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The Fiduciary Duty of Disclosure after *Dabit*

MY TOPIC IS THE IMPACT OF THE RECENT UNITED STATES Supreme Court decision in *Merrill Lynch v. Dabit*,¹ upon Delaware's common law fiduciary duty of disclosure.² *Dabit* reminds us that Congress and the SEC are not the only sources for federalizing state corporate law and roles of governance. The Supreme Court must be counted as well.

Dabit held that the Securities Litigation Uniform Standards Act of 1998³ (SLUSA) preempted a class action under Oklahoma state law, claiming that Merrill Lynch had made misleading, manipulative disclosures to its brokers and to the market.⁴ Those misdisclosures allegedly caused Merrill Lynch's former brokers to hold, rather than sell, certain shares in their customers' accounts, thereby causing those accounts to lose significant value.⁵ Although *Dabit* did not involve a claim for breach of the Delaware fiduciary duty of disclosure, the specific question that I raise is whether *Dabit* will be interpreted to require federal preemption of any aspect of the Delaware disclosure duty, and if so, which aspects. To discuss that in a cogent way, I first will briefly review *Dabit*,⁶ and then summarize the evolution of Delaware's fiduciary duty of disclosure.⁷ That will set the stage for us to consider whether *Dabit* might become a vehicle to federally preempt claims based on that state law fiduciary duty.⁸

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1. *Merrill Lynch, Pierce, Fenner & Smith, Inc. v. Dabit*, 547 U.S. 71, 126 S. Ct. 1503 (2006).

2. I must make two preliminary disclaimers. First, the views you will be reading are entirely my own. They are made individually, not officially, and do not necessarily represent the views of my Court or my colleagues. Second, much of what I will do here is raise questions. Because *Dabit* was handed down only recently, at this point it is too early for clear answers, so whatever thoughts I may have are necessarily speculative.

3. 15 U.S.C. § 78bb(f) (2000).

4. *Dabit*, 126 S. Ct. at 1514.

5. *Id.* at 1507.

6. *See infra* Part I.

7. *See infra* Part II.

8. *See infra* Part III.

I. *DABIT* SUMMARIZED

A. *The Statutory Framework*

The *Dabit* story originates with the passage of the Private Securities Litigation Reform Act of 1995⁹ (PSLRA), which Congress adopted to curtail perceived abuses of the federal securities class action process. We all remember the basic statutory reforms—limiting recoverable damages and attorneys’ fees, providing a safe harbor for forward looking statements, imposing new restrictions on how lead plaintiffs are selected, mandating heightened pleading requirements in actions brought under Section 10(b) of the 1934 Act and Rule 10b-5,¹⁰ and imposing an automatic stay of discovery pending the resolution of any motion to dismiss.¹¹ The intent and the effect of these reforms was “to deter or at least quickly dispose of [securities class action suits] whose nuisance value outweigh[ed] their merits.”¹²

But, the PSLRA also had an important unintended consequence: it prompted some members of the plaintiffs’ bar to circumvent these obstacles by avoiding the federal forum altogether and bringing class actions under state law in state courts.¹³ As a result, in 1998 Congress enacted SLUSA, “[t]o stem this ‘shif[t] from Federal to State courts’ and to ‘prevent certain State private securities class action lawsuits alleging fraud from being used to frustrate the objectives of’ the Reform Act.”¹⁴ SLUSA’s main thrust was to prohibit “covered class action[s] based upon the statutory or common law of any State or subdivision thereof” from being “maintained in any State or Federal court by any private party” where the complaint alleges either:

- (A) a misrepresentation or omission of a material fact in connection with the purchase or sale of a covered security; or
- (B) that the defendant used or employed any manipulative or deceptive device or contrivance in connection with the purchase or sale of a covered security.¹⁵

The terms “covered security” and “covered class actions” are statutorily defined. SLUSA defines a “covered security” as one that is traded nationally and is listed on

9. 15 U.S.C. §§ 77z-1, 78u-4 (2000). The PSLRA “insists that securities fraud complaints ‘specify’ each misleading statement; that they set forth the facts ‘on which [a] belief’ that a statement is misleading was ‘formed’; and that they ‘state with particularity facts giving rise to a strong inference that the defendant acted with the required state of mind.’” *Dura Pharms., Inc. v. Broudo*, 544 U.S. 336, 345 (2005) (quoting 15 U.S.C. §§ 78u-4(b)(1), (2)).

