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Removing '33 Act Class Actions Under SLUSA And CAFA

Not so simple.

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IN THE WAKE of the historic financial meltdown that has dominated the national headlines for the past few months, plaintiffs' securities lawyers have filed hundreds of class action lawsuits. Many of these are classic securities fraud cases brought under §10(b) of the Securities Exchange Act of 1934 ('34 Act). But plaintiffs' counsel have also filed many class actions arising from public offerings of various securities, including IPOs, secondary, preferred stock and mortgage-backed securities offerings, and others. These cases are typically brought under §§11 and 12(a)(2) of the Securities Act of 1933 ('33 Act).[1]

With increasing frequency, plaintiffs' lawyers have brought these '33 Act class actions in state courts, apparently believing that these courts would be more receptive to their claims. Federal and state courts have concurrent jurisdiction over '33 Act claims under 15 U.S.C. §77v(a), and forum selection is therefore the plaintiffs' choice to make. There is currently a split in authority as to whether these class actions can be removed to federal court.

Removal of a case asserting a federal claim from state court would not ordinarily be difficult. The general removal statute, 15 U.S.C. §1441(b), allows defendants sued on federal claims to remove those cases. But, until 1998, §22 of the '33 Act (15 U.S.C. §77v) included a blanket prohibition on removal of any '33 Act cases.[2]

Within the past 10 years, Congress has enacted two statutes designed to federalize class action litigation: the Securities Litigation Uniform Standards Act of 1998 (SLUSA) and the Class Action Fairness Act of 2005 (CAFA). Both SLUSA and CAFA provide a possible basis for the removal of '33 Act class actions. Neither statute is a model of clarity, however, and federal courts have issued a series of sometimes conflicting rulings concerning removal under the two statutes.

Some courts have construed the acts' removal provisions narrowly to prevent removal. Other courts, including the Second Circuit and some judges in the Southern and Eastern Districts of New York, have construed the removal provisions broadly to effectuate Congress' purpose in amending the removal laws for class actions. This article examines some of those rulings.

Removal Under SLUSA

In 1995, Congress enacted the Private Securities Litigation Reform Act (PSLRA),[3] designed to correct perceived abuses in securities litigation. Among other things, the PSLRA raised the bar on pleading fraud in securities cases and largely ended the "race to the courthouse" phenomenon by changing the way in which courts select the lead plaintiff and its counsel.

In response to these reforms, some plaintiffs' firms began filing securities class actions in state courts. To avoid removal under the federal question prong of the removal statute, these cases often pled securities-related fraud solely under state law theories such as common law fraud. SLUSA was enacted in 1998 to stop these attempts to make an end-run around federal courts and the PSLRA. Among other things, SLUSA authorized removal and federal preemption of securities class actions brought under state law.

SLUSA preempts any class action "based upon the statutory or common law of any State" if it involves allegations of untrue statements or omissions of material fact in connection with the purchase or sale of a

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"covered security." 15 U.S.C. §77p(b). Such class actions, whether brought in state or federal court, are to be dismissed. Id. SLUSA also amended the jurisdiction and anti-removal provision of the '33 Act (15 U.S.C. §77v) so that state court jurisdiction is now concurrent with federal jurisdiction except with respect to "covered class actions." It also amended the removal bar so that it is now explicitly subject to §77p(c), which permits removal of any "covered class action" involving a "covered security." Id.[4]

Courts have split on whether SLUSA permits removal only of class actions asserting state law securities claims or whether it also allows removal of class actions that plead '33 Act claims without also pleading state law claims.[5] A slight majority of district courts addressing the issue have ruled that SLUSA permits removal of any covered class action, whether brought solely under the '33 Act or in tandem with state law claims.

These courts have focused on a number of textual and other factors, including the language of §77v(a) of the '33 Act, which, following its amendment by SLUSA, still provides for concurrent state and federal jurisdiction for non-class '33 Act cases but exclusive federal jurisdiction for "covered class actions." 15 U.S.C. §77v(a). See, e.g., *Rovner v. Vonage Holdings Corp.*, Civ. Action No. 07-178 (FLW), 2007 U.S. Dist. LEXIS 8656, at *10 (D.N.J. Feb. 5, 2007).

