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Not So Fast! Ninth Circuit Clarifies the Role of Materiality in Triggering SLUSA's Class Action Bar

Securities Litigation Quick Read

WRITTEN BY

Peter N. Villar | Pamela S. Palmer | Alice M.G. Hodsden | Kevin Crisp | Howard M. Privette

In a noteworthy decision refining application of the Securities Litigation Uniform Standards Act (SLUSA), the Ninth Circuit recently held that SLUSA did not bar a state law class action for alleged breach of fiduciary duties brought by investors against a financial advisory firm. In *Anderson v. Edward D. Jones & Col, L.P*, decided in March 2021, the panel reversed a dismissal of fiduciary duty claims, while clarifying that SLUSA only bars actions based on alleged misrepresentations or omissions that would violate federal securities laws — including the requirement of "materiality" in relation to the plaintiffs' decision to purchase or sell securities. Nothing in the complaint suggested that the alleged omissions factored into the plaintiffs' decisions to purchase or sell securities, but rather factored only into their decisions about which fee model to accept for their brokerage accounts.

By way of background, SLUSA was enacted to prevent investor-plaintiffs from using state-based securities class-action lawsuits to make an end run around federal legislation designed to reform abuses in the filing of federal securities class actions — *i.e.,* the Private Securities Litigation Reform Act of 1995. In essence, SLUSA precludes plaintiffs from maintaining state law class actions alleging fraud or misrepresentations "in connection with the purchase or sale" of securities traded on a national stock exchange.

In *Andersen*, the plaintiffs allege that the financial advisory firm breached its fiduciary duties under Missouri and California law by failing to conduct a "suitability analysis" — and by failing to disclose this omission — before encouraging investors to switch their fee-based accounts to commission-based accounts. They alleged that this same conduct also violated Section 10(b) of the federal Securities Exchange Act of 1934. The firm encouraged investors to switch from accounts that were "free" — except for transaction-based brokerage fees — to accounts for which the firm took an annual fee based on a percentage of assets in the account, regardless of the number of securities transactions in the account.[1] The plaintiffs allege that because they are low-volume, buy-and-hold traders, a "suitability analysis" would have revealed that their accounts were inappropriate for the percentage-of-assets fee model.[2] Thus, the firm allegedly failed to act in the plaintiffs' best financial interest and fraudulently induced them to enter into unsuitable fee-based accounts that generated higher brokerage and advisory fees.

The District Court dismissed the federal securities claim for failure to state a claim, and it dismissed the state law fiduciary duty claim under SLUSA, both with prejudice. The plaintiffs appealed only the dismissal of the state fiduciary claims.[3]

The Ninth Circuit's decision flagged the lower court's failure to consider whether the alleged misconduct was a "material" factor "in connection with the purchase or sale" of securities — as required to trigger the SLUSA bar against a state law-based securities class action. The panel found that the complaint contained no allegations that the alleged failure to make a suitability analysis (or disclose that failure) factored into the plaintiffs' decisions to purchase or sell securities.[4] To the contrary, the plaintiffs alleged that despite switching from commission-based to fee-based accounts, their "buy-and-hold philosophy remained unchanged."[5] Thus, the firm's alleged failure and omission did not make a material difference in the plaintiffs' decisions to buy or sell securities — *i.e.,* was not material "in connection with the purchase or sale" of securities.[6] The alleged fiduciary duty claims were remanded for further proceedings.

This decision is an important clarification of how the element of materiality operates in analyzing whether alleged fraud or misconduct is "in connection with" the purchase or sale of a security. As the panel explained, the Supreme Court's interpretation of the phrase "in connection with" has shifted in recent years from a relatively broad interpretation — "it [wa]s enough that the fraud alleged *coincide[d]* with a securities transaction" in *Dabit*[7] — to a narrower interpretation that "a fraudulent misrepresentation or omission is not made 'in connection with' such a 'purchase or sale of a covered security' unless it is *material* to a decision … to buy or sell a covered security" in *Troice*[8]

The Ninth Circuit noted that its "pre-*Troice* cases read 'in connection with'" too broadly.[9] Its prior test for application of SLUSA did not "not explicitly include the requirement of 'materiality.'"[10] In *Anderson,* the panel made clear that, going forward, analysis of whether conduct is "in connection with the purchase or sale [raising the SLUSA bar]" … "must include inquiry into the materiality of the alleged misrepresentation or omissions to purchase or sale of a covered security."[11]

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[1] *Anderson v. Edward D. Jones & Co., L.P.*, 990 F.3d 692, 697.

[2] *Id.*

[3] *Id.* at 700.

[4] *Id. at* 709.

[5] *Id.* at 705.

[6] *Id.* at 709.

[7] *Id.* at 702, quoting *Merrill Lynch, Pierce, Fenner & Smith Inc. v. Dabit*, 547 U.S. 71, 85, 126 S.Ct. 1503 (2006) (emphasis added).

[8] *Chadbourne & Parke LLP v. Troice*, 571 U.S. 377, 387, 134 S. Ct. 1058 (2014).

[9] *Anderson*, 990 F.3d at 703, quoting *Banks v. N. Tr. Corp.*, 929 F.3d 1046, 1053 (9th Cir. 2019).

[10] *Id.*, citing *Northstar Fin. Advisors, Inc. v. Schwab Invs.*, 904 F.3d 821, 828 (9th Cir. 2018), *holding modified by Anderson v. Edward D. Jones & Co., L.P.*, 990 F.3d 692 (9th Cir. 2021); *Fleming v. Charles Schwab Corp.*, 878 F.3d 1146, 1155 (9th Cir. 2017).

[11] *Id.* at 702.

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