

To Preempt or Not to Preempt - Courts Issue Competing SLUSA Rulings

June 25, 2018

During two weeks in April, two different courts — the Second Circuit and the New Jersey Superior Court — considered nearly identical allegations regarding variable products and reached diametrically opposed conclusions about the extent to which the claims were barred by the Securities Litigation Uniform Standard Act (SLUSA).

In *Shuster v. AXA Equitable Life Insurance*, a putative class action involving variable life insurance policies, the plaintiff alleged that the contracts provided that AXA was not to make any material changes to the investment strategy related to the policies without first informing appropriate regulatory agencies. Plaintiff claimed AXA breached this provision by implementing a new “volatility-management strategy” in 2009 without adequately informing the New York Department of Financial Services, and that this act affected policyholders’ investment, resulting in reduced returns. The action’s procedural history included AXA’s removal of the case to the New Jersey federal district court and its move to dismiss the breach of contract claim as barred by SLUSA, which preempts class actions that allege misrepresentation or omission of a material fact in connection with the purchase or sale of a security. The New Jersey federal district court judge remanded the action. In state court, AXA again moved to dismiss, this time successfully.

In an April 17 ruling affirming the action’s dismissal, the New Jersey Superior Court found, based on the complaint’s allegations, the alleged misrepresentation did not necessarily induce the purchase of securities, but did result in a trading strategy within AXA’s accounts that ultimately reduced returns to putative class members. Like the trial court, the appellate court relied on a New York federal district court case, *Zweiman v. AXA Equitable Life Insurance Company*, which challenged the same investment strategy. There, in a 2015 opinion, the court broadly construed the requirement that the deception occur “in connection” with the purchase or sale of securities, finding the element was satisfied because the alleged fraud negatively impacted the securities. The New Jersey Superior

Court agreed with this logic and found that SLUSA precluded the breach of contract claim. The Shuster court did not, however, cite a Second Circuit ruling reversing a SLUSA-based dismissal of a suit involving a putative class of variable annuity policyholders issued the week before — despite the fact that the same alleged misconduct by the same defendant was at issue.

Specifically, in its April 10 ruling in *O'Donnell v. AXA Equitable Life Ins. Co.*, the Second Circuit considered a strikingly similar case and refused to adopt the *Zweiman* court's analysis. Rather than broadly construing SLUSA's "in connection with" element, the Second Circuit noted that the alleged misrepresentation to a regulator and the inaction of a securities holder to buy or sell were unconnected. It also found there was no reasonable inference that AXA misled the plaintiff or the market more generally in a manner that influenced the purchase or sale of securities. As a result, the Second Circuit concluded that SLUSA did not preempt the plaintiff's breach of contract claim.

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