These courts have also focused on the purpose of SLUSA: "To stem th[e] 'shif[t] from Federal to State courts' and 'prevent certain State private securities class action lawsuits alleging fraud from being used to frustrate the objectives of' the PSLRA." *Merrill Lynch, Pierce, Fenner & Smith Inc. v. Dabit*, 547 U.S. 71, 82 (2006), quoting SLUSA §§2(2), (5), 112 Stat. 3227. See *Rubin*, 2007 U.S. Dist. LEXIS 17671 at *18.

In *Rubin*, Judge Korman ruled that holding that '33 Act claims coupled with state law claims are removable while those brought alone are not would "lead to an absurd result that would undermine the principal purpose of SLUSA, which was to stop 'state-court litigation of class actions involving nationally traded securities.'" Id. at *17, quoting *Dabit*, 547 U.S. at 82.

Courts that have concluded that SLUSA did not make '33 Act claims removable have focused on other aspects of the inartfully drawn statute. For example, some courts have reasoned that the object of SLUSA was to bar state court securities class actions based on state law, not '33 Act cases. See, e.g., *Pipefitters*, 2005 U.S. Dist. LEXIS 14202 at *6-7. These courts have focused on language in §77p(c), added by SLUSA, which provides that "covered class action[s] brought in any State court involving a covered security, as set forth in subsection (b), shall be removable…."

Subsection (b) says that covered class actions based on state law may not be maintained in any court. Id. The *Pipefitters* court interpreted this language to mean that '33 Act cases were not removable because they were not based on state law. The court did not consider the fact that SLUSA's purpose of providing an exclusive federal forum for securities-related class actions would be frustrated by allowing pure '33 Act cases to remain in state court while allowing hybrid ones to be removed, a result which, as Judge Korman found in *Rubin*, seems facially absurd.

Removal Under CAFA

CAFA presents an alternative to removal under SLUSA.

CAFA added a subsection to the diversity jurisdiction statute (28 U.S.C. §1332(d)) and a corresponding removal provision (28 U.S.C. §1453) allowing class actions to be filed in, or removed to, federal court if "minimal diversity" exists, e.g., any plaintiff is from a state different from any defendant, and the case involves at least $5 million. Unlike SLUSA, however, CAFA did not amend the '33 Act removal prohibition.

In a recent decision, *New Jersey Carpenters Vacation Fund v. Harborview Mortgage Loan Trust 2006-4*, No. 08-CV-5093 (HB), 2008 U.S. Dist. LEXIS 72039 (S.D.N.Y. Sept. 24, 2008), Judge Harold Baer ruled that CAFA "trumped" the '33 Act removal bar notwithstanding the absence of any specific language in CAFA addressing the '33 Act.

CAFA was enacted in 2002 for reasons similar to those that motivated Congress to enact SLUSA: the proliferation of class actions in state courts, especially in certain jurisdictions that were perceived as particularly plaintiff-friendly. CAFA "makes it harder for plaintiffs' counsel to 'game the system' by trying to defeat diversity jurisdiction." S. Rep. 109-14 at 5 (2005). Because "interstate class actions typically involve more people, more money and more interstate commerce ramifications than any other type of lawsuit," CAFA was intended to ensure that such actions could "be heard by federal courts if any of the defendants so desire[d]." Id.

CAFA contains several express exceptions to defendants' right to removal.

First, under the SLUSA exception, it does not apply to any class action that involves a "covered security," which, as noted above, is the touchstone for coverage under SLUSA. Thus, SLUSA and CAFA are mutually exclusive.

Second, under the corporate governance exception, there is a carve-out for claims relating to governance of a business enterprise under state law.

Third, under the securities exception, CAFA does not cover cases "that solely involve…a claim that relates to the rights, duties (including fiduciary duties) and obligations relating to or created by or pursuant to any security…." See 28 U.S.C. §1453(d)(1)-(3).

Unlike SLUSA, CAFA left the language of the '33 Act's removal bar undisturbed, and so the core question presented by the interplay of the removal bar and CAFA is whether the latter "trumps" the removal bar by implication. The issue implicates two venerable rules of statutory construction applicable to instances of conflicting statutes.

