of-Law Rules Made The Class Unmanageable Under Fed. R. Civ. P. 23(b)(3). The Seventh Circuit Court of Appeals recently ruled against the propriety of certifying nationwide class actions without first conducting an analysis of the law to be applied to the class members under the forum's choice-of-law rules. Plaintiffs have recently argued that nationwide class treatment of product liability or other tort-based claims is appropriate without reference to the forum's choice-of-law rules because the claims arise from acts or omissions committed by defendants in the forum of their principal place of business. Defendants have argued, sometimes unsuccessfully, that the claims of each class member must be adjudicated according to the law determined under the forum's choice-of-law rules, making class treatment inappropriate under Fed. R. Civ. P. 23(b)(3). The Seventh Circuit recently resolved this controversy by ruling that the District Court erred in certifying two nationwide class actions and applying the law of the forum in which the Defendants were headquarted. Instead, the plaintiffs' claims were to be judged solely by the laws of the jurisdictions in which the class members resided, making class certification unmanageable. Judge Easterbrook concluded by saying: "No matter what one makes of the decentralized approach as an original matter, it is hard to adopt the central-planner model without violence not only to Rule 23 but also to principles of federalism." **In re Bridgestone/Firestone, Inc. Tires Product Liability Litigation, 288 F.3d 1012 (7th Cir. 2002)**

Consumer Fraud/Class Certification

Common Issues of Fact Do Not Predominate for Putative Managed Care Subscriber Class. On September 29, 2002, Judge Federico Moreno of the U.S. District Court for the Southern District of Florida declined to certify a putative nationwide class of approximately 145 million subscribers to managed health care plans offered by defendants Cigna Corporation, Aetna, Inc., Humana, Foundation Health Systems, United Healthcare, and Prudential. Following the recent Eleventh Circuit decision in *Sikes v. Teleline, Inc.*, 281 F.3d 1350 (11th Cir. 2002) (see Mintz Levin Class Action Newsletter, May 2002), Judge Moreno ruled that the plaintiffs' request for class certification foundered on their burden to establish the existence of a scheme to defraud and reasonable reliance on such scheme in order to prevail on their claims under the Racketeer Influenced and Corrupt Organizations Act (RICO), 18 U.S.C. § 1961, *et seq.*, and the burden to prove reliance in connection with their claims under the Employee Retirement Income Security Act of 1974 (ERISA), 29 U.S.C. § 1100, *et seq*. The primary obstacle to certification of a subscriber class was

Third Circuit Panel Rules that Defendant...*continued*

The panel's decision in Colbert would provide a potentially valuable strategy for defendants in federal court cases with well-defined damages and one or two representative plaintiffs. If it is possible under the circumstances to ascertain the maximum relief possible on the representative plaintiff's claims, a prompt offer of judgment could successfully moot the representative's claims and avoid class certification. A maximum damages calculation is possible not only in claims involving statutes such as the FDCPA that set forth defined damage amounts, but can also be done in cases alleging securities fraud, in which the maximum amount recoverable by the shareholder can be determined based on the decline in stock price over the relevant period. The decision would also encourage plaintiffs to bring class certification motions even earlier in the case — perhaps at the same time as the complaint is filed.

The principle announced in the panel decision, however, may not survive *en banc* review. The order vacating the panel decision and granting rehearing required the vote of a majority of the twelve Third Circuit judges, the court now appears ready to rule in favor of the plaintiffs. In their brief seeking rehearing, the plaintiffs' attorneys argued that the panel's decision conflicted with existing Third Circuit law and Supreme Court precedent, and that would create a split among the federal circuits in which the Third Circuit would be alone, with four others having ruled the other way. Final resolution of this issue awaits reargument of the appeal and issuance of the *en banc* decision.

Bucking the SLUSA Trend: Recent Cases Address Plaintiffs' Attempts to Bring Securities Class Actions in State Court

Introduction

The Private Securities Litigation Reform Act of 1995 (PSLRA) aimed to curb strike suits by, among other things, strengthening the pleading requirements for claims under the federal securities laws. But a loophole quickly developed as plaintiffs increasingly filed securities fraud suits in state court under state statutory or common law, thereby avoiding PSLRA's restrictions. In response, Congress enacted the Securities Litigation Uniform Standards Act of 1998 (SLUSA) in order to "prevent plaintiffs from seeking to evade the protections that Federal law provides against abusive litigation by filing suit in State court, rather than Federal court." H.R. Rep. No. 105-803 (1998). In effect, SLUSA makes federal court the exclusive jurisdiction for securities fraud class actions meeting its definitions, and ensures they will be governed exclusively by federal law. This article looks at recent trends in how federal courts have applied SLUSA.

