

**CAFA v. SECURITIES ACT:
Which Law Governs Class Action
Removal to Federal Court?**

By
Brian Anderson
Lilit Voskanyan
O'Melveny & Myers LLP

WLF

Washington Legal Foundation
Critical Legal Issues WORKING PAPER Series

Number 164
April 2009

TABLE OF CONTENTS

ABOUT WLF'S LEGAL STUDIES DIVISION.....	ii
ABOUT THE AUTHOR.....	iii
INTRODUCTION.....	1
I. THE TWO COMPETING REMOVAL LAWS.....	2
II. THE TWO COMPETING APPELLATE DECISIONS.....	5
CONCLUSION.....	10

ABOUT WLF'S LEGAL STUDIES DIVISION

The Washington Legal Foundation (WLF) established its Legal Studies Division to address cutting-edge legal issues by producing and distributing substantive, credible publications targeted at educating policy makers, the media, and other key legal policy outlets.

Washington is full of policy centers of one stripe or another. But WLF's Legal Studies Division has deliberately adopted a unique approach that sets it apart from other organizations.

First, the Division deals almost exclusively with legal policy questions as they relate to the principles of free enterprise, legal and judicial restraint, and America's economic and national security.

Second, its publications focus on a highly select legal policy-making audience. Legal Studies aggressively markets its publications to federal and state judges and their clerks; members of the United States Congress and their legal staffs; government attorneys; business leaders and corporate general counsel; law school professors and students; influential legal journalists; and major print and media commentators.

Third, Legal Studies possesses the flexibility and credibility to involve talented individuals from all walks of life - from law students and professors to sitting federal judges and senior partners in established law firms - in its work.

The key to WLF's Legal Studies publications is the timely production of a variety of readable and challenging commentaries with a distinctly common-sense viewpoint rarely reflected in academic law reviews or specialized legal trade journals. The publication formats include the provocative COUNSEL'S ADVISORY, topical LEGAL OPINION LETTERS, concise LEGAL BACKGROUNDERS on emerging issues, in-depth WORKING PAPERS, useful and practical CONTEMPORARY LEGAL NOTES, interactive CONVERSATIONS WITH, law review-length MONOGRAPHS, and occasional books.

WLF's LEGAL OPINION LETTERS and LEGAL BACKGROUNDERS appear on the LEXIS/NEXIS® online information service under the filename "WLF" or by visiting the Washington Legal Foundation's website at www.wlf.org. All WLF publications are also available to Members of Congress and their staffs through the Library of Congress' SCORPIO system.

To receive information about previous WLF publications, contact Glenn Lammi, Chief Counsel, Legal Studies Division, Washington Legal Foundation, 2009 Massachusetts Avenue, NW, Washington, D.C. 20036, (202) 588-0302. Material concerning WLF's other legal activities may be obtained by contacting Daniel J. Popeo, Chairman.

ABOUT THE AUTHORS

Brian Anderson is a partner and **Lilit Voskanyan** is an associate in the Washington, D.C. office of O'Melveny & Myers LLP. Both are members of the firm's Class Actions, Mass Torts, and Aggregated Litigation practice group.

CAFA v. SECURITIES ACT: Which Law Governs Class Action Removal to Federal Court?

By

Brian Anderson
Lilit Voskanyan
O'Melveny & Myers LLP

INTRODUCTION

Within the past year, two U.S. Courts of Appeal reached opposite conclusions on an issue that looks likely to become a source of debate in securities class litigation until final resolution in the U.S. Supreme Court. The rulings of the Ninth Circuit in *Luther v. Countrywide Home Loans Servicing LP*, 533 F.3d 1031 (9th Cir. 2008), and of the Seventh Circuit a few months later in *Katz v. Gerardi*, 552 F.3d 558, 2009 U.S. App. LEXIS 13 (7th Cir. Jan 5, 2009), created a circuit split on the question whether putative class actions that meet the diversity jurisdiction requirements of the Class Action Fairness Act of 2005 (“CAFA”) and allege federal claims arising only under the Securities Act of 1933 (“Securities Act”) can be removed to federal court.