10. 15 U.S.C. § 78j(b); 17 C.F.R. § 240.10b-5 (2007).

11. *Merrill Lynch, Pierce, Fenner & Smith, Inc. v. Dabit*, 547 U.S. 71, 126 S. Ct. 1503, 1511 (2006).

12. *Id.*

13. *Id.*

14. *Id.*

15. 15 U.S.C. § 78bb(f)(1).

a regulated national exchange, and it defines a “covered class action” as one in which damages are sought on behalf of more than fifty people.¹⁶

Perhaps the most important pieces of this statutory jigsaw puzzle, for our purposes, are the state-law based “carve outs” from SLUSA’s preemption command. SLUSA exempts certain lawsuits from its operation: actions brought by a state agency or state pension plan, actions under contracts between issuers and indenture trustees, derivative actions brought by shareholders on behalf of a corporation, and certain class actions based on the law of the state in which the issuer of the covered security is incorporated.¹⁷ This last category includes class actions involving a recommendation or other communication made by or on behalf of a corporate issuer to its stockholders concerning decisions with respect to voting their securities, acting in response to a tender or exchange offer, or exercising appraisal rights.¹⁸ For both this and for the derivative suit carve outs, the legislative history makes it clear that the lawsuit must be brought in the state where the issuer is incorporated.¹⁹

Having walked through the statutory framework, let us next turn to *Dabit* itself.

B. *The Dabit Case*

Dabit was a class action brought in an Oklahoma federal court by a broker who was previously employed by Merrill Lynch.²⁰ The class consisted of all former or current brokers who, while employed by the firm during a specified period, continued to own certain overvalued securities that they had purchased for themselves and their clients.²¹ The gist of the complaint was that Merrill Lynch had disseminated misleading research, and thereby manipulated the stock prices of its investment banking clients’ stocks.²² Specifically, plaintiff *Dabit* alleged that Merrill Lynch’s research analysts, under management’s direction, had issued overly optimistic appraisals of stock values.²³ The plaintiff brokers relied on those analysts’ reports in advising their investor clients and in deciding whether to sell their own holdings.²⁴ As a

16. *Dabit*, 126 S. Ct. at 1512 (citing 15 U.S.C. § 78bb(f)(5)(B), (E)). Another important weapon in SLUSA’s preemptive armor is that it allows all covered class actions that are filed in state court to be removed to federal court. 15 U.S.C. § 78bb(f)(2).

17. *Dabit*, 126 S. Ct. at 1512; 15 U.S.C. §§ 78bb(f)(3)(A)–(C), (f)(5)(C).

18. 15 U.S.C. § 78bb(f)(3)(ii) exempts class actions that involve:

- (II) any recommendation, position, or other communication with respect to the sale of securities of an issuer that—
 - (aa) is made by or on behalf of the issuer or an affiliate of the issuer to holders of equity securities of the issuer; and
 - (bb) concerns decisions of such equity holders with respect to voting their securities, acting in response to a tender or exchange offer, or exercising dissenters’ or appraisal rights.

19. See generally S. REP. NO. 105-182 (1998).

20. *Dabit*, 126 S. Ct. at 1507.