Recent Cases Applying SLUSA

SLUSA bars class action lawsuits on behalf of fifty or more people that are based upon the statutory or common law of any state in

the sheer breadth of the alleged misrepresentations made to each of the 145 million putative class members. The relevant representations were made by a host of subsidiaries of the defendants as well as the subscribers' own employers. Representations were made in written and oral form, and changed in content over time based on regulatory and other inputs. While plaintiffs pointed to some common printed materials used by all defendants, defendants were able to establish numerous variations in representations made to putative class members. Given the variety of representations made, the court found that there was not a uniform course of conduct that would merit certification of an injunctive class under Rule 23(b)(2), especially because a single injunction would be unlikely to redress the conduct at issue. The court declined to certify a money damages class under Rule 23(b)(3) because individualized issues predominate with respect to proof of a scheme to defraud, which would have to be established based on the content of specific representations made to each putative class member. Individualized issues also predominated on the question of reliance, which could not be presumed and must be established for every plaintiff class member. ***In re Managed Care Litig.*, MDL No. 1334, Order Granting Provider Track Class Certification and Denying Subscriber Track Certification (S.D. Fl. Sept. 26, 2002).**

Environmental Products Liability/Class Certification

Judge denies motion to certify multi-state class action alleging pollution caused by gasoline additive. The difficulty in obtaining certification of a plaintiff class seeking recovery for alleged multiple point source contamination is highlighted in the recent decision of Judge Shira Scheindlin of the U.S. District Court for the Southern District of New York that denied plaintiffs' motion to certify a four-state class action seeking a injunctive relief to remedy the alleged contamination of private water wells from methyl tertiary butyl ether (MBTE), a common gasoline additive. The representative plaintiffs, residing in New York, Florida, Illinois and California, alleged that their private wells had been contaminated by MBTE that had migrated out of gasoline spilled at service stations and other facilities near their homes. The plaintiffs requested certification of a class of all private well owners in their fours states for purposes of seeking injunctive relief to prevent such pollution in the future. Judge Scheindlin denied that request. She found that the class representatives did not satisfy the requirement of Fed. R. Civ. P. 23(a)(3) that their claims be typical of the class as a whole because each alleged unique facts concerning the source of alleged contamination, the injury sustained and the relief sought. The

Bucking the SLUSA Trend...*continued*

which the plaintiffs allege a misrepresentation or omission of a material fact, or the use of any manipulative device or contrivance, in connection with the purchase or sale of a "covered security." 15 U.S.C. § 78bb(f)(1). The Act makes such state lawsuits removable to federal court, where they are subject to dismissal under the Act's prohibitions. 15 U.S.C. § 78bb(f)(2). Recently, defendants in securities class actions have taken advantage of SLUSA by removing claims to federal court and seeking their dismissal. These cases have often required the courts to resolve two ambiguities in SLUSA: (1) What is a "covered security"? and (2) When is a misrepresentation or omission "in connection with the purchase or sale" of a security?

"Covered Security"

SLUSA defines a "covered security" as a security listed on the New York Stock Exchange, American Stock Exchange, or Nasdaq, or a security issued by an investment company that is registered, or for which a registration statement has been filed. 15 U.S.C. § 78bb(f)(5)(E). The question whether a particular security is a "covered security" has arisen recently in the context of variable annuity contracts and money market mutual fund shares. In both cases, the courts have construed the term "covered security" broadly.

In May, the Ninth Circuit ruled that tax-deferred variable annuities (in this case simplified employee pensions) are covered securities under SLUSA. *Patenaude v. Equitable Life Assurance Society,* 2002 WL 979747 (9th Cir. 2002). The court reasoned that a security was covered by SLUSA if it was "issued by an investment company that is registered, or that has filed a registration statement, under the Investment Company Act of 1940." 2002 WL979747 at 2. Variable annuities must be registered with the Securities and Exchange Commission (SEC) as securities. Even when insurance companies sell the annuities, they must register them with the SEC as separate "investment companies." *Id.* Thus, the variable annuity sold by Equitable Life in this case fell under the plain meaning of SLUSA's definition of "covered security." Consequently, the court dismissed the plaintiff's state law claims under SLUSA.