The Securities Act expressly prohibits removal of certain actions filed in state court arising under the Act, even if they otherwise meet the requirements of federal question or diversity jurisdiction. CAFA generally allows the removal of any class action meeting its requirements for diversity jurisdiction, subject to

certain limited exceptions. These two conflicting removal statutes create a quandary for judges and practitioners: if a class action is filed alleging Securities Act violations in state court, yet the action meets CAFA's diversity jurisdiction criteria, is it removable because CAFA says it is removable, or not removable because the Securities Act says it is not removable? Which law trumps? At the moment, federal judges disagree on how this question should be answered.

I. THE TWO COMPETING REMOVAL LAWS

Section 22(a) of the Securities Act generally prohibits removal of cases filed in state court arising under the Securities Act, even though such actions assert federal law claims and, therefore, would normally be removable under federal question jurisdiction. The only exception to this bar on removal is for “a covered class action” involving “a covered security.”¹ This exception was added in 1998 as part of the Securities Litigation Uniform Standards Act (“SLUSA”). SLUSA sought to curb the practice of filing securities actions solely under state law and/or filing them in state court in order to circumvent the heightened pleading and other procedural requirements governing federal securities claims under the Private Securities Law Reform Act of 1995 (“PSLRA”). SLUSA provides that “covered class actions” that are “based upon the statutory or

¹15 U.S.C. § 77v(a) (“Except as provided in 15 U.S.C. § 77p(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. §§ 77p(c); 77p(b).

common law of any State” and allege securities fraud in connection with the purchase or sale of a covered security are removable to federal court and are preempted by federal law.² Covered class actions are those in which damages are sought on behalf of more than 50 persons, or are made on a representative basis, with common questions of law or fact predominating over individual questions, and certain groups of lawsuits proceeding as a single action in the same court, involving common questions of law or fact, and claiming damages on behalf of more than 50 persons.³ Covered securities are certain securities traded on a national exchange, securities that are equal or senior to publicly traded securities, and securities issued by registered investment companies.⁴ If a case presents these exceptions, SLUSA permits removal; if the case does not present these exceptions, Section 22(a) prohibits removal.

On the other hand, Section 1453(b) of CAFA provides that any class action may be removed to federal court if it meets certain criteria establishing diversity jurisdiction.⁵ To be removable under CAFA, the case must place in controversy an amount exceeding \$5 million, at least one member of the proposed class

²15 U.S.C. § 77p(c) (“Any covered class action brought in any State court involving a covered security, as set forth in subsection (b), shall be removable to [federal court], and shall be subject to subsection (b).”); § 77p(b) (prohibiting any state or federal court from hearing covered class actions involving covered securities that are based on the statutory or common law of a state and allege untrue statements or deceit in connection with a sale or purchase of a security).

³See 15 U.S.C. § 77p(f)(2).

⁴See 15 U.S.C. § 77p(f)(3) (defining a “covered security” and referencing § 77r(b)(1)-(2) as part of the definition); 15 U.S.C. § 77r(b)(1)-(2).

⁵28 U.S.C. § 1453(b).

must be diverse from at least one party adverse to the class, and it must propose a plaintiff class of more than 100 members.⁶ The only exceptions to removal under CAFA are spelled out in Section 1453(d). Those are class actions that solely involve claims concerning a “covered security” within the meaning of 15 U.S.C. § 77p(f)(3) and certain claims relating to internal corporate governance issues and certain rights and duties relating to securities.⁷ To be sure, CAFA does not bar removal of such cases; instead CAFA simply defers to SLUSA’s framework for removing “covered class actions” involving “covered securities.”⁸ An action not removable under SLUSA, however, may still be removable under CAFA if it meets its jurisdictional requirements and does not involve any of its removal exceptions.

The simultaneous existence of class action removal rules in both the Securities Act and CAFA presents a dilemma. What happens when the class action falls under CAFA and alleges only claims arising under the Securities Act that are not covered by SLUSA?⁹ Which statute governs whether the action can be removed?

⁶28 U.S.C. § 1332(d)(2). Section 1332(d)(9) contains exceptions to district courts’ original federal jurisdiction established by Section 1332(d)(2) but these exceptions are the equivalent of the exceptions found in Section 1453(d) and thus do not change the analysis here.

