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Second Circuit Limits Reach of SLUSA Preclusion in State Law Variable Annuity Class Action

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In *O'Donnell v. AXA Equitable Life Insurance Co.*, No. 17-cv-1085, 2018 WL 1720808 (2d Cir. Apr. 10, 2018), the United States Court of Appeals for the Second Circuit reversed an order dismissing a variable annuity policyholder's putative class action against AXA Equitable Life Insurance Company ("AXA") as precluded by the Securities Litigation Uniform Standards Act of 1998 ("SLUSA"), 15 U.S.C. § 78bb(f). Plaintiff alleged that AXA breached its contractual duties by employing a new strategy for its variable annuity policies without obtaining proper approval from the New York State Department of Financial Services ("DFS"). AXA allegedly misled the regulator by failing to adequately inform and explain the significance of the changes to its insurance product in documentation submitted to DFS. The Court held that because the plaintiff and putative class members were unaware of the defendant's alleged misrepresentation to DFS, the misrepresentation could not have been "in connection with" a purchase or sale of securities, and thus could not be governed by SLUSA. This decision establishes important limits on SLUSA preclusion and the scope of the United States Supreme Court's seminal SLUSA decision, *Merrill Lynch, Pierce, Fenner & Smith Inc. v. Dabit*, 547 U.S. 71 (2006).

In November 2008, plaintiff purchased a variable deferred annuity policy from AXA, which provided that AXA could invest assets at its discretion and make certain material changes to the policyholder's account as permitted by law. New York Insurance Law Section 4240(e) required that AXA provide DFS with information about the proposed changes and await approval.

AXA filed the required documentation, which DFS approved, and AXA subsequently introduced the AXA Tactical Manager Strategy ("ATM Strategy"), a volatility management strategy that allowed AXA to limit its own equity exposure to market volatility while potentially limiting policyholders' gains. In 2011, DFS entered into a Consent Order finding that "[t]he absence of detail and discussion in the filings regarding the significance of the implementation of the ATM Strategy had the effect of misleading the Department regarding the scope and potential effects of the ATM Strategy." Had DFS been properly informed, it may have required that existing policyholders affirmatively opt into the new approach.

Following entry of the Consent Order, plaintiff brought a putative class action in Connecticut state court alleging that AXA breached its contractual duties when it implemented the ATM Strategy without obtaining the required approval from DFS. AXA removed the action to federal court, where O'Donnell moved to remand the action to state court and AXA cross-moved to dismiss the complaint as precluded by SLUSA.

Under SLUSA, a class action is properly removed to federal court and dismissed where the state action (1) is a "covered class action," (2) based on state statutory or common law, (3) concerning a covered security, and (4) alleges that defendants made a misrepresentation or omission of a material fact in connection with the purchase or sale of the security. The question in *O'Donnell* was whether the fourth requirement had been satisfied.

The Court explained that "[h]ere, AXA invites us to conclude that O'Donnell has pled a [SLUSA-covered] claim in a context where the alleged misrepresentation was made to a regulator and unknown to the holders of the securities. We decline this invitation." The Court concluded that the misrepresentation could not have been made "in connection with" the decision to buy or sell a covered security "for the simple reason that it was unknown to

the [securityholders].” Citing *Dabit*, AXA argued that “it is enough that the alleged fraud ‘coincide’ with a securities transaction — whether by the plaintiff or by someone else.” However, the Second Circuit refused to extend *Dabit* to reach a situation where, as here, no link could be drawn between the misrepresentation and the inaction of a securityholder.

The Second Circuit took a limiting view of the broad language of *Dabit* in determining that the mere temporal overlap of a holder’s passive retention of a security and an alleged misrepresentation unknown to the holder fails the “in connection with” requirement for SLUSA preclusion. The decision appears poised to foreclose certain defendants from invoking SLUSA preclusion to achieve dismissal of actions, while creating a corresponding opportunity for plaintiffs to pursue class action suits that might have seemed dubious under pre-*O’Donnell* precedent.