In so doing, the circuit court rejected the plaintiff's argument that the plain meaning of "covered security" should be subordinate to the context, purpose, and legislative history of SLUSA and related statutes. The court found that the statutory context and legislative history actually buttressed the conclusion that SLUSA was intended to cover variable annuities. *Id.* at 4. Given the clear language of the text, the court rejected the plaintiff's contention that the legislative history's silence on the status of variable annuities indicated Congress' intention to exclude them from the Act's coverage. *Id.* at 3.[1]

[1] The Second Circuit, using the same rationale, has also held that a variable annuity contract purchased from a life insurance company was a covered security under SLUSA, and it dismissed the plaintiffs' claims under state statutory and common law. *Lander v. Hartford Life & Annuity Ins. Co.*, 251 F.3d 101 (2nd Cir. 2001).

court also found that the class representatives did not satisfy the adequacy of representation requirement of Rule 23(a)(4) because their election to pursue only injunctive claims (in order to enhance likelihood of class certification) created potential conflicts with class members who, unlike named plaintiffs, might be able to assert viable personal injury claims that could potentially be barred under the doctrine of res judicata. The putative class also failed the maintainabililty requirements of Rule 23(b). The class could not be maintained as a class for injunctive relief under Rule 23(b)(2) because the relief sought on behalf of the class varied signficantly from person to person. As a consequence, the relief sought lacked the degree of specificity required for issuance of an injunction under Fed. R. Civ. P. 65. Further, potentially responsible parties other than defendants were not before the court. These considerations would cause an injunctive class to fail the manageability requirements of Rule 23(b). The individualized issues that preclude certification of an injunctive class also preclude certification under Rule 23(b)(3). In a final effort to salvage class certification, plaintiffs proposed issue certification under Rule 23(c)(4), with trials on general liability issues applicable to the entire class, with individual trials to follow. The court concluded that this process was impermissible because it would lead to reexamination of prior jury verdicts in the individual liability trials, would unduly pressure defendants to settle based on the risk of the outcome of the general liability trials, and would not result in substantial efficiencies, given the resulting need for numerous individual trials. ***Methyl Tertiary Butyl Ether (MTBE) Products Liability Litig.*,** **2002 WL 1560358 (S.D.N.Y. Jul. 16, 2002).**

Privacy/Class Action Settlement

DoubleClick Settlement Approved Requiring Modification of Privacy Policies and Attorneys' Fees. On May 21, 2001, a federal district court in the Southern District of New York granted final approval to the settlement of the nineteen pending federal and state privacy class actions against DoubleClick, Inc., the world's largest provider of Internet advertising services and products. The settlement requires DoubleClick to modify its privacy policies and practices, and pay $1.8 million in attorneys' fees, but does not obligate DoubleClick to pay any monetary damages to the plaintiff class. As highlighted in the May 2002 issue of The *Mintz Levin Class Action Newsletter,* the willingness of plaintiffs to agree to this settlement, and of the Court to approve it, highlights the difficulties of proving and obtaining class-wide money damages in privacy class actions. But the final settlement also raises the specter of Government injunctions and fines in the privacy arena.

Bucking the SLUSA Trend...*continued*

In March 2002, the United States District Court for the Central District of California dismissed a state-law misrepresentation claim under SLUSA, ruling that money market mutual fund shares purchased with funds deposited for later purchase of CD's are covered securities. *Rothschild Trust v. Morgan Stanley Dean Witter,* 2002 WL 570642 (C.D. Cal. Mar. 27, 2002). Mutual funds meet the statutory definition of "security," since that term includes a "portfolio of securities," *i.e.*, a "group or index of securities." *Id.* at 4. Moreover, the court noted that, to be covered by SLUSA, a security need only be traded on a national exchange or issued by a registered investment company, not both. *Id.* There was undisputed evidence that the securities involved were issued by a registered investment company. *Id.*

"In connection with the purchase or sale"

The recent decisions under SLUSA evidence conflicting judicial approaches to the meaning of the statute's "in connection with the purchase or sale" requirement. Some courts have taken a broad view of when alleged misrepresentations are "in connection with the purchase or sale of a covered security," while the most recent federal circuit case on the issue takes a narrower view.

