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Removal of Class Action Securities Cases in the Age of CAFA

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A circuit split has emerged regarding whether claims brought under the Securities Act of 1933 (the Securities Act) may be removed from state court pursuant to the Class Action Fairness Act of 2005 (CAFA). This is a key issue for the many corporations now facing Securities Act claims following the recent dramatic stock market declines.

Section 22(a) of the Securities Act, as originally enacted in 1933, flatly prohibited the removal of Securities Act claims from state to federal court. Although Section 22(a) was recently amended by the Securities Litigation Uniform Standards Act of 1998 (SLUSA), at least some categories of Securities Act claims remain subject to Section 22(a)'s anti-removal provision. CAFA was enacted to permit the removal of class actions involving at least 100 claimants where the amount in controversy is greater than $5 million and where there is "minimal" diversity between plaintiffs and defendants. Since CAFA applies to "any civil action" meeting these requirements, its provisions would seemingly cover class actions brought under the Securities Act.

This raises the disputed question: if Securities Act claims not otherwise removable under SLUSA qualify for removal under CAFA, are they governed by CAFA's removal provisions or the Securities Act's anti-removal provisions? The handful of courts addressing this question have reached opposite conclusions. The Ninth Circuit in *Luther v. Countrywide Home Loans Servicing LP*, 533 F.3d 1031 (9th Cir. 2008), held that CAFA does not permit removal of Securities Act claims in light of Section 22(a). However, the Seventh Circuit in *Katz v. Gerardi*, 552 F.3d 558 (7th Cir. 2009), and the U.S. District Court for the Southern District of New York in *N.J. Carpenters Vacation Fund v. Harborview Mortgage Loan Trust 2006-4*, 581 F. Supp. 2d 581 (S.D.N.Y. 2008), both concluded that Section 22(a) presents no barrier to removal of Securities Act claims under CAFA.

Following is a discussion of removal under the Securities Act and CAFA, and how *Luther*, *Katz* and *Harborview* each addressed the interplay between these two statutes.

General Federal Removal Provisions

Pursuant to 28 U.S.C. § 1331, actions arising under federal law are within the original jurisdiction of the federal courts. Federal courts also have original jurisdiction over actions satisfying the requirements of diversity jurisdiction set forth in 28 U.S.C. § 1332. Specifically, Section 1332 provides that federal courts shall have original jurisdiction of all civil actions where the matter in controversy exceeds $75,000 and there is "complete" diversity, *i.e.* where all plaintiffs are from different states than all defendants. *See* 15-102 Moore's Federal Practice - Civil § 102.12. Removal of actions over which the federal courts have original jurisdiction is governed by 28 U.S.C. § 1441, which states:

> Except as otherwise expressly provided by Act of Congress, any civil action brought in a State court of which the district courts of the United States have original jurisdiction, may be removed [to federal court] . . . .

28 U.S.C. § 1441(a). Thus, an action within the original jurisdiction of the federal courts is removable under Section 1441(a) unless Congress has "otherwise expressly provided."

The Anti-Removal Provision of the Securities Act

A claim under a federal statute such as the Securities Act would ordinarily be within the original jurisdiction of the federal courts under Section 1331 and removable under Section 1441. However, Section 22(a) of the Securities Act, as originally written in 1933, provided for concurrent jurisdiction between state and federal courts over Securities Act claims, and stated that "[n]o case arising under [the Securities Act] and brought in any State court of competent jurisdiction shall be removed to any court of the United States." *See* 15 U.S.C. § 77v(a) (1933). Thus, the original Securities Act "expressly provided" that Securities Act claims were not removable under Section 1441.

Section 22(a) was amended by SLUSA to create exclusive federal jurisdiction over Securities Act claims "as provided in section 16 [of the Securities Act] with respect to covered class actions," and Section 22(a)'s anti-removal language was amended to state:

> *Except as provided in section 16(c)*, no case arising under [the Securities Act] and brought in any State court of competent jurisdiction shall be removed to any court of the United States.

