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# Court Dismisses Madoff-Related Class Action as Preempted

Posted by Herbert M. Wachtell, Wachtell, Lipton, Rosen & Katz, on Wednesday March 24, 2010

**Editor's Note:** Herbert M. Wachtell is a partner and co-founder of Wachtell, Lipton, Rosen & Katz. This post is based on a Wachtell Lipton firm memorandum by Mr. Wachtell, Stephen R. DiPrima, Emil A. Kleinhaus and Graham W. Meli.

In a decision with substantial implications for class action suits arising out of Bernard Madoff's Ponzi scheme and other fraud cases, the United States District Court for the Southern District of New York threw out a class action against Union Bancaire Privée, which advised funds of funds with allocations to Madoff feeder funds. *Barron v. Igolnikov*, No. 09 Civ. 4471 (S.D.N.Y. Mar. 10, 2010). In so doing, the federal court reaffirmed that private securities class actions alleging misrepresentations or omissions must be brought under the federal securities laws.

The court dismissed the case in its entirety, holding that the plaintiff's claims, which were brought entirely under state law, were preempted by both the Securities Litigation Uniform Standards Act ("SLUSA") and New York's Martin Act. Congress enacted SLUSA in 1998 in response to concerns that state-law class actions were being used to circumvent the heightened pleading requirements that apply to suits under the federal securities laws. The statute mandates dismissal of class actions based on state law if they allege misrepresentations or omissions of material fact in connection with the purchase or sale of a "covered security," including securities traded on a national exchange. The court in *Barron* held that the requirements for SLUSA preemption were satisfied. Of particular note for other Madoff-related cases, the court held that (1) the "purchase or sale" requirement of SLUSA was satisfied by Madoff's representations that he was buying and selling securities, even though he apparently never did so; (2) the "misrepresentation or omission" requirement was satisfied by Madoff's fraud; and (3) even though the funds in which the plaintiff and the other members of the proposed class invested were not themselves "covered securities," that requirement of SLUSA was satisfied because Madoff purported to be trading exchange-listed securities.

After concluding that SLUSA preempted the action in its entirety, the court went on to hold that New York's Martin Act — the state's securities-regulation statute, which may only be enforced by the Attorney General — also preempted the complaint. The Court's holding under the Martin Act is likely to apply to other Madoff-related cases as well.

The effect of these rulings is that if shareholder plaintiffs wish to pursue Madoff-related claims against fund managers on a class basis, they will have to proceed under the federal securities laws, where they will have to plead and prove fraud. That will be a tall order where the gravamen claim is that the fund managers should have detected Madoff's fraud.