The United States District Court for the Southern District of New York has addressed two class actions this year in which plaintiffs who had purchased stock at the recommendation of securities analysts claimed that the selling securities firms were promoting certain stock in order to boost their investment banking business. In *Korsinsky v. Salomon Smith Barney,* the plaintiff claimed that Salomon Smith Barney (SSB) recommended certain telecommunications stocks in order to induce companies to bring their investment banking business to SSB in violation of its fiduciary duties under state law. 2002 WL 27775, at 1 (S.D.N.Y. Jan. 10, 2002). The court found that the alleged misrepresentations were "in connection with the purchase or sale of a covered security" because the plaintiff defined the class as those who bought AT&T stock after SSB's "Buy" recommendation and because the complaint alleged that the positive recommendation caused both investors to buy AT&T stock and the price of the stock to rise. *Id.* at 5. But the court suggested that a class action would not be removable under SLUSA if class members had purchased the stock prior to a "Buy" rating and were simply holding — rather than purchasing — the stock because of the allegedly misleading recommendation. *Id.* at 6.

In *McCullagh v. Merrill Lynch,* the plaintiff claimed that Merrill Lynch violated a New York statute by prohibiting its employees from making negative recommendations about companies that could adversely affect Merrill Lynch's ability to retain investment banking business. 2002 WL 362774, at 1 (S.D.N.Y. Mar. 6, 2002). The court rejected the plaintiffs' argument that their claim dealt not with the purchase of stock, but rather with their choice to retain Merrill Lynch as their broker. *Id.* at 2. The opinion, following *Korsinsky,* held that public statements that "affect the public's interest in the

Recent Developments

Settlement/Class Member Challenge

Recent United States Supreme Court Decision Makes Appeals of Class Action Settlements Easier. In June, the Supreme Court held that people affected by a class action settlement can appeal the approval of the settlement, even if they failed to formally intervene, as long as they objected to the settlement during the trial court proceedings. As a result, settlement negotiations may become more complicated, and more time consuming, and preliminary settlements less certain once reached. Specifically, defense counsel cannot assume that an agreement reached with the named plaintiffs will be rubber-stamped by the trial court or that, once the class counsel are placated, no significant objections or appeals will arise.

The Court's decision is in line with the proposed revisions to the rules governing class actions. The revisions generally enhance judicial oversight of class actions generally and settlements in particular. The revised rules have been approved by the Rules Committee for the Judicial Conference and are on track to go into effect by December 2003. The revisions require, among other things, that a court hold a hearing on any settlement that will bind the class members, and that any approval must be supported by written findings. The revised rules also provide that class members can object to any proposed settlement, voluntary dismissal, or compromise that would bind the class members. Such objectors would also be entitled to have discovery to the extent reasonably necessary to support their objections.

Under the current rules, hearings are commonly held on proposed settlements and notice to the absent class members is commonly issued. Thus, even before the proposed rules become effective, non-party objectors have significant power to disrupt settlements, demanding a seat at the table during settlement negotiations under threat of appeal if their objections are not heard.

Armed with standing to appeal and the power to demand discovery, non-party objectors can mount a significant challenge to a proposed settlement prior to and even after approval by the trial court. **Devlin v. Scardelletti, 122 S. Ct. 200 (2002) (O'Connor, J.).**

Bucking the SLUSA Trend...*continued*

corporation's stock are made in connection with sales or purchases of that stock." *Id.* at 3. Although the plaintiffs did not allege any stock purchase based upon the supposed misrepresentations, the court found that the allegedly fraudulent statements affected the public's interest in that stock. *Id.* at 4. Furthermore, the claims were found to concern the stock purchase because the plaintiffs sought disgorgement of commissions paid to Merrill Lynch. *Id.* In both cases, the Southern District of New York noted that the "in connection with the purchase or sale" requirement should be read flexibly. *Id.* at 3; Korsinsky, 2002 WL 27775, at 5.[2]