15 U.S.C. § 77v(a) (1998) (amendment in italics).

SLUSA's amendments to Section 22(a) thus refer to Section 16(c) of the Securities Act, which provides that "[a]ny covered class action brought in any Sate court involving a covered security, as set forth in subsection (b) [of Section 16], shall be removable to the Federal district court for the district in which the action is pending . . . ." 15 U.S.C. § 77p(c). Section 16(b) in turn provides for the dismissal of any "covered class action" brought under state law alleging "an untrue statement or omission of a material fact in connection with the purchase or sale of a covered security; or . . . 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 U.S.C. § 77p(b). A "covered class action" is generally a class action in which common questions of law and fact predominate among the class members, and a "covered security" is generally one that is traded nationally and listed on a regulated national exchange. 15 U.S.C. §§ 77p(f)(2)-(3), 77r(b).

The courts have disagreed over the scope of SLUSA's amendments to the Securities Act. The majority of courts have held that under SLUSA defendants may remove "covered class actions" asserting either Securities Act claims or the state law claims described in Section 16(b).[1] Other courts have interpreted SLUSA more narrowly, holding that while SLUSA permits the removal of Section 16(b) state law claims, it does not permit the removal of Securities Act claims.[2]

Regardless of which interpretation of SLUSA is correct, it is clear that at least some Securities Act cases, including those failing to meet SLUSA's definition of a "covered class action," are not covered by SLUSA and therefore remain subject to Section 22(a)'s anti-removal provisions.

CAFA

Enacted in 2005, CAFA amended 28 U.S.C. § 1332 to expand diversity jurisdiction for class actions consisting of more than 100 class members whose claims, in the aggregate, exceed $5,000,000. 28 U.S.C. §§ 1332(d)(2), (5)(B). CAFA provides that for "any civil action" meeting these requirements, defendants need only show "minimal" diversity, rather than "complete" diversity, to remove the action to federal court under Section 1332. 28 U.S.C. § 1332(d)(2). In other words, federal courts have original jurisdiction over such an action if any plaintiff is diverse with any defendant, even if some plaintiffs and defendants are not diverse. Cases qualifying under CAFA's relaxed diversity requirements are removable pursuant to 28 U.S.C. § 1453.

These provisions of CAFA "greatly expanded the scope of diversity jurisdiction in large, multistate class actions," which is precisely what Congress intended. 15-102 Moore's Federal Practice -

Civil § 102.26[1]. CAFA arose from Congress's concern that "cases involving large sums of money, citizens of many different States, and issues of national concern, have been restricted to State courts even though they have national consequences." 151 Cong. Rec. S1086-01, S1103 (daily ed. Feb. 8, 2005). Plaintiffs had been "shopping for magnet State courts, and they [were] able to keep them there," *id.*, despite an apparent "state court provincialism against out-of-state defendants." S. Rep. No. 109-14, at 6. CAFA's purpose therefore was to allow "federal court consideration of interstate cases of national importance under diversity jurisdiction." 28 U.S.C. § 1711.

Nevertheless, there are several exceptions to CAFA's removal provisions. *See* 28 U.S.C. §§ 1332(d)(3)-(5), (9); 28 U.S.C. § 1453(d). Most relevant here are the exceptions set forth in Section 1453(d) which relate to securities and corporate governance actions. Under Section 1453(d), the following claims are not removable under CAFA even if CAFA's requirements are otherwise met: "(1) a claim concerning a covered security as defined [in the Securities Act and the Securities Exchange Act of 1934]; (2) a claim that relates to the internal affairs or governance of a corporation or other form or business enterprise and arises under or by virtue of the laws of the State in which such corporation or business enterprise is incorporated or organized; or (3) a claim that relates to the rights, duties (including fiduciary duties), and obligations relating to or created by or pursuant to any security (as defined under section 2(a)(1) of the Securities Act . . .)." 28 U.S.C. § 1453(d); *see also* 28 U.S.C. § 1332(d)(9).

The Luther, Katz and Harborview Opinions

CAFA permits removal of "any civil action" meeting its requirements, language that on its face would appear to permit removal of Securities Act claims that do not fall within CAFA's exceptions. Yet unless removal of a Securities Act claim is permitted by SLUSA, Section 22(a) of the Securities Act expressly prohibits removal of the claim. The question therefore becomes whether CAFA or Section 22(a) governs the removal of Securities Act claims qualifying under CAFA.

Luther v. Countrywide Home Loans Servicing LP.