21. *Id.*

22. *Id.*

23. *Id.*

24. *Id.*

result, both the clients and the brokers continued to hold their stocks long past the point where, had the truth been known, they would have sold.²⁵ Invoking diversity jurisdiction, plaintiff *Dabit* claimed that by engaging in that conduct, Merrill Lynch had breached the fiduciary duty and covenant of good faith and fair dealing that it owed to its brokers and customers under Oklahoma law.²⁶

Dabit, together with other similar suits, was transferred by the Judicial Panel on Multidistrict Litigation to the United States District Court for the Southern District of New York.²⁷ Merrill Lynch then moved to dismiss the complaint, arguing that the action was preempted by the SLUSA provision that no class action based on state law and alleging a misrepresentation or omission of a material fact “in connection with the purchase or sale” of a security could be maintained by a private party in any state or federal court.²⁸ The Southern District granted the motion and dismissed the action.²⁹

On appeal, the Second Circuit reversed.³⁰ The appellate court concluded that the class action was not preempted by SLUSA because the claim was that the brokers had been fraudulently induced, not to sell or purchase, but to retain or delay selling their securities. Because the brokers were holders and not purchasers or sellers, their claim did not allege fraud “in connection with the purchase or sale” of securities under SLUSA.³¹ Therefore, those claims fell outside the statute’s preemptive scope.³²

That ruling created a split among the circuits, resulting in the Supreme Court granting certiorari. In an 8–0 opinion authored by Justice Stevens,³³ the Court held that *Dabit*’s claim was preempted by SLUSA, and it vacated the decision of the Second Circuit.³⁴

The issue before the Supreme Court was very narrow. The plaintiffs argued (and the Second Circuit agreed), that the statutory language “in connection with the purchase and sale” of a security meant that for SLUSA to apply, the plaintiff must be either a buyer or a seller.³⁵ That, the plaintiffs argued, was consistent with the Supreme Court’s 1975 decision in *Blue Chip Stamps v. Manor Drug Stores*,³⁶ which held that to have standing to bring a private Rule 10b-5 action, the plaintiff must be either a buyer or seller of the security that is the subject of the alleged fraud.³⁷

25. *Id.*

26. *Id.*

27. *Id.* at 1508.

28. *Id.* at 1507.

29. *Id.* at 1508.

30. *Id.* at 1507.

31. *Id.*

32. *Id.*

33. Justice Alito did not participate.

34. *Dabit*, 126 S. Ct. at 1514–15.

35. *Id.* at 1512.

36. 421 U.S. 723 (1975).

37. *Id.* at 735–36.

Arguing the contrary position, Merrill Lynch contended that the “in connection with the purchase or sale” language could not be read so narrowly, because to do so would undermine the statutory purpose of preventing certain state private securities class action lawsuits from being used to frustrate the objectives of the PSLRA.³⁸

The United States Supreme Court agreed with Merrill Lynch’s position that for statutory preemption purposes, a broad reading of the “in connection with” phrase was required.³⁹ The Court held that it is sufficient that the alleged fraud “coincide” with a securities purchase or sale, and that it does not matter whether the purchaser or seller happens to be the plaintiff or someone else.⁴⁰ The identity of the plaintiff, the Court said, “does not determine whether the complaint alleges fraud ‘in connection with the purchase or sale’ of securities. The misconduct of which [Dabit] complains here—fraudulent manipulation of stock prices—unquestionably qualifies as fraud ‘in connection with the purchase or sale’ of securities” as the phrase was defined in prior Supreme Court case law.⁴¹

Dabit did not involve a claim based upon the state law fiduciary duty of disclosure. Therefore, any argument that duty of disclosure claims are preempted by SLUSA would require extending *Dabit* to reach this species of disclosure claim. To evaluate how, if at all, the argument for such an extension might be framed, it is useful first to explore the terrain that the fiduciary duty of disclosure has come to occupy. Because I am most familiar with Delaware disclosure case law, I will focus on key decisions from that jurisdiction.

