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SECOND CIRCUIT REVIEW

BY MARTIN FLUMENBAUM AND BRAD S. KARP

Federal Sway Boosted Over State Securities Class Actions

In this month's column, we discuss *Estate of Pew v. Cardarelli*,[1] in which the U.S. Court of Appeals for the Second Circuit bolstered federal courts' jurisdiction over securities class actions brought under state law.

In a matter of first impression in the circuit courts, the Second Circuit narrowly construed a securities law exception to the Class Action Fairness Act (CAFA) general grant of federal removal jurisdiction to qualified class actions.[2]

Section 1453 of CAFA states:

> (b) In general.—A *class action may be removed to a district court of the United States*...without regard to whether any defendant is a citizen of the State in which the action is brought...
>
> (c) Review of remand orders.—
>
> (1) In general.—Section 1447 shall apply to any removal of a case under this section, except that notwithstanding section 1447(d), *a court of appeals may accept an appeal from an order of a district court granting or denying a motion to remand* a class action to the State court from which it was removed.
>
> ...
>
> (d) Exception.—This section shall not apply to any class action that solely involves—
>
> ...
>
> (3) a *claim that relates to the rights, duties (including fiduciary duties), and obligations relating to or created by or pursuant to any security*....[3]

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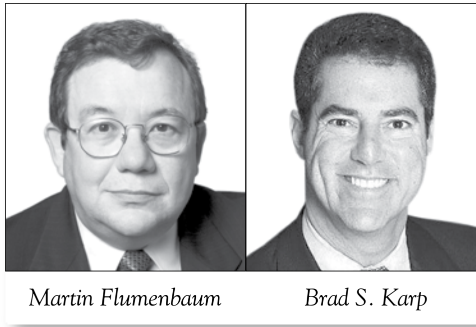

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In its decision, written by Chief Judge Dennis Jacobs and joined by Judge Amalya L. Kearse, over a dissenting opinion written by Judge Rosemary S. Pooler, the Second Circuit held that in order to fall under the exception in 28 U.S.C. §1453(d)(3) "relat[ing] to the rights" created in the security holder requires a claim to be grounded in the terms of the securities themselves (such as how interest rates are to be calculated). Because the state law claim at issue did not seek to enforce the rights of the security holders as holders, but rather asserted consumer fraud violations, the Second Circuit reversed the district court's decision to remand the putative class action to state court.

Background and Procedural History

Plaintiffs, seeking to represent a class of individuals who purchased unsecured debt instruments issued by Agway Inc. (Agway) between September 2000 and September 2002, filed suit in New York Supreme Court against Agway officers and Agway's auditor, PricewaterhouseCoopers. Plaintiffs alleged federal securities law violations based on alleged misrepresentations in Agway's financial statements, which plaintiffs claimed had fraudulently concealed Agway's insolvency at the time it issued the relevant debt instruments.

After defendants removed the action to the U.S. District Court for the Northern District of New York on grounds of federal question jurisdiction, plaintiffs amended their complaint to plead essentially the same acts of concealment under New York's consumer fraud law, N.Y. Gen. Bus. Law §349(a). Northern District Chief Judge Norman A. Mordue granted defendants' motion to dismiss plaintiffs' federal claims with prejudice, and further declined to exercise supplemental jurisdiction over plaintiffs' state law claims, dismissing them without prejudice.[4] The Second Circuit affirmed.[5]

Plaintiffs then filed suit in New York Supreme Court, making essentially the same allegations, but seeking relief only under New York's consumer fraud statute. Defendants removed the action to federal court under CAFA, 28 U.S.C. §1453(b). Plaintiffs moved to remand the case to state court, and Chief Judge Mordue granted plaintiffs' motion.[6]

Defendants then filed a petition to the Second Circuit, pursuant to 28 U.S.C. §1453(c), seeking permission to appeal the district court's remand order.

The Second Circuit Decision

CAFA provides a general grant of federal removal jurisdiction to class actions where there exists diversity and an aggregate amount in controversy of at least $5 million. As the Second Circuit noted,

> [o]ne purpose of CAFA is to provide a federal forum for securities cases that have national impact, without impairing the ability of state courts to decide cases of chiefly local import or cases that concern traditional state regulation of the state's corporate creatures. CAFA does that by expanding federal diversity jurisdiction, by allowing removal of securities cases of national impact from the state courts,

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and by conferring appellate jurisdiction to review orders granting or denying motions to remand such removed cases.[7]

The court also observed, however, that there is "an exception to CAFA's grant of original [and appellate] federal jurisdiction, for any class action that solely involves a claim… that relates to the rights, duties (including fiduciary duties), and obligations relating to or created by or pursuant to any security."[8] The key question faced by the court, then, was whether a state law class action—involving a sale of securities but based on consumer fraud laws—was removable to federal court under CAFA, or whether the district court properly remanded the case to state court under CAFA's exception for cases "relat[ing] to the rights, duties…, and obligations relating to… any security."