In February, the Eighth Circuit held that a breach of contract claim brought by a subscriber to an online securities price information and stock brokerage service was not preempted by SLUSA, because the alleged misrepresentation was not "in connection with the purchase or sale of a covered security." *Green v. Ameritrade,* 279 F.3d 590, 598-99 (8th Cir. 2002). In applying SLUSA's "in connection with" language, the court looked to cases interpreting identical language in SEC Rule 10b-5. The Supreme Court has ruled that only purchasers and sellers of securities have standing to sue under that rule. *Id.* at 597 (citing *Blue Chip Stamps v. Manor Drug Stores,* 421 U.S. 723, 725 (1975)). The Eighth Circuit thus concluded that only claims by purchasers and sellers of securities were covered by SLUSA. *Green,* 279 F.3d at 598. The court noted that, after his original complaint was removed under SLUSA, the plaintiff in *Green* amended his initial complaint to remove any mention of the purchase or sale of securities. (The original complaint claimed that subscribers had bought and sold options based on quote information that Ameritrade had misrepresented as real-time). *Id.* Moreover, the plaintiff specifically disclaimed any damages for any sale or purchase made in reliance on the allegedly stale price information. *Id.* at n.7. The court concluded that, even if the plaintiff were artfully pleading to cloak a misrepresentation claim as a contract claim in order to avoid SLUSA preemption, that practice was acceptable as long as his state-law claim did not require proof of a purchase or sale of a covered security in reliance upon the misrepresentation. *Id.* at 599.

Other Challenges and Limitations to SLUSA

Some plaintiffs, trying to avoid dismissal under SLUSA, have challenged SLUSA or tried to limit its scope. For example, in *Patenaude* (discussed above), the Ninth Circuit rejected the plaintiff's argument that dismissal was inconsistent with the McCarran-Ferguson Act, which provides that no federal law shall be construed to supersede any State regulation of the insurance industry. 15 U.S.C. § 1012(b). Noting that tax-deferred variable annuities retain aspects of both a

[2] The Supreme Court also recently took a broad view of this language in the context of a Rule 10b-5 claim. *See SEC v. Sandford,* 122 S.Ct 1899, 1906 (2002) (holding that broker's alleged selling of customer's securities with undisclosed intent to misappropriate proceeds was fraud in connection with the sale of a security.

security and an insurance product, the court found that SLUSA seeks only to regulate certain securities class actions and does not displace state insurance regulation. 2002 WL979747, at 6. A district court in Florida rejected a constitutional challenge to SLUSA, holding that the Act did not exceed Congress's Commerce Clause powers. *Riley v. Merrill Lynch,* 168 F. Supp. 2d 1352, 1359 (M.D. Fla. 2001). The court found that Congress had properly exercised its prerogative to preempt a portion of state law. *Id.* at 1356-58. In *Rothschild Trust* (discussed above), the district court held that the plaintiff's securities claims were not consumer protection claims outside the scope of SLUSA. 2002 WL 570642, at 7. The court stressed that the alleged misrepresentations concerned the likely return on an investment. *Id.* This distinguished the case from others in which the misrepresentations did not relate to the value of securities. *See, e.g., Shaw v. Charles Schwab,* 128 F. Supp. 2d 1270, 1274 (C.D. Cal. 2001) (finding that fraud challenge to brokers' commissions lay more in the realm of consumer protection than securities litigation and was not preempted by SLUSA); *Abada v. Charles Schwab,* 127 F. Supp. 2d 1101, 1103 (S.D. Cal. 2000) (remanding to state court a claim based merely on broker's technical inability to process an order).

In addition, federal courts have remanded to state courts securities class actions that are not preempted by SLUSA because they fall under an exception for suits based on the law of the state in which the issuer of the security is incorporated, see *Lazar v. Gregerson,* 2002 WL 535405, at *4 (N.D. Cal. Apr. 8, 2002), and they have remanded claims brought under federal securities laws, *see In re Waste Management, Inc. Securities Litigation,* 194 F. Supp. 2d 590, 596 (S.D. Tex. 2002) (noting that SLUSA only provides for removal of state law claims and that Securities Act of 1933 provides for concurrent federal and state court jurisdiction).