⁷See 28 U.S.C. § 1453(d)(1)-(3).

⁸See, e.g., *Pew. v. Cardarelli*, 527 F.3d 25, 30 (2d Cir. 2008) (“[CAFA] carves out class actions for which jurisdiction exists elsewhere under federal law, such as under [SLUSA], *i.e.*, state-law fraud claims in connection with the purchase or sale of securities traded on a national stock exchange.”) (citations omitted).

⁹The conflict between Section 22(a) of the Securities Act and Section 1453(b) of CAFA arises when the *only federal* claims asserted in the class action arise under the Securities Act.

II. THE TWO COMPETING APPELLATE DECISIONS

The Ninth Circuit's current position is that the Securities Act ban on removal supercedes CAFA's allowance of removal on a theory that the Securities Act is more "specific" than the "general" removal provision of CAFA.¹⁰ In *Luther*, plaintiff filed a class action against Countrywide Home Loans Servicing LP and several other defendants alleging various violations of the Securities Act stemming from defendants' issuance of allegedly false and misleading registration statements and prospectus supplements. Defendants removed under CAFA, and plaintiff brought a motion to remand, relying on Section 22(a) of the Securities Act. The district court granted the motion, and the removing defendants appealed.¹¹ In a short opinion, the Ninth Circuit rejected defendants' contention that CAFA, as a later-enacted statute, supersedes Section 22(a) of the Securities Act. It said "CAFA's general grant of the right of removal

If the Securities Act claims are joined with other federal question claims, and the case qualifies for removal under Section 1332(d) of CAFA, Section 22(a) would not bar removal because 28 U.S.C. § 1441(c) authorizes removal of such "otherwise nonremovable claims." Thus, CAFA and the Securities Act clash only when the sole claim arising under federal law is based on the Securities Act. It should also be noted that some courts have interpreted SLUSA as authorizing removal of a "covered class action" raising only Securities Act claims – as distinct from non-covered class actions raising only Securities Act claims or individual actions raising only Securities Act claims, which are subject to Section 22(a)'s jurisdictional and removal bar. *See, e.g. Knox v. Agria Corp.*, 08 Civ. 7651 (WHP), 2009 U.S. Dist. LEXIS 6078, at *5-15 (S.D.N.Y. Jan. 27, 2009) (collecting conflicting authorities and basing its conclusion on SLUSA's stripping of state courts of jurisdiction over "covered class actions"). The scope of this article being limited to the interaction between the removal rules of CAFA and the Securities Act for class actions which are not "covered class actions" and which do not involve "covered securities," we do not examine the merits of that position.

¹⁰*Luther*, 533 F.3d at 1032.

¹¹*Id.* at 1932-33.

of high-dollar class actions does not trump § 22(a)'s specific bar to removal.”¹² Quoting *Radzanower v. Touche Ross & Co.*, 426 U.S. 148, 153 (1976), for the proposition 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 opined that the Securities Act is “the more specific statute” because “it applies to the narrow subject of securities cases and § 22(a) more precisely applies only to claims arising under the Securities Act.”¹³ The court said that CAFA, on the other hand, “applies to a ‘generalized spectrum’ of class actions” and thus should yield to Section 22(a).¹⁴

Several months after *Luther*, the Seventh Circuit, speaking through Judge Easterbrook, adopted the opposite position – that CAFA trumps the Securities Act. In *Katz v. Gerardi*, the court first took issue with the Ninth Circuit’s conclusion that Section 22(a) is the more specific of the two statutes:

The canon favoring preservation of specific statutes arguably affected by newer, but more general, statutes works when one statute is a subset of the other. For example, if the 2005 Act dealt with all civil suits, then a law applicable only to civil securities actions would be more specific. But §22(a) of the 1933 Act is not a subset of the 2005 Act. Section 22(a) covers only securities actions, but it includes all securities actions—single-investor suits as well as class actions, small class actions as well as large multi-state ones. The 2005 Act, by contrast, covers only large, multi-state class actions.

¹²*Id.* at 1034.

