

Article

Securities Act claims of 'national importance'

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[Section 22\(a\)](#) of the Securities Act of 1933 (Securities Act) creates concurrent jurisdiction in both state and federal courts for private rights of action under the Securities Act. It also specifically provides that claims brought in state court under the Securities Act are not removable to federal court. In recent years, however, actions by Congress and the courts have cast doubt on the ability of plaintiffs to prosecute Securities Act class actions in state court.

In 1995, Congress passed the Private Securities Litigation Reform Act (Reform Act) to curb perceived abuse of the class action system, including nuisance filings and frivolous and burdensome securities litigation. However, the Reform Act had an unintended consequence: "It prompted at least some members of the plaintiffs' bar to avoid the federal forum altogether. Rather than face the obstacles set in their path by the Reform Act, plaintiffs and their

representatives began bringing class actions under state law, often in state court," *Merrill Lynch, Pierce, Fenner & Smith, Inc. v Dabit*, 547 U.S. 71, 82 (2006). In response, Congress enacted the Securities Litigation Uniform Standards Act of 1998 (SLUSA), which precludes state law class actions alleging misrepresentations or omissions of material fact in connection with the purchase or sale of "covered securities" — defined to include securities traded on a national securities exchange — and provides for removal to federal court of any such class action brought in state court. SLUSA also amended section 22(a) such that it does not prevent removal of actions otherwise implicated by SLUSA.

In 2005, Congress passed the Class Action Fairness Act (CAFA), the stated purposes of which include "providing for Federal court consideration of interstate cases of national importance under diversity jurisdiction." CAFA amended the diversity jurisdiction statute by adding 28 U.S.C. § 1332(d), conferring original federal jurisdiction over any class action with minimal diversity. Under CAFA, diversity is established where the aggregate amount in controversy exceeds \$5m and any class member is diverse from any defendant.

CAFA also provides for removal of class actions to federal court "without regard to whether any defendant is a citizen of the State in which the action is brought," and for permissive appellate review of remand orders in 28 U.S.C. § 1453. However, CAFA's class action removal provision contains several exceptions, set forth in 28 U.S.C. § 1453(d), including the following:

(1) a claim concerning a covered security as defined under section 16(f)(3) of the Securities Act and section 28(f)(5)(E) of the Exchange Act of 1934; [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) and the regulations issued thereunder.

In 2008, the Second Circuit concluded that SLUSA and CAFA "confirm 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)..." *Pew v Cardarelli*, 527 F.3d 25, 32 (2d Cir. 2008). Notwithstanding this "overall design," courts continue to disagree as to whether CAFA's removal provisions apply to State Court class actions brought under the Securities Act.

Luther v Countrywide Home Loans Servicing, LP

In *Luther v Countrywide Home Loans Servicing, LP*, 533 F.3d 1031 (9th Cir. 2008), plaintiffs filed a complaint in state court in California alleging that the offering documents for certain mortgage-backed securities issued by a subsidiary of Countrywide contained misrepresentations and omissions in violation of sections 11, 12(a)(2) and 15 of the Securities Act. Defendants removed the action to the United States District Court for the Central District of California pursuant to CAFA, but the district court remanded, holding that section 22(a)'s removal bar trumped CAFA.

Defendants appealed, arguing that the removal bar set forth in section 22(a) of the Securities Act was "superseded" by CAFA. The Ninth Circuit rejected this argument and affirmed the remand order, concluding that "CAFA's general grant of the right of removal of high-dollar class actions does not trump section 22(a)'s specific bar to removal of cases arising under the Securities Act of 1933." The Ninth Circuit focused on the principle of statutory construction that a statute dealing with a "narrow, precise and specific subject," i.e., section 22(a), should not be "submerged" by "a later enacted statute covering a more generalized spectrum," i.e., CAFA. The Ninth Circuit reasoned that the Securities Act was the "more specific statute" because it applies to the "narrow subject of securities cases and more precisely section 22(a) applies only to claims arising under the Securities Act of 1933" whereas CAFA "applies to a 'generalized spectrum' of class actions."