II. THE FIDUCIARY DUTY OF DISCLOSURE SUMMARIZED

A classic, although perhaps not complete, definition of the fiduciary duty of disclosure under Delaware law is that corporate directors are required to disclose all material information within their control when they seek stockholder action.⁴² This duty has been with us, although in different forms, for quite some time. For example, the duty appears in the shareholder ratification cases, where corporate fiduciaries solicit, and then rely upon, shareholder consent to a transaction between the fiduciary and the corporation.⁴³ In such cases, the fiduciaries have the burden of showing that the shareholders gave their consent after receiving full disclosure of all material facts.⁴⁴ Even in cases where stockholder approval is a statutory prerequisite to undertake a challenged transaction such as a merger—a context where “ratification,” technically speaking, is not implicated—the fiduciaries will often invoke the

38. *Dabit*, 126 S. Ct. at 1512–13.

39. *Id.* at 1513–14.

40. *Id.*

41. *Id.* at 1515.

42. *Stroud v. Grace*, 606 A.2d 75, 84 (Del. 1992).

43. *See, e.g., Cahall v. Lofland*, 114 A. 224 (Del. Ch. 1921), *aff'd*, 118 A. 1 (Del. 1922).

44. *Id.*

stockholder approval defensively, either to avoid judicial review or reduce its intensity.⁴⁵

The birth of the disclosure duty as a basis for affirmatively imposing liability upon corporate fiduciaries can be traced to the 1977 Delaware Supreme Court decision in *Lynch v. Vickers Energy Corp.*⁴⁶ In *Lynch*, a majority stockholder parent corporation made a going private tender offer for the stock owned by the minority public shareholders.⁴⁷ After the tender offer was completed, a shareholder class action was filed, claiming that the parent corporation had failed to disclose to its minority shareholders material information indicating that their stock was worth more than what the parent offered to pay.⁴⁸ The Delaware Supreme Court agreed.⁴⁹ Holding that corporate fiduciaries had a duty to disclose all germane facts with "complete candor" to the minority stockholders when seeking to buy the minority's stock, the Delaware Supreme Court determined that those disclosures had not been made.⁵⁰ Therefore, the majority stockholder parent was liable for the resulting damages, measured by the difference between the adjudicated fair value of the shares and the tender offer price.⁵¹

Lynch was the starting point for a later expansion of this liability-creating duty to other fiduciaries and to other contexts. Six years later, the duty of disclosure was invoked as a basis to remedy misleading proxy disclosures soliciting minority stockholder approval of a going private merger. In *Weinberger v. UOP, Inc.*,⁵² two "inside" directors of the subsidiary being merged had developed material information, obtained solely by virtue of their fiduciary position, relating to the value of the subsidiary's stock.⁵³ Those inside directors, who also were senior executives of the parent company, disclosed that information to their employer (the parent company) but not to their fellow directors of the subsidiary.⁵⁴ As a result, that information was not disclosed to the minority stockholders whose proxies approving the deal were being solicited.⁵⁵ Both the majority stockholder and the subsidiary's inside directors were held liable for violating (among other things) their fiduciary disclosure obligations.⁵⁶

45. See, e.g., *In re Wheelabrator Tech., Inc. S'holders Litig.*, 663 A.2d 1194, 1203 (Del. Ch. 1995) (noting that where director action implicates the duty of loyalty due to conflicts of interest, supermajority shareholder approval of the transaction at issue, even required by statute, may leave entire fairness as the standard of review, but shift the burden of proof to the plaintiff).

46. 383 A.2d 278 (Del. 1977).

47. *Id.* at 279.

48. *Id.*

49. *Id.* at 281.

50. *Id.*

51. *Id.* at 281-82.

52. 457 A.2d 701 (Del. 1983).

53. *Id.* at 705.

54. *Id.*

55. *Id.* at 707-08.

56. *Id.* at 712.