¹³*Id.*

¹⁴*Id.*

Is the 1933 Act more specific because it deals only with securities law, or is the 2005 Act more specific because it deals only with nationwide class actions? There is no answer to such a question, which means that the canon favoring the specific law over the general one won't solve our problem.¹⁵

In other words, *Radzanower* would trump the rule of recency that mandates that a later-enacted law prevails over previous law only if the previous law is more specific than the newer law. When that is not the case, as in *Katz*, the rule of recency would control.

Judge Easterbrook also disagreed with the Ninth Circuit's opinion on the grounds that "[c]anons such as 'the specific prevails over the general' are just doubt resolvers to be applied when two statutes inherently conflict." Instead, the Seventh Circuit said that Section 1453(d) leaves no doubt about how the 1933 Act, 1934 Act, and 2005 [CAFA] Act fit together."¹⁶ Impliedly relying on the maxim *expressio unius est exclusio alterius*, the court concluded that the language of CAFA itself supplies all the answers to the supposed conflict. The exceptions listed in 1453(d) of CAFA mean that they are the only exceptions to CAFA's removal provision. To hold otherwise, "would be to make most of § 1453(d) pointless." If a claim does not fit into any of the "no removal" exceptions of Section 1453(d), and it meets the federal jurisdiction requirements

¹⁵*Katz*, 2009 U.S. App. LEXIS at *7-8.

¹⁶*Id.* at *9.

of CAFA, it is removable under 1453(b).¹⁷

The only other court to address the question of removal under the Securities Act and CAFA was 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). In an opinion issued prior to the Seventh Circuit decision in *Katz*, the Southern District concluded that the CAFA removal provision overrides the Securities Act, but employed a course of reasoning different from *Katz*. *N.J. Carpenters* relied on the overall design of CAFA and its “overriding purpose . . . to provide for federal court jurisdiction in cases of national importance” in reaching its conclusion.¹⁸ The court set the framework for its analysis by observing that CAFA was enacted to reform the class action mechanism, which “had been co-opted by unscrupulous attorneys who aggressively forum shopped to ‘magnet’ or ‘magic’ State jurisdictions” and by taking note of the intent of drafters of CAFA “to substantially expand Federal court jurisdiction over class actions, not to create loopholes.” Thus, the court claimed that the jurisdictional provision of CAFA “should be read broadly, with a strong preference that interstate class actions should be heard in a Federal court if properly removed by a defendant.”¹⁹

With this in mind, the court first drew upon the analytical model used by

¹⁷*Id.* at *9-10.

¹⁸581 F. Supp. 2d at 587-88.

¹⁹*Id.* at 584-85 (citing various legislative history sources).

the Second Circuit in *California Public Employee's Retirement Systems v. WorldCom, Inc.*, 368 F.3d 86 (2d Cir. 2004), to resolve a conflict between Section 22(a) of the Securities Act and a removal provision for bankruptcy cases in 28 U.S.C. § 1452(a). Section 1452(a) provides that a party may remove “any claim or cause of action in a civil action other than a proceeding before the United States Tax Court or a civil action by a governmental unit to enforce such governmental unit’s police or regulatory power” if the district court has jurisdiction under § 1334. The *WorldCom* court had contrasted this language of Section 1452(a) with the language of the general removal provision in 28 U.S.C. § 1441(a) that “[e]xcept 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” The absence of Section 1441(a)’s explicit exception for other express congressional acts in Section 1452(a) suggested to the *WorldCom* court that when Congress enacted Section 1452(a) of the Bankruptcy Code, it did not intend for Section 22(a) and its analogues to block removal of bankruptcy-related claims.²⁰

N.J. Carpenters concluded from this that just as “Congress acted intentionally to treat [Sections 1441(a) and 1452(a)] differently and gave sweeping removal power for bankruptcy cases,” so too “CAFA, which targets only diversity cases that are class actions, [] has sweeping removal power [with] sole limitations [being] those exclusively listed in the defined exceptions such as

²⁰*WorldCom*, 368 F.3d at 106.