Finally, the United States District Court for the Southern District of New York recently held that a breach of contract claim, brought in connection with an initial public offering, failed to allege a misrepresentation or omission of a material fact and thus was not preempted by SLUSA. *MDCM Holdings v. Credit Suisse First Boston Corp.*, No. 01 Civ. 9333 (SAS), slip op. at 13-18 (S.D.N.Y. June 25, 2002). The court noted that SLUSA only preempts claims that allege either a "misrepresentation or omission of a material fact" or "any manipulative or deceptive device or contrivance." *Id.* at 12. The court found that while the complaint alleged failure to carry out promises under an underwriting agreement, it did not allege intent to do so at the time of contract formation, an essential element of fraud. *Id.* at 13-14. As in *Green v. Ameritrade* (discussed above), the plaintiff's contract claims required no proof of misrepresentation or fraud. *Id.* at 16 (noting similarity to *Green,* 120 F. Supp. 2d at 796, 799). In any case, New York law precludes fraud claims when they relate to a breach of contract. *MDCM,* at 16.

Employee Benefit Class Actions Arising Out of 401(k) Plan Management Decisions Increase in Wake of Enron

As has been widely reported, Enron is facing several class actions alleging fraud and breach of fiduciary duty in the management of the company's 401(k) plan. *Tittle v. Enron Corp.,* No. H-01-3913, (S.D. Texas filed Nov. 3, 2001); *McCown v. Arthur Anderson LLP,* No. 2002-05395 (Tex. Dist. Ct., Harris County complaint filed Jan. 31, 2002). These suits have triggered a series of similar actions against other companies including Global Crossing, Lucent Technologies, Nortel Networks, Providian Financial Corp., Qwest Communications, and Williams Companies. *McAllister v. Winnick,* C.D. Cal. No. 02-1323; *Ramkissoon v. Winnick,* No. 2:02cv1478 (C.D. Cal. complaint filed Feb. 20, 2002); *Johnson v. Winnick,* No. 02-02070 (C.D. Cal. complaint filed Mar. 12, 2002); *Van Nes v. Williams Companies,* No. 02-CV-159-E(M) (N.D. Okla. complaint filed Feb. 28, 2002); *Reinhart v. Lucent Technologies,* No. 01-CV-3491 (D.N.J. complaint filed July 19, 2001); *Spindler v. Providian Fin. Corp.,* No. 3:01-cv-05220 (N.D. Cal. complaint filed Dec. 26, 2001); *Brooks v. Qwest Communications Int'l, Inc.,* No. 1:02cv464 (D.C. Colo. complaint filed Mar. 8, 2002); *Kauffmann v. Nortel Networks Corp.,* No. 3:02cv253 (M.D. Tenn. complaint filed Mar. 20, 2002).

This list is likely to continue to expand given recent drops in the stock market and the number of companies that have encouraged investment in company stock through their 401(k) plans.

The suits allege that the plan administrators failed to disclose information about the true financial condition of the company, causing plan participants to continue to invest in company stock — either directly or through company matching contributions — until public announcements were made causing the value of the stock to plummet. In many cases, the plans provided that company matching contributions would be made exclusively with company stock and, in

several cases, the company prohibited plan participants from directing company contributions into other investment vehicles, further increasing the percentage of company stock held by plan participants. Most of the class actions allege that the employers had a fiduciary obligation to provide detailed financial statements to employees and that the employers breached their fiduciary duties when they failed to provide that information.

These allegations are novel, as ERISA does not explicitly require employers to provide detailed financial statements to employees absent a specific request. *See* 29 U.S.C. § 404. Moreover, if ERISA is construed to require the disclosure of certain non-public information, it may conflict with securities laws that prohibit the disclosure of such information. *See* 17 C.F.R. § 243.100. Whether these cases have merit has yet to be determined, and expert opinion is divided.

One relevant issue is whether the plan participants directed the investment in company stock or if the company matched employee investments with company stock. If the company matched the employee investments with company stock, the company is investing its money in company stock and the question becomes whether plan fiduciaries were required to override the terms of the plan requiring the employer to match employee investment. With employee-directed investment in company stock, the employee is investing *his or her* money in company stock. This activity raises a potential conflict with securities laws. If the plan fiduciaries are in possession of material non-public information about the company, disclosure of that information may violate the securities laws.

Another issue is whether plan fiduciaries with knowledge of securities fraud are obligated to disclose that to the plan participants. If so, then allegations of securities fraud could give rise to class actions, not only in the traditional form of securities derivative actions but also under ERISA.