Plaintiffs in *Luther* were purchasers of mortgage pass-through certificates issued by CWALT, Inc., an affiliate of Countrywide Home Loans Servicing LP (Countrywide). They filed a putative class action in California state court against Countrywide, CWALT and several Countrywide subsidiaries and employees, alleging that defendants violated Sections 11 and 12(a)(2) of the Securities Act by understating the risks associated with the certificates. Defendants removed the action to the U.S. District Court for the Central District of California pursuant to CAFA, and plaintiffs moved to remand the case back to state court based on Section 22(a) of the Securities Act.

The district court granted plaintiffs' motion, and, on appeal, the Ninth Circuit affirmed, holding that a Securities Act claim subject to Section 22(a)'s anti-removal provision is not removable under CAFA. Relying on the Supreme Court's decision in *Radzanower v. Touche Ross & Co.*, 426 U.S. 148 (1976), the Ninth Circuit applied the "basic principle of statutory construction that a statute dealing with a narrow, precise, and specific subject is not submerged by a later enacted statute covering a more generalized spectrum." The Court found that as between Section 22(a) of the Securities Act and CAFA, "the Securities Act . . . is the more specific statute; it applies to the narrow subject of securities cases and § 22(a) more precisely applies only to claims arising under the Securities Act of 1933. CAFA, on the other hand, applies to a 'generalized spectrum' of class actions."

On this basis, the Court held that CAFA's general grant of the right of removal "does not trump § 22(a)'s specific bar to removal of cases arising under the Securities Act." The case was therefore remanded to state court pursuant to Section 22(a).

Katz v. Gerardi

Plaintiffs in *Katz* contributed interests in real property to a real estate investment trust (REIT) in exchange for interests called A-1 Units. After the REIT merged into a separate entity, plaintiffs were offered a choice of cash or shares in the post-merger entity. Plaintiffs brought Securities Act claims against various entities associated with the REIT in Illinois state court, asserting that the offer violated the terms of the A-1 Units because neither the cash nor the post-merger shares offered the same tax benefits as the A-1 Units.

Defendants removed the action to the U.S. District Court for the Northern District of Illinois pursuant to CAFA, and plaintiffs moved for remand. Relying on *Luther*, the district court agreed with the plaintiffs that Section 22(a) trumped CAFA and prohibited removal of their Securities Act claims.

The Seventh Circuit reversed, rejecting the district court's and *Luther*'s characterization of CAFA as a "generalized" statute that must yield to the "specific" anti-removal provisions of Section 22(a). According to the Court, "[t]he canon favoring preservation of specific statutes arguably affected by newer, but more general statutes works when one statute is a subset of the other," and "§ 22(a) of the [Securities] Act is not a subset of" CAFA. This is because "Section 22(a) covers only securities actions, but it includes all securities actions," including "small actions" brought by individual investors. By contrast, CAFA "covers only large, multi-state actions." Section 22(a) therefore covers some actions that CAFA does not (and vice versa). As put by the Court, "[i]s the [Securities] Act more specific because it deals only with securities law, or is [CAFA] more specific because it deals only with nationwide class actions?" The Court ruled that "[t]here is no answer to such a question," and it was therefore impossible to determine which of the two statutes is more "specific" and which is more "general."

The Court stated that "[t]he language of [CAFA], rather than a canon" of statutory construction, dictates how CAFA applies to Securities Act cases. Since the exceptions to CAFA in 28 U.S.C. § 1453(d) specify those securities claims that cannot be removed under CAFA, the Court reasoned that "[o]ther securities class actions are removable if they meet the requirements of CAFA . . . ." According to the Court, any other reading of Section 22(a) and CAFA would "make most of § 1453(d) pointless," because if Section 22(a) prohibits removal of all Securities Act claims under CAFA, there would be no reason for Section 1453 to specify which of those claims are removable and which are not.

The Court recognized that "[t]here is some incongruity in removing a securities action under [CAFA], which creates a species of diversity-of-citizenship jurisdiction, even though the 1933 Act creates a federal claim." Nevertheless, the Court held that "Section 1453(d) leaves no doubt about how the [Securities] Act . . . and [CAFA] fit together."

New Jersey Carpenters v. Harborview

Plaintiffs in *Harborview* were purchasers of bonds alleging that the bond prospectuses and registration statements contained misrepresentations. Plaintiffs filed actions in New York state court asserting that various defendants violated the Securities Act in connection with the bond issuances. Relying on CAFA, defendants removed the case to the U.S. District Court for the Southern District of New York, and plaintiffs moved to remand.