[Section 1332(d) and 1453(d)]. Had 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.”²¹ Furthermore, noting the congressional concern about multiple copycat suits filed in various jurisdictions and artfully crafted to avoid removal—for instance, by asserting only claims under the Securities Act and expressly disclaiming any other causes of action—and in view of the fact that “review of SLUSA and CAFA confirms an overall design to assure that federal courts are available for all securities cases that have national impact,” the court concluded that CAFA overrides Section 22(a).²²

CONCLUSION

In the aftermath of these cases, counsel who are called on to defend class actions arising under the Securities Act filed in a state court will have to demonstrate to federal courts outside the discussed jurisdictions that the outcome in *Katz* and *N.J. Carpenters* is preferable to that in *Luther*. The variety of interpretive techniques used in these cases demonstrates that a full arsenal of tools in a lawyer’s toolbox, in the form of analysis of the text, legislative history and purpose of the relevant statutes, will have to be used to make the case for the primacy of CAFA.

Katz’s criticism of the Ninth Circuit’s specificity analysis is hard to assail,

²¹*N.J. Carpenters*, 581 F. Supp. 2d at 587.

²²*Id.* at 585, 587-588 (citations omitted).

but *Katz's* reasoning itself may appear, at first glance, to be vulnerable to counter-arguments. One could say, for example, that the same *expressio unius* canon counsels construction in favor of the Securities Act. After all, Section 22(a) has its own set of exceptions, and it is plausible to infer from this that unless the case involves a covered class action and a covered security, Section 22(a)'s ban on removal is absolute. This construction seems to be further bolstered by the familiar propositions that removal provisions are construed narrowly, with doubts to be resolved against removability,²³ and that implied repeals of statutes are disfavored.²⁴ But the correctness of the outcome in *Katz* is underscored both by the analytical approach it employed and the context and purpose of the relevant statutory framework, on which it did not rely. *Katz* did not explicitly invoke the *expressio unius* canon, but it employed its logic to aid in its construction of the text of Section 1453(b) *in addition to* the rule of recency canon which controlled the dispute. That is, once it was determined that the specificity factor was not in play, the rule of recency dictated that the court look to Section 1453(b) for an answer to the removal question. Section 1453(b) is clear that unless one of the exceptions in 1453(d) and 1332(d) applies, the Securities Act claim is removable.

More fundamentally, it would be an ironic construction of the Securities

²³See, e.g. *Lupo v. Human Affairs Int'l, Inc.*, 28 F.3d 269, 274 (2d Cir. 1994) (citations omitted).

²⁴See, e.g., *United States v. United Cont'l Tuna Corp.*, 425 U.S. 164, 168-69 (1979) (citations omitted).

Act, SLUSA, which amended it, and CAFA if Section 22(a) were allowed to trump CAFA. SLUSA was passed to close the loopholes left by PSLRA, which had not prevented plaintiffs' counsel from sidestepping its (PSLRA's) heightened pleading and procedural requirements by filing state actions in state courts. SLUSA sought to block this kind of maneuvering by expanding federal jurisdiction for securities class actions based upon state statutory and common law.²⁵ CAFA, with its relaxed federal jurisdiction requirements and provision for federal adjudication of state-law claims, aimed to further curb the forum shopping manifest in copycat filings of class actions in various state courts. To now construe this progression of continuous efforts to curtail the excesses of abusive class action litigation as leaving a gaping hole for Securities Act class actions would in itself amount to impliedly nullifying those efforts.

The irony is even more salient when one considers that Section 22(a)'s override of CAFA would mean that a federal question claim arising under the Securities Act cannot be litigated in a federal forum, but a purely state-law claim is easily removable. Indeed, a recognized exception to the implied repeal doctrine is that where the two statutes are in irreconcilable conflict, the later one constitutes an implied repeal of an earlier one to the extent of the conflict.²⁶ A broad construction of Section 22(a) in contravention of CAFA would undermine the basic purpose of the past decades' class action reform efforts and

²⁵See 15 U.S.C. § 77p(b)-(c).

²⁶See, e.g., *Posadas v. Nat'l City Bank*, 296 U.S. 497, 503 (1936).

impair the jurisdictional framework CAFA sought to establish. This conclusion is supported neither by the text nor the context in which the Securities Act and CAFA operate.