The class actions against Enron are the model for these suits. There, the plaintiffs have alleged that the company encouraged employees to invest in the 401(k) plan while systematically misrepresenting its financial condition and failing to disclose financial information. Thus, plaintiffs allege, plan administrators violated their fiduciary duties of loyalty and prudence. This model repeats in the cases brought against other companies, including Global Crossing, Lucent Technologies, Nortel Networks, Providian, Qwest, and Williams.

In many of these cases, the plaintiffs have also alleged that the company further restricted the participants' ability to diversify their investments by limiting their ability to transfer company contributions made in company stock into other investment vehicles. In Enron, the plaintiffs allege that Enron violated ERISA when it both "locked-down" the 401(k) plan, effectively preventing employees from selling their Enron shares and then announced that it had to restate its financial results causing the stock to plummet. In other cases, the plaintiffs allege that the plans prohibited transfer of company matching funds altogether, or required that employees reach age 55, before removing funds from company stock. In some cases, plaintiffs bolster these complaints with numbers reflecting a lack of diversity in company plans. Williams, for example, had 65% of its plan assets in company stock; Qwest had 39% in company stock. These concentrations are not uncommon among large corporations; according to a Congressional study, nearly one-third of the Fortune 500 companies have 401(k) plan assets invested in company stock in concentrations exceeding the level at Enron.

The outcome of these cases is uncertain. Whether Congress will act on this is another open question. But, as these cases increase, large corporations will be pressured to allow employees to better diversify their 401(k) investments and to provide better financial information to plan participants.

Proposed Changes to Rule 23 Take Next Step Toward Approval

At its June 10-11, 2002 meeting, the U.S. Judicial Conference's Committee on Rules of Practice and Procedure ("Standing Committee") unanimously approved recommendations of its Advisory Committee on Civil Rules to amend Rule 23. The approved amendments would revise the requirement for certification, notice and settlement, and would add two new sections dealing with appointment of class counsel and award of attorneys' fees.

Regarding the timing of class certification and notice provisions of Rule 23(c), both the version as approved by the Standing Committee and the original August 15, 2001 proposal require that a court certify a class "at an early practicable time." But the approved amendment deletes the original proposal that notice be given to all classes. Instead, it provides, "For any class certified under Rule 23(b)(1) or (2), the court may direct appropriate notice to the class." The Advisory Committee deleted the notice requirement for all classes after hearing testimony that such notice would be prohibitively expensive for many civil rights actions.

Proposed Changes to Rule 23...*continued*

Regarding Rule 23(e), the Advisory Committee recommended revising the earlier proposal that would have required court approval of any pre-certification voluntary dismissal, withdrawal, or settlement. Recognizing that a court cannot compel unwilling parties to litigate, the Advisory Committee decided to require court approval only for a "settlement, voluntary dismissal, or compromise of the claims, issues or defenses of a certified class." The Advisory Committee also recommended revising an earlier proposal that would have allowed the court to ask the parties to file any side agreement reached along with the settlement agreement. The approved amendment instead requires the parties to identify for the court such side agreements.

One of the most significant and controversial proposals is the "second opt-out" provision of Rule 23(e)(3). After much discussion, the Advisory Committee recommended that the court retain discretionary authority as to whether to allow a second opt-out after notice of the terms of a proposed settlement in a (b)(3) class. The proposed amendment now provides, "the court may refuse to approve a settlement unless it affords a new opportunity to request exclusion to individual class members who had an earlier opportunity to request exclusion but did not do so."

The new proposed amendments would provide, for the first time, procedures for appointing class counsel (Proposed Rule 23(g)) and for awarding attorneys' fees (Proposed Rule 23(h)). The Advisory Committee revised the August 15, 2001 proposals to state up front the criteria for the appointment of class counsel and to include two additional criteria: counsel's experience in handling claims of the type asserted and knowledge of the applicable law. The revision also emphasizes "the work counsel has done in identifying or investigating potential claims in the action" over counsel's experience in handling class actions, to avoid the "entrenchment of a small specialized bar." Other changes include allowing the court to appoint interim counsel before certification (approved Proposed Rule 23(g)(2)(A)) and, in cases in which more than one counsel seeks appointment, requiring that the court appoint the applicant "best able to represent the interests of the class" (approved Proposed Rule 23(g)(2)(B)). As for an award of attorneys' fees under approved Proposed Rule 23(h), the only change is to revise a requirement that notice of fee motions by class counsel be given to all class members to a requirement that such notice be "directed to class members."