

New York High Court Applies the "Single-Entity Exemption" in the Securities Litigation Uniform Standards Act of 1998

June 12, 2011

In *RGH Liquidating Trust v. Deloitte & Touche, LLP*, 2011 WL 2471542 (N.Y. June 23, 2011), the [New York Court of Appeals](#) held that a liquidating trust established pursuant to a bankruptcy reorganization plan was a single "person" within the meaning of the "single-entity exemption" in the [Securities Litigation Uniform Standards Act of 1998](#) ("SLUSA"). SLUSA effectively vests federal courts with exclusive jurisdiction over most securities fraud actions involving more than fifty plaintiffs. It provides further that for purposes of counting the number of plaintiffs, "a corporation, investment company, pension plan, partnership, or other entity, shall be treated as one person or prospective class member, but only if the entity is not established for the purpose of participating in the action." Here, the Court of Appeals held that the bankruptcy liquidating trust fell within that single-entity exemption because the primary purpose of the trust was not to pursue the litigation. For this reason, the action brought by the trust was not subject to preemption or removal to federal court. With this decision, the Court clarified the scope of state court jurisdiction over securities fraud class actions.

SLUSA provides that no state or federal court may entertain a "covered class action" brought by a private party and based on state statutory or common law, which alleges fraud or manipulation in connection with the purchase or sale of a "covered security." SLUSA defines a "covered class action" as a "single lawsuit" or "group of lawsuits" in which "damages are sought on behalf of more than 50

persons or prospective class members, and questions of law or fact common to those persons or members . . . predominate over any questions affecting only individual persons or members.” See 28 U.S.C. §§ 77p(f)(2)(A); 78bb(f)(5)(B). As noted above, SLUSA’s “single-entity exemption” specifies that for the purposes of counting whether there are fifty or more persons or prospective class members, “a corporation, investment company, pension plan, partnership, or other entity, shall be treated as one person or prospective class member, but only if the entity is not established for the purpose of participating in the action.” See 28 U.S.C. §§ 77p(f)(2)(C); 78bb(f)(5)(D).

RGH Liquidating Trust (the “Trust”) filed suit against Deloitte LLP and Jan Lommele, a principal of Deloitte, for accounting fraud in New York State Supreme Court. Deloitte moved to dismiss, arguing that the Trust represented more than fifty claimants, thereby making its claim subject to dismissal under SLUSA. The Trust countered that it qualified for the single-entity exemption. The trial court agreed, holding that the Trust was a single entity within the meaning of SLUSA. Deloitte appealed. The Appellate Division, First Department, reversed in part, holding that the Trust was not completely exempt from SLUSA as a single entity because some of its claims were being asserted on behalf multiple bondholders and not on behalf of the estate. *RGH Liquidating Trust v. Deloitte & Touche, LLP*, 71 A.D.3d 198 (1st Dep’t Dec. 8, 2009). The Appellate Division, however, agreed that the trial court properly declined to dismiss the Trust’s claims for the benefit of the of the other groups of creditors. On July 8, 2010, the Appellate Division certified a question to the New York Court of Appeals, asking whether its modification of the trial court’s order was proper. The Court of Appeals answered that it was not and that the order of the trial court should be reinstated.

In reviewing the Appellate Division’s decision, the Court of Appeals concentrated on whether the Trust was established for the “purpose of participating in the action” and thereby was precluded from taking advantage of SLUSA’s single-entity exemption. The Court held that the “primary purpose” of the Trust was far

broader than the pursuit of creditors' causes of action. Rather, the Trust was created to receive trust property, assume any liabilities, and thereafter to liquidate and distribute the trust property for the benefit of the trust beneficiaries. The Trust was indeed empowered to evaluate litigation claims and to maximize the value of the Trust Property, but litigation was not its primary purpose.

The Court of Appeals also disagreed with the Appellate Division's conclusion that the Trust's claims for the benefit of the bondholders, as opposed to the claims for the benefit of the banks, the former employees and the Pension Benefit Guarantee Corporation, should be dismissed. The Appellate Division held that these claims were barred by SLUSA because they were not being asserted on behalf of the Reliance bankruptcy estate but were being asserted on behalf of the individual bondholders. The Court of Appeals held, however, that the bondholders' claims were property within the bankruptcy estate, and that the Trust brought the action on behalf of the estate for the benefit of the bondholders. Because the claims were included within the bankruptcy estate, the Court held that identification of the true injured party was unnecessary.

This decision of first impression in New York confirms that in determining the scope of SLUSA preemption and the single-entity exemption, a court should look to the primary purpose of the plaintiff entity, and not to the identity of the true "injured parties" on whose "behalf" the litigation was brought.

For further information, please contact [John Stigi](#) at (310) 228-3717 or [Kathryn Hines](#) at (212) 634-3054.