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TOP STORY

Federal Court Asserts Jurisdiction over State Securities Case

Court refuses to render binding precedent as meaningless as Game of Thrones plot

By Erik A. Christiansen

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A U.S. circuit court of appeals has held that state law–based class actions can now proceed in federal court against trustees for imprudent discretionary investment decisions. In a case of first impression, the [U.S. Court of Appeals for the Ninth Circuit](#) invoked the premature death of the Night King in the [Game of Thrones HBO television series](#) and ruled that the [Securities Litigation Uniform Standards Act of 1988 \(SLUSA\)](#) does not deprive a federal court of jurisdiction over state law–based class actions involving trustee investment decisions.



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The U.S. district court in [Banks v. Northern Trust Corporation](#) dismissed a putative state law–based class action filed by a beneficiary against a trustee of an irrevocable trust on SLUSA-preclusion grounds. SLUSA precludes plaintiffs from circumventing the stringent pleading requirements of the [Private Securities Litigation Reform Act of 1995](#) (PSLRA) by barring certain types of state law–based securities fraud class actions. The federal district court held that state law class action claims of trustee self-dealing, elder abuse, and excessive fees were covered securities fraud claims made “in connection with” securities transactions, which are barred by SLUSA.

The court of appeals in *Northern Trust* reversed. Relying on the U.S. Supreme Court case of [Chadbourne & Park LLP v. Troice](#), the court of appeals in *Northern Trust* held that where the trustee is both the buyer of securities and the fraudster, the trading misconduct is not “in connection with” a covered security and can proceed. The *Northern Trust* court reasoned that the U.S. Supreme Court in *Troice* interpreted SLUSA to require a misrepresentation that makes a significant difference in an investment decision by the plaintiff. Beneficiaries of an irrevocable trust do not make trading decisions. Without an investment decision by a plaintiff, there is no “connection with” a purchase or sale of a security. Allegations of trustee self-dealing, elder abuse, and overcharging do not involve misrepresentations by a defendant that impact a plaintiff’s investment decision. Accordingly, SLUSA preclusion did not apply.

Northern Trust Court Distinguishes SLUSA Preclusion for Agents

Northern Trust argued that there was no difference for the purposes of SLUSA between an agent like a stockbroker and a trustee like Northern Trust, as they are both fiduciaries. The court of appeals disagreed. Relying on the U.S. Supreme Court decision in *Troice*, the court of appeals noted that “SLUSA does not preclude cases where ‘the only party who decides to buy or sell a covered security as a result of a lie is the liar’ because ‘that is not a ‘connection’ that matters.’” The court of appeals explained that while “both agents and trustees are fiduciaries . . . there are significant differences between the two.” An agent acts for his principal subject to the principal’s control. A trustee in an irrevocable trust acts for beneficiaries, but not subject to their control. Without control of the investments, there is no connection to securities necessary to implicate SLUSA preclusion.

Court of Appeals Defends *Troice* by Trouncing Game of Thrones

Northern Trust also tried to rely upon two pre-*Troice* cases. Both earlier decisions involved claims by beneficiaries against trustees and both cases held SLUSA precluded the action. The court of appeals, however, rejected the two earlier decisions and instead relied on the post-*Troice* decision of [Henderson v. Bank of N.Y. Mellon Corp.](#) The *Henderson* case explained *Troice*’s modification of the U.S. Supreme

Court's earlier decision in [Merrill Lynch, Pierce, Fenner & Smith Inc. v. Dabit](#). *Troice* clarified *Dabit* and illuminated the "in connection with" requirement for SLUSA preclusion. The court of appeals explained that "[the Trustee] would like us to read *Dabit* without considering its clarification in *Troice*. But we will not render *Troice* meaningless in the way that Game of Thrones rendered the entire Night King storyline meaningless in its final season."

In the Game of Thrones television series, a threat from a White Walker Night King had been built up prominently, only to end abruptly halfway through the final season when Arya Stark killed the Night King. The court of appeals seemingly saves *Troice* from a similar fate at the hands of the earlier *Dabit* decision.

A Question Remains

A question remains after *Northern Trust* about whether a beneficiary's unexercised ability to control a trustee invokes SLUSA preclusion. The court of appeals hinted at the potential outcome when it rejected the defendant's argument that there is SLUSA preclusion when a stockbroker is granted full discretionary authority to trade securities. The appellate court reasoned that with a discretionary trading account, "[u]nlike in the irrevocable trust context, a principal can revoke control from an agent in the course of their relationship. In the irrevocable trust context, by contrast, unless otherwise specified in the trust instrument, a beneficiary cannot alter the powers of a trustee or remove the trustee without petitioning a court of law."

Despite the contrast between irrevocable trustees and discretionary stock brokers, "it remains to be seen whether the ability to control is enough, even if it is not exercised in the case of a trustee and a beneficiary. Had the case involved the ability of the beneficiaries to direct trading, there might have been a different outcome," offers [John E. Clabby](#), Tampa, FL, cochair of the [ABA Section of Litigation's Class Actions Subcommittee](#) of the [Securities Litigation Committee](#).

Part of the lack of clarity in recent SLUSA decisions is that "SLUSA jurisprudence is an incoherent mess. The statute is in the top five of the worst drafted statutes in history and is incomprehensible," laments [Nicholas I. Porritt](#), Washington, DC, cochair of the Section of Litigation's [Derivative Suits Subcommittee](#) of the Securities Litigation Committee. Nevertheless, Porritt agrees with the court of appeals and believes the *Northern Trust* decision was correctly decided. "Some judges have read SLUSA preclusion too narrowly," explains Porritt. "SLUSA was designed to deal with state-law circumvention of Rule 10(b) (5) securities cases after passage of the PSLRA and should not apply to every class action claim that involves securities."

[Erik A. Christiansen](#) is an associate editor for *Litigation News*.

Hashtags: #SLUSA #Securities #10(b)(5) #PSLRA #Trustees #Beneficiaries

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