These cases and many others decided after *Lynch* and into the 1980s, all arose in a familiar context, where imposing dollar liability was a sensible remedy.⁵⁷ The context was the nondisclosure of material information by fiduciaries in connection with the purchase of minority shareholders' stock, where the fiduciaries had a personal, conflicting interest in the transaction. Wholly apart from any disclosure violations, those conflict transactions implicated the fiduciary duty of loyalty.⁵⁸ In cases where the courts found that the duty of loyalty had been breached, the violation of the duty of disclosure was viewed either as further evidence, or as yet another instance, of such disloyalty. My point—and an important insight for which Professor Lawrence A. Hamermesh deserves the credit—is that the fiduciary duty of disclosure, in its formative years, was strongly rooted in the fiduciary duty of loyalty.⁵⁹

As time went on, the duty of disclosure became unmoored from its loyalty roots, and came to develop a life of its own. In *Smith v. Van Gorkom*,⁶⁰ a case involving an arm's-length merger, the Delaware Supreme Court held that failure to disclose material information to stockholders could expose directors to liability for breach of fiduciary duty in the highly different context where the directors have no conflict at all, i.e., are disinterested in the transaction.⁶¹ *Van Gorkom* suggested that the duty of disclosure could be rooted in, or be an adjunct of, the duty of care, a suggestion that later Delaware case law confirmed.⁶²

By 1993, the duty of disclosure reached its high point as an affirmative liability-creating doctrine. In *Tri-Star*, a class action for damages arising out of a sale of assets by a controlling stockholder to the corporation in exchange for additional shares of corporate stock, the Delaware Supreme Court stated that no reliance on the misdisclosure is required to establish liability for breach of the fiduciary duty of disclosure.⁶³ Nor was proof of actual damages required because "existing law and policy [had] evolved into a virtual per se rule of damages for breach of the fiduciary duty of disclosure."⁶⁴

Eventually the Supreme Court concluded that those broad expressions of the duty of disclosure as a potential source of liability had gone too far and limited the

57. Nelson Ferebee Taylor, *Evolution of Corporate Combination Law: Policy Issues and Constitutional Questions*, 76 N.C. L. REV. 687, 792 (1998).

58. *Id.*

59. Lawrence A. Hamermesh, *Calling Off the Lynch Mob: The Corporate Director's Fiduciary Disclosure Duty*, 49 VAND. L. REV. 1087 (1996). Hamermesh disputes the characterization of *Lynch* as the "seminal" duty of disclosure case. *Id.* at 1115–16.

60. 488 A.2d 858 (Del. 1985).

61. *Id.* at 872–73. The *Van Gorkom* court enunciated an independent duty of directors when they submit a merger proposal to stockholders and authorized a damages remedy against the directors who fail to fulfill that duty. *Id.* at 893; see also *Cinerama, Inc. v. Technicolor, Inc.*, 663 A.2d 1156, 1166 (Del. 1995) (noting that in *Van Gorkom* the Trans Union directors violated not only their duty of care, but also their duty of disclosure).

62. *Zirn v. VLI Corp.*, 621 A.2d 773, 778 (Del. 1993).

63. *In re Tri-Star Pictures, Inc., Litig.*, 634 A.2d 319, 325 (Del. 1993) (dictum).

64. *Id.* at 333.

reach of the doctrine. Four years after *Tri-Star* was decided, in *Loudon v. Archer-Daniels-Midland*,⁶⁵ the Court essentially retracted that opinion's suggestion that nominal damages are always recoverable where a disclosure violation is established, and also limited the reach of *Tri-Star* to cases involving similar facts.⁶⁶ Only six months ago, the Delaware Supreme Court held that a violation of the duty of disclosure will not entitle shareholders to recover compensatory damages unless the shareholders show that the disclosure violation resulted in specific economic harm to them.⁶⁷ These developments have not diminished the vitality of the fiduciary duty of disclosure. What they have done, however, is limit the use of that doctrine as a vehicle for imposing fiduciary liability to cases where damages-in-fact are established as a consequence of the misdisclosure.