Under the so-called Rule of Recency, the more recently enacted statute controls. See *In Re Ionosphere Clubs Inc.*, 922 F.2d 984 (2d Cir. 1990). An equally well-settled rule holds that a statute that addresses an issue in more specific terms controls over a more general enactment. See *Radzanower v. Touche Ross & Co.*, 426 U.S. 148, 153 (1976). Although CAFA is more recent than the '33 Act bar, the latter is more specific. Which should control?

In the recent *New Jersey Carpenters* case, Judge Baer ruled that CAFA "trumped" the '33 Act removal bar and upheld the removal of a class action filed in New York state court that asserted only '33 Act claims. In the absence of any definitive Second Circuit authority concerning the CAFA removal provision, the judge looked to Second Circuit law regarding an analogous removal provision: the bankruptcy removal statute, 28 U.S.C. §1452.

Like CAFA, §1452 permits removal of certain actions filed in state court—actions having a relationship to federal bankruptcy cases—but does not alter the removal bar of 15 U.S.C. §77v. Considering these conflicting provisions, the Second Circuit has held that the bankruptcy removal statute controls over the '33 Act removal bar. *California Public Employees' Retirement System v. WorldCom Inc.*, 368 F.3d 86 (2d Cir. 2004).

The Second Circuit found persuasive the fact that Congress clearly intended to centralize bankruptcy-related litigation in one federal forum. It also found that the omission in §1452 of the type of broad carve-out for any Act of Congress found in the general removal statute (28 U.S.C. §1441(a)),[6] evidenced Congress' intent that bankruptcy cases be removable notwithstanding the existence of a conflicting federal law. See also *In re Global Crossing, Ltd. Sec. Litig.*, No. 02 Civ. 910 (GEL), No. 02 Civ. 10199 (GEL), 2003 WL 21659360 (S.D.N.Y. July 15, 2003).

In *New Jersey Carpenters*, Judge Baer relied on *WorldCom* to hold that CAFA "trumped" the '33 Act removal bar. Judge Baer also cited the Second Circuit's recent opinion in *Estate of Pew v. Cardarelli*, 527 F.3d 25 (2d Cir. 2008),[7] in which the court noted that both SLUSA and CAFA demonstrate congressional intent to create a federal forum for "all securities cases that have national impact…." Id. at 32. Judge Baer therefore held that the '33 Act class action before him was properly removed unless one of the exceptions to CAFA removal applied.[8]

In *Luther v. Countrywide Home Loans Servicing LP*, 533 F.3d 1031 (9th Cir. 2008), the Ninth Circuit reached the opposite conclusion in a brief opinion. The court's conclusion that CAFA did not permit removal was based entirely on the *Radzanower* principle that a more specific statute—here, the '33 Act removal bar—governs over a more general one—here, the CAFA removal provision. The court in *Luther* did not address the Rule of Recency, which would appear to present at least as strong an argument in favor of removal as the "general vs. specific" rule of *Radzanower*. Nor did *Luther* address the absence of language in the CAFA removal prohibition generally deferring to other Acts of Congress or the strong pro-federal forum policy articulated in the legislative history of CAFA or the analogous bankruptcy removal statute.

Exceptions to CAFA Removal

As noted above, CAFA provides for three exceptions to removal, sometimes referred to as the SLUSA, corporate governance and securities exceptions. 28 U.S.C. §1453(d)(1)-(3). These exceptions are intended to be "narrowly construed" to include "only litigation based solely on (a) state statutory law regulating the organization and governance of business enterprises…; (b) state common law regarding the duties owed between and among owners and managers of business enterprises; and (c) the rights arising out of the terms of the securities issued by business enterprises." See S. Rep. 109-14 at 45.

In '33 Act cases, the securities exception provides a possible barrier to removal. In *Estate of Pew*, the Second Circuit gave this exception a narrow construction. That case concerned claims under a New York consumer protection statute relating to debt instruments issued by Agway Inc. The gist of the claims was that the officers of Agway and its auditors failed to disclose that Agway was insolvent.