The Court denied plaintiffs' motion and held that CAFA permits removal of Securities Act claims despite the anti-removal provisions of Section 22(a). The Court offered several bases for its ruling. First, like *Katz*, the Court noted that CAFA sets forth exceptions to the scope of its removal provisions, and that the Securities Act claims in the instant case did not fall within those exceptions. Second, the Court noted that unlike Section 1441, CAFA does not explicitly recognize that other acts of Congress, such as Section 22(a), may preclude removal of an action that CAFA would otherwise permit. According to the Court, "[h]ad Congress wanted to treat CAFA like the

general removal statute of § 1441(a) and leave intact other statutory regimes, it could easily have done so." Finally, the Court relied on CAFA's underlying purpose in concluding that Congress intended to permit the removal of Securities Act claims, finding that "CAFA overrides the Securities Act's anti-removal provision because this case involves exactly the type of case CAFA was concerned about – a large, non-local securities class action dealing with a matter of national importance, the mortgage-backed securities crisis that is currently wreaking havoc with the national and international economy."

Conclusion

CAFA does not permit removal of actions based on "covered securities," which include securities traded on national exchanges such as the NYSE and NASDAQ. Because these securities are popular targets for securities class action plaintiffs, a sizeable chunk of Securities Act cases are automatically excluded from CAFA's removal provisions.

However, for Securities Act claims based on non-covered securities – mortgage-backed securities being a notable example – removability under CAFA remains an open question, and it is unclear how courts will deal with this issue going forward. If a trend does exist, it is toward permitting removal of Securities Act cases under CAFA. Both *Katz* and *Harborview* were decided after *Luther*, and each rejected *Luther*'s reasoning. Whereas *Luther* focused mainly on the application of a statutory cannon, *Katz* and *Harborview* scrutinized the language and purpose of CAFA, which may explain the outcome in those cases.

Regardless of any trend in the cases, the current Circuit split will likely persist unless the Supreme Court resolves the disagreement. In the meantime, plaintiffs will be encouraged to file suit in the Ninth Circuit to preclude removal under CAFA. The irony of this result is that plaintiffs will use forum-shopping to avoid a statute whose very purpose was to prevent plaintiffs from forum-shopping.

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[1] *See Knox v. Agria Corp.*, No. 08-cv-07651 (S.D.N.Y. Jan. 27, 2009); *Rubin v. Pixelplus Co.*, No 06-cv-02964 (E.D.N.Y. Mar. 13, 2007); *Pinto v. Vonage Holdings Corp.*, No. 07-cv-00062 (D.N.J. May 7, 2007); *Rovner v. Vonage Holdings Corp.*, No. 07-cv-00178 (D.N.J. Feb. 7, 2007); *In re King Pharm. Inc.*, 230 F.R.D. 503 (E.D. Tenn. 2004); *Brody v. Homestore, Inc.*, 240 F. Supp. 2d 1122 (C.D. Cal. 2003); *Kulinski v. Am. Elec. Power Co.*, No. 03-cv-00412 (S.D. Ohio Sept. 19, 2003); *Alkow v. TXU Corp.*, No. 02-cv-02738 (N.D. Tex. May 8, 2003).

[2] *See Unschuld v. Tri-S Sec. Corp.*, No. 06-cv-02931 (N.D. Ga. Sept. 14, 2007); *Irra v. Lazard Ltd.*, No. 05-cv-03388 (E.D.N.Y. Aug. 15, 2006); *Zia Med. Staffing Network, Inc.*, 336 F. Supp. 2d 1306 (S.D. Fla. 2004); *In re Tyco Int'l, Ltd.*, 322 F. Supp. 2d 116 (D.N.H. 2004); *Nauheim v. The Interpublic Group of Cos.*, No. 02-cv-09211 (N.D. Ill. Apr. 16, 2003); *Hawaii Structural Ironworkers Pension Trust Fund v. Calpine Corp.*, No. 03-cv-00714 (S.D. Cal. Aug. 27, 2003); *In re Waste Mgmt., Inc. Sec. Litig.*, 194 F. Supp. 2d 590 (S.D. Tex. 2002).