Whatever may be its utility as a basis for class actions seeking to hold fiduciaries liable, the duty of disclosure continues to be a potent force in many important business contexts. In interested transactions, the duty is an element of "fair dealing," which in turn is a critical component of entire fairness review.⁶⁸ In challenges to transactions requiring shareholder approval, the doctrine tests whether the shareholder vote was properly informed, and, thus, whether the transaction was properly approved. Accordingly, in mergers or tender offers the duty of disclosure remains fully vital, whether it arises in the context of conflict transactions of the kind involved in *Lynch* and *Weinberger*, or in takeover cases such as *Macmillan*,⁶⁹ where shareholders are asked to approve a transaction that is the subject of a contest for corporate control. That brings me to the central question, which is what portion or aspects of the state law fiduciary duty of disclosure—if any—are arguably preempted under SLUSA as glossed by *Dabit*?

III. PREEMPTION UNDER *DABIT*

In analyzing whether a state law-based class action is preempted by SLUSA, there are only three important inquiries: (1) is the security that is the subject of the lawsuit a "covered security"; (2) is the class action at issue a "covered class action"; and (3) if the answer to both questions is yes, then is this particular action carved out from coverage by the statute itself?⁷⁰ Applying that approach to the Delaware fiduciary duty of disclosure helps clear away much of the underbrush.

In applying that three-pronged inquiry to Delaware class action practice, I will assume that in all cases the class action is brought by a private plaintiff who alleges "a misrepresentation or omission of material fact in connection with the purchase

65. 700 A.2d 135 (Del. 1997).

66. *Id.* at 142.

67. *In re J.P. Morgan Chase & Co. S'holders Litig.*, 906 A.2d 766, 774 (Del. 2006).

68. *Berger v. Intelident Solutions, Inc.*, 911 A.2d 1164, 1171 (Del. Ch. 2006).

69. *Mills Acquisition Co. v. Macmillan, Inc.*, 559 A.2d 1261, 1267 (Del. 1988).

70. *See, e.g., Sofonia v. Principal Life Ins. Co.*, 465 F.3d 873, 876 (8th Cir. 2006).

or sale of a covered security.”⁷¹ Starting from that premise, if the class action involves a corporation whose shares are not listed and traded nationally, then the security is not “covered,” and SLUSA does not apply. Also, if the class action is not for damages, or if it is brought on behalf of fifty people or less, then the class action is not “covered,” and SLUSA does not apply. This means that SLUSA has no effect on duty of disclosure class actions that involve either (i) securities that are unlisted or not traded nationally, (ii) class actions seeking equitable, non-damages relief—a category that describes much of the hostile takeover litigation in the Delaware courts—or (iii) class actions for damages brought on behalf of fifty persons or less.

If the class action and the security are both “covered,” then the only remaining question is whether the class action at issue is carved out by SLUSA itself. This, I believe, is where the problems, if any, will arise. Even if so, they will arise only within a very limited sphere. I say that because duty of disclosure actions brought derivatively on behalf of the corporation are expressly carved out from SLUSA.⁷² The most typical Delaware duty of disclosure cases, by and large, are currently brought by stockholders seeking to invalidate a transaction involving the shareholders, the corporation, and/or the corporation’s directors and officers. Thus, the likely most relevant carve out is found in subsection (f)(3) of SLUSA, which provides that a covered class action “that is based upon the statutory or common law of the State in which the issuer is incorporated [or organized] may be maintained in a State or Federal court by a private party” if it involves:

- (I) *the purchase or sale of securities by the issuer or an affiliate of the issuer exclusively from or to holders of equity securities of the issuer; or*
- (II) *any recommendation, position, or other communication with respect to the sale of securities of an issuer that—*
 - (aa) *is made by or on behalf of the issuer or an affiliate of the issuer to holders of equity securities of the issuer; and*
 - (bb) *concerns decisions of such equity holders with respect to voting their securities, acting in response to a tender or exchange offer, or exercising dissenters’ or appraisal rights.*⁷³

This language would appear to carve out of SLUSA preemption any duty of disclosure-based class actions for damages challenging a merger or tender offer, transactions that involve purchases or sales of securities by the issuer exclusively from or to the shareholders. That language also appears, in my view at least, to carve out class actions attacking disclosures to shareholders made by the board or

71. 15 U.S.C. § 78bb(f) (2000).