After observing that the claim did not fall within the SLUSA or corporate governance exceptions, the Second Circuit examined the securities exception and concluded that it was limited to "claims grounded in the terms of the security itself…." Id., 527 F.3d at 32. The court reasoned that the securities exception cannot be read so broadly as to include all securities-related claims; such a reading would render meaningless much of the language in §1453(d)(3), namely, the limitation to claims relating to "the rights, duties (including fiduciary duties) and obligations relating to or created by or pursuant to" any security. Such a broad reading would also make the SLUSA exception superfluous. Id. at 31.

The Second Circuit also examined the legislative history of CAFA, which, it said, "speak[s] directly to the issue here" by stating that the exceptions were meant to apply to litigation concerning "'rights arising out of the *terms of the securities* issued by business enterprises'" and "'*disputes over the meaning of the terms of a security*.'" Id. at 33, quoting S. Rep. 109-14, at 45 (emphases in original). The court therefore concluded that none of the exceptions applied and that the case was properly removed.

In *New Jersey Carpenters*, Judge Baer also examined whether any of the CAFA exceptions were applicable. Because the securities at issue, mortgage pass-through certificates, were not traded on a national securities exchange, the SLUSA exception did not apply. Nor did the corporate governance exception. Judge Baer relied on the Second Circuit's narrow construction of the securities exception in *Estate of Pew* to find that exception inapplicable.

Conclusion

According to the Second Circuit, "Review of SLUSA and CAFA confirms an overall design to assure that the federal courts are available for all securities cases that have national impact (including those that involve securities traded on national exchanges), without impairing the ability of state courts to decide cases of chiefly local import or that concern traditional state regulation of the state's corporate creatures." *Estate of Pew*, 527 F.3d at 32.

Class actions under the '33 Act seeking to assign blame for, and shift investor losses stemming from, the financial crisis present precisely such issues of "national impact." Congress' goal of ensuring a federal forum for such cases would be defeated if courts did not permit removal of '33 Act cases satisfying the requirements of SLUSA and CAFA.

1. Section 11 provides for claims arising from false registration statements. Section 12(a)(2) provides for claims for misrepresentations or omissions in prospectuses relating to IPOs. Neither requires a showing of scienter (i.e., intent to defraud).
2. The reason for this removal bar remains murky. "[T]here is little—if any—legislative history underlying the non-removal provision of the '33 Act." Jeffrey T. Cook, "Recrafting the Jurisdictional Framework for Private Rights of Action Under the Federal Securities Laws," 55 Am. U.L. Rev. 621, 632 (2006).
3. Pub. L. 104-67, 109 Stat. 737 (codified in part at 15 U.S.C. §§77z-1, 78u).
4. For purposes of §77p(c), a "covered security" is essentially a security listed or authorized to be listed on a national securities exchange. 15 U.S.C. §77r(b).
5. Compare, e.g., *Rubin v. Pixelplus*, No. 06-CV-2964, 2007 U.S. Dist. LEXIS 17671 (E.D.N.Y. March 13, 2007) and *Alkow v. TXU Corp.*, Nos. 02-CV-2738-K, 02-CV-2739-K, 2003 U.S. Dist. LEXIS 7900 (N.D. Tex. 2003) (interpreting SLUSA to permit removal where plaintiffs sued only under '33 Act), with *Pipefitters Local 522 and 633 Pension Trust Fund v. Salem Commc'ns Corp.*, No. 05-CV-2730, 2005 U.S. Dist. LEXIS 14202 (C.D. Cal. June 28, 2005) (remanding removed class action pleading only '33 Act claims).
6. Section 1441(a) provides for removal of cases where federal courts would have original jurisdiction, "[e]xcept as otherwise expressly provided by Act of Congress…."
7. In *Estate of Pew*, the Second Circuit accepted an appeal of an otherwise unreviewable remand order under 28 U.S.C. §1453(c). Definitive law on CAFA removal will likely develop quickly because, unlike virtually all other remand orders, orders granting or denying remand of a CAFA removal are appealable. Id.
8. See discussion on exceptions.

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