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Eighth Circuit Finds State Law “Best Execution” Claims Are Precluded by SLUSA

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The Eighth Circuit’s recent decision in *Zola v. TD Ameritrade, Inc.*—which affirmed the dismissal of a series of class actions based on a brokerage firm’s alleged violations of best execution duties when routing customer trades—represents the latest decision in a line of growing authority finding that the Securities Litigation Uniform Standards Act of 1998 (“SLUSA”) bars class action plaintiffs from bringing state law “best execution” claims.²

Statutory Framework

In 1995, Congress passed The Private Securities Litigation Reform Act (“PSLRA”), which imposed a variety of reforms—including a heightened pleading standard for securities fraud claims—to address “perceived abuses” of federal class action securities litigation.³ The PSLRA, however, also prompted plaintiffs to bring securities class actions under state law in an attempt to avoid the effects of the legislation in federal courts.⁴ Thus, to prevent plaintiffs from circumventing the PSLRA, Congress passed SLUSA. SLUSA, in relevant part, bars plaintiffs from bringing “(1) a covered class action (2) based on state law claims (3) alleging that defendant made a misrepresentation or omission or employed any manipulative or deceptive device (4) in connection with the purchase or sale of (5) a covered security.”⁵

The *Zola* Decision

In *Zola*, plaintiffs filed three separate class action complaints against brokerage firm TD Ameritrade, Inc. asserting breach of contract, breach of fiduciary duty, and various other state law claims.⁶ Plaintiffs alleged that TD Ameritrade “failed to direct client orders to the trading venues that offered the ‘best execution’ possible for the order—that is, the best price, speed of execution, and likelihood that the trade would be executed”—and, instead, directed the orders to venues willing to pay the largest “kickbacks,” *i.e.*, rebates or payments for order flow” to TD Ameritrade.⁷ The United States District Court for the District of Nebraska held that plaintiffs’ claims were precluded by SLUSA and dismissed the complaints. On appeal, plaintiffs argued that SLUSA did not apply because the complaints failed to allege (1) a “misrepresentation or omission” or a “manipulative or deceptive device or contrivance” that was (2) “in connection with” the purchase or sale of a covered security.⁸ The Eighth Circuit disagreed.

Judge Robert L. Wollman, writing for the unanimous court, explained that plaintiffs could not avoid the impact of SLUSA simply by styling their claims as breach of contract claims because the Court “look[s] at the substance of the allegations, based on a fair reading of the complaint” in order to determine



whether a plaintiff has alleged a misrepresentation or omission of material fact.⁹ Although plaintiffs' complaints "carefully avoided allegations that explicitly sounded in fraud (words like misrepresentation, omission or deception . . .)," plaintiffs' claims were nonetheless grounded upon an alleged omission: "TD Ameritrade's failure to disclose the fact that it was selling its order flow to [trading venues that were] the highest bidders."¹⁰ The Court's finding was in keeping with Eighth Circuit precedent holding that a plaintiff has alleged a misrepresentation or omission when the "core" of the complaint is that the broker "did not disclose its practice of not obtaining best execution, permitting it to acquire and retain trading venue rebates."¹¹

The Eighth Circuit also found the alleged omission was "in connection with" the purchase or sale of a covered security because TD Ameritrade received payments from the trading venues in exchange for routing orders to buy and sell securities.¹² In doing so, the Court noted that SLUSA's "in connection with" requirement is interpreted broadly and is satisfied if the alleged fraud simply "coincides with" a securities transaction.¹³

Ramifications

The *Zola* decision is in accord with recent cases from the Second, Seventh, and Ninth Circuits finding that SLUSA precludes class action plaintiffs from bringing state law claims based on an alleged violation of the duty of best execution—regardless of whether they are characterized as sounding in contract or breach of fiduciary duty—when the gravamen of those claims is a purported omission or misrepresentation by defendants in connection with the routing of covered securities.¹⁴ These decisions should provide broker-dealers, investment advisers, and their executives and employees with helpful precedent when seeking to dispose of state law "best execution" claims at the pleading stage.



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² No. 16-3013, 2018 U.S. App. LEXIS 12261 (8th Cir. May 10, 2018).

³ *Id.* at *5-6 (quoting *Merrill Lynch v. Dabit*, 547 U.S. 71, 81 (2006)).

⁴ *Dabit*, 547 U.S. at 82.

⁵ *Fleming v. Charles Schwab Corp.*, 878 F.3d 1146, 1152 (9th Cir. 2017); see also 15 U.S.C. 78bb(f)(1). A "covered class action" is "a lawsuit in which damages are sought on behalf of more than 50 people" and a "covered security" is one that is "traded nationally and listed on a regulated national exchange." *Dabit*, 547 U.S. at 83 (citing 15 U.S.C. 78bb(f)(5)(B) and (E)).

⁶ Several individuals and entities related to TD Ameritrade were also named as defendants. All defendants are collectively referred to herein as "TD Ameritrade."

⁷ 2018 U.S. App. LEXIS 12261, at *3.

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⁸ *Id.* at *7. There was no dispute as to SLUSA’s other requirements: the lawsuits were: (i) “covered class actions” that were (ii) based on “state law” and (iii) involved the purchase or sale of “covered securities.” *Id.* at *7, 14.

⁹ *Id.* at *8 (internal citations omitted).

¹⁰ *Id.* at *9.

¹¹ *Id.* at *8–9 (quoting *Lewis v. Scottrade, Inc.*, 879 F.3d 850, 854 (8th Cir. 2018)).

¹² *Id.* at *14.

¹³ *Id.* at *12; see also *Fleming*, 878 F.3d at 1155.

¹⁴ See, e.g., *Lewis*, 879 F.3d at 852–854; *Fleming*, 878 F.3d at 1154–56; *Kurz v. Fid. Mgmt. & Research Co.*, 556 F.3d 639, 641–42 (7th Cir. 2009); *Rayner v. E*TRADE Fin. Corp.*, 248 F. Supp. 3d 497, 501–05 (S.D.N.Y. 2017); see also *Pearce v. UBS PaineWebber, Inc.*, No. 3:02-2409-17, 2003 U.S. Dist. LEXIS 26130, at *45 (D.S.C. Nov. 4, 2003) (noting, in dicta, that “SLUSA preempts state law claims” for best execution) (emphasis in original).