72. *Id.* So too are class actions by state agencies, state pension plans, and indenture trustees enforcing an indenture agreement, but these are not a material segment of the disclosure-related class action litigation typically brought in the Delaware courts. *Id.*

73. *Id.* § 78bb(f)(3)(A)(ii).

management in connection with tender offers responses, or in connection with merger-related proxy solicitations and the exercise of appraisal rights arising out of such mergers.

Having enumerated what categories are not preempted, the bottom line issue becomes: what portion of Delaware class action practice is preempted by SLUSA as interpreted by *Dabit*? The answer, I submit, is: very little that is significant to the duty of disclosure class actions typically brought in the Delaware state courts. Indeed, only two categories of class action disclosure claims appear to be arguable candidates for preemption.

The first category—and one that clearly is preempted—is the “holders” claim that the U.S. Supreme Court held was preempted in *Dabit*.⁷⁴ By that I mean a claim by a class of securities holders who contend that the improper disclosures induced them to hold when they otherwise would have sold. Like Oklahoma, Delaware has recognized this type of disclosure claim in *Malone v. Brincat*.⁷⁵ Under Delaware law, that claim is not, strictly speaking, one for breach of the fiduciary duty of disclosure.⁷⁶ Rather, it is a claim for breach of the “more general fiduciary duty of loyalty and good faith.”⁷⁷ Putting that distinction to one side, it is doubtful that federal preemption of holders’ class claims would have any significant effect on Delaware class action practice. Under Delaware case law, claims asserting common law or equitable fraud involve individual issues of loss and reliance that would predominate over common questions of law or fact. For that reason, class action treatment would likely be precluded in any event.⁷⁸

The second category of claims that arguably are federally preempted is a subset of the paradigm securities class action that SLUSA was intended to preempt: the “fraud on the market” lawsuit. These types of lawsuits are brought against public companies whose stock goes down, allegedly in response to a materially misleading disclosure or omission. The plaintiffs in those cases, which typically are brought under Rule 10b-5, are either buyers or sellers of securities.

The category of class actions by “purchasers” is one that can be quickly eliminated from consideration because purchaser class actions do not implicate the fiduciary duty of disclosure. The reason is that fiduciary duties run only to existing stockholders, and purchasers are not existing stockholders. Indeed, in these cases the purchasers become stockholders only because of the wrongful disclosure that is the very subject of the lawsuit.

74. *Merrill Lynch, Pierce, Fenner & Smith, Inc. v. Dabit*, 547 U.S. 71, 126 S. Ct. 1503, 1514 (2006).

75. 722 A.2d 5 (Del. 1998).

76. *Id.* at 10.

77. *Id.*

78. In *Malone*, the Delaware Supreme Court pointedly cited its earlier decision in *Gaffin v. Teledyne, Inc.*, which held that “[a] class action may not be maintained in a purely common law or equitable fraud case since individual questions of law or fact, particularly as to the element of justifiable reliance, will inevitably predominate over common questions of law or fact.” *Id.* at 14 (quoting 611 A.2d 467, 474 (Del. 1992)). *Malone* suggests that justifiable reliance would be a particularly troublesome issue in “holder” cases. *Id.* at 14–15.

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That leaves for consideration only fraud on the market class action suits brought on behalf of stockholders who sell as a result of the alleged wrongful disclosure, where the sale is not related to a carved-out transaction such as a merger or tender offer. This category, even if preempted, is of little consequence to Delaware class action practice because these “fraud on the market” cases are not brought in Delaware state courts.

To summarize, in my view, given the definitions of “covered security,” “covered claim,” and the so-called Delaware carve out, very little that is significant to current Delaware securities class action practice appears in jeopardy from SLUSA or *Dabit*. But this is only one person’s opinion. The ultimate decision will be for the courts to make.