The Asset Management Industry
SERVING INDIVIDUAL INVESTORS
INVESTMENT COMPANY INSTITUTE

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Institute Files Amicus Brief In Illinois SLUSA Class Action Alleging Negligence Based On Market Timing

[22711]

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TO: BOARD OF GOVERNORS No. 5-08BROKER/DEALER ADVISORY COMMITTEE No. 20-08
SEC RULES MEMBERS No. 63-08
SMALL FUNDS MEMBERS No. 42-08 RE: INSTITUTE FILES AMICUS BRIEF IN ILLINOIS SLUSA CLASS ACTION ALLEGING NEGLIGENCE BASED ON MARKET TIMING

As you may recall, the Securities Litigation Uniform Standards Act (SLUSA) was enacted by Congress in 1998 to curb vexatious litigation by establishing uniform national standards for securities class actions. It sought to accomplish this by preempting state class actions alleging fraud in connection with the purchase or sale of certain securities, including mutual fund shares, and requiring that such suits proceed only in the federal courts. A class action filed in state court in Madison County, Illinois has raised the issue of whether a plaintiff may avoid preemption under SLUSA by alleging that the defendants' conduct was negligent or reckless, rather than fraudulent. The trial court in this case has certified this issue to the Appellate Court of Illinois.

The Institute has filed the attached brief with the appellate court arguing that failure to extend SLUSA's preemption to class actions alleging negligence or reckless conduct will result in the abusive litigation that SLUSA sought to prevent. [1] The facts of this case and the arguments raised in the Institute's brief are summarized below.

The Plaintiffs' Case

The plaintiffs filed a class action in state court alleging that the defendant mutual funds and their investment advisers acted negligently or recklessly in their pricing of mutual fund shares, to the detriment of the plaintiffs, who were shareholders of the funds. The plaintiffs' core contention in the case is that the defendants permitted savvy market timers to engage in abusive market timing to the detriment of the plaintiff shareholders. Before this case could be heard on the merits, the defendants sought dismissal arguing that – though the plaintiffs styled their claim as one involving negligence or recklessness – the essence of their claim is that the defendants engaged in fraudulent conduct. As such, the defendants argue that the plaintiffs' claims are preempted by SLUSA and should be dismissed by the trial court. The trial court denied the defendants' motion for judgment on the pleadings, but agreed to certify an interlocutory appeal to the appellate court on this issue.

The Institute's Amicus Brief

The Institute's amicus brief supports the defendants' view that SLUSA should be read to preempt class actions that are filed in state court alleging negligence or recklessness in connection with securities covered by SLUSA. The brief seeks to impress upon the court the harm to mutual fund investors – and the flight of class actions to state court – that could result if SLUSA is read narrowly to preempt only those class action expressly alleging fraud. In support of this view, the brief discusses the structure, history, purpose, and intent of SLUSA. It argues that, in its essence, the plaintiffs' claim is one alleging fraud and, as such, its preemption is entirely consistent with the plain text of SLUSA. It discusses the "enormous potential for abuse – to the detriment of issuers and investors alike" that result from class actions like that filed by the plaintiffs. Quoting from the House Report on SLUSA, the brief states that "get rich quick litigation benefits only those who seek to line their own pockets by bringing abusive and meritless suits." [2]

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Attachment

endnotes

[1] This is the second amicus brief the Institute has filed involving SLUSA. Our first brief was filed in the U.S. Supreme Court on the issue of whether SLUSA preempted class actions brought by "holders" of securities or, instead, was limited to class actions brought by purchasers or sellers of securities. The U.S. Supreme Court held that SLUSA preempted class actions brought by holders, which was the position advocated by the Institute. See Merrill Lynch, Pierce, Fenner & Smith Inc. v. Dabit, 547 U.S. 71 (2006).

[2] Brief at p. 22.