New Jersey Carpenters Vacation Fund v HarborView Mortgage Loan Trust

Two months after *Luther*, the Southern District of New York reached the opposite conclusion. In *New Jersey Carpenters Vacation Fund v HarborView Mortgage Loan Trust*, 581 F. Supp. 2d 581 (S.D.N.Y. 2008), plaintiffs filed suit in state court in New York alleging misrepresentations in the prospectus and registration statement of certain mortgage loan pass-through certificates in violation of sections 11, 12 and 15 of the Securities Act. Defendants removed pursuant to CAFA and plaintiffs moved to remand relying on section 22(a) and *Luther*. The court denied the motion, concluding that Congress intended CAFA to supersede section 22(a) for certain class actions that

concern "matter[s] of national importance."

Katz v Gerardi

The Seventh Circuit recently joined the Southern District of New York in disagreeing with *Luther*. In *Katz v Gerardi*, 552 F.3d 558 (7th Cir. 2009), plaintiffs filed an action in state court in Illinois alleging that a prospectus and registration statement involving a real estate investment trust contained "false and misleading information" in violation of sections 11, 12(a)(2) and 15 of the Securities Act. Defendants removed the action to the United States District Court for the Northern District of Illinois pursuant to CAFA, but the district court remanded.

The Seventh Circuit vacated the district court order. After finding that section 22(a) of the Securities Act and CAFA "are incompatible" and that "one or the other must yield," the Seventh Circuit concluded that "securities class actions covered by [CAFA] are removable, subject to the exceptions in § 1332(d)(9) and § 1453(d)." In other words, if CAFA's minimal diversity exists, and none of the exceptions to CAFA are implicated, a Securities Act case may be removed pursuant to CAFA. *Katz* did not involve "covered securities," and the action was remanded to the district court for a determination as to whether the exception to removal set forth in § 1453(d)(3) applied.

Where we stand now

The split in interpretation of CAFA, represented in these three decisions, has already led to forum shopping by plaintiffs who wish to proceed in state court. However, there are signs that the legacy of *Luther* may be short lived, given that the district court judge who remanded *Luther* recently acknowledged in another CAFA case that "[d]efendants appear to have non-frivolous arguments for a change in the law due to post-*Luther* developments," *Pub. Employees' Ret. Sys. v Morgan Stanley*, No. CV 08-01469, 2009 U.S. Dist. LEXIS 19246, at *5 n.1 (C.D. Cal. Mar. 6, 2009).

Questions remain, however, about the interplay between SLUSA and CAFA. Under *Katz*, a Securities Act class action filed in state court may be removed pursuant to CAFA unless it involves a "covered security," as such a claim is excepted from CAFA removal under 28 U.S.C. § 1453(d)(1). This means that under *Katz*, a section 11 case concerning securities not traded on a national exchange (e.g., the real estate certificates at issue in *Katz*) is subject to removal pursuant to CAFA, but an identical claim involving a nationally traded "covered security" is not. This is an odd result, given the "overall design to assure that the federal courts are available for all securities cases that have national impact," recognized by the Second Circuit.

Any gap created by CAFA and *Katz*, however, may be filled by SLUSA. Several district courts have concluded that SLUSA may be used to remove to federal court Securities Act class actions filed in state court concerning "covered securities." Applying those cases together with *Katz*, defendants could remove all Securities Act cases either under SLUSA or CAFA, and be confident that securities claims with national impact would be heard in a federal forum.

Defendants looking to remove Securities Act class actions concerning "covered securities" pursuant to SLUSA, however, can expect plaintiffs to argue that SLUSA, as written, only applies to class actions "based upon the statutory or common law of any State," and is therefore inapplicable to state court lawsuits only bringing claims under the Securities Act. While we believe that removability of these claims is consistent with the overall movement toward federal jurisdiction for securities claims with national impact, given the procedural manner in which these questions concerning CAFA and SLUSA removal arise, it may be some time before the Supreme Court definitively resolves these questions.

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