As an initial matter, the Second Circuit joined the Third, Ninth, Tenth and Eleventh circuits in holding that §1453(c)(1)'s requirement that a petition to review a remand order be filed "not less than 7 days after entry of the order" contained a typographical error. The court ruled that the "uncontested legislative intent behind" the statute was not to impose a waiting period, but rather a deadline of "not *more* than 7 days."[9] The court found that defendants had made a timely petition to review the district court's decision to remand, and so review was proper.

Turning to the district court's decision to remand the case based on CAFA's exception for claims relating to the rights, duties, and obligations relating to any security, the Second Circuit held that the plain meaning of the statute was "ambiguous" because of "imperfect drafting."[10] As a result, the court examined the statute's wording, statutory context and legislative history.

With respect to the wording of §1453(d)(3), the court divided the clause into four subclauses:

> [i] the section "shall not apply to any class action that solely involves a claim…that relates to
> [ii] the rights, duties…, and obligations
> [iii] relating to or created by or pursuant to
> [iv] any security…."[11]

The court held that the clause cannot be read to cover any and all securities, because that would afford no meaning to subclauses [ii] and [iii], which it concluded are terms of limitation. The court held that "duties" are owed by persons (human or artificial); "obligations" are owed by instruments; and "rights" are those of the security holders to whom these duties and obligations run. Although the court acknowledged that the Agway debt instruments created "obligations" and therefore corresponding "rights," plaintiffs' lawsuit did not implicate those rights because the lawsuit was based on state-law consumer fraud claims, rather than "claims grounded in the terms of the security itself."[12] As a result, the court ruled that the lawsuit does not "relate[] to" those rights and obligations, so it does not fall under the exception to CAFA's removal provision.

The court then examined the statutory context and legislative history of CAFA. It held that the statute "confirms an overall design to assure that the federal courts are available for all securities cases that have national impact…, 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."[13] The statute's legislative history, as well, confirms this reading, according to the court. Congress "intended that [the exception at issue in §1453(d)(3)] should be reserved for disputes over the meaning of the terms of a security, such as how interest rates are to be calculated, and so on."[14] The court concluded that the wording, statutory context and legislative history of CAFA are consistent.

> *The Second Circuit ruled that to fit within the exception allowing remand to state court a lawsuit must concern the rights, duties or obligations that are grounded in the terms of the securities themselves.*

Conclusion

The Second Circuit, therefore, ruled that a state-law securities class action that otherwise satisfies the relatively low jurisdictional threshold for federal removal under CAFA will not be remanded to state court solely because the lawsuit relates in some way to any securities. Instead, the court ruled that to fit within the exception allowing remand to state court a lawsuit must concern the rights, duties or obligations that are grounded in the terms of the securities themselves. Because the putative class action in question was not grounded in the actual terms of the securities at issue, the Second Circuit (i) ruled that it has appellate jurisdiction to review the district court's remand order, (ii) granted defendants leave to appeal, (iii) reversed the district court's order to remand the case to state court, and (iv) remanded the case to the district court for further proceedings consistent with its opinion.

1. *Estate of Pew v. Cardarelli*, No. 06-5703, 2008 WL 2042809 (2d Cir. May 13, 2008) (*Estate of Pew*).
2. Class Action Fairness Act of 2005, Pub.L. No. 109-2, 119 Stat. 4 (codified at 28 U.S.C. §§1332(d), 1453, and 1711-15).
3. 28 U.S.C. §1453 (emphasis added). 28 U.S.C. §1332(d) confers original federal jurisdiction over any class action with minimal diversity and an amount in controversy of at least $5 million. However, §1332(d)(9)(C) provides an exception for class actions relating to the rights, duties, and obligations relating to any security, using language that parallels the exception to the removal provision contained in §1453(d)(3). Thus, as the Second Circuit noted, "CAFA's jurisdictional and removal provisions operate in tandem." *Estate of Pew*, 2008 WL 2042809 at * 5.
4. See *Pew v. Cardarelli*, No. 5:03-cv-742, 2005 WL 3817472 *7 (N.D.N.Y. March 17, 2005); Id. at *16.
5. See *Pew v. Cardarelli*, 164 Fed.Appx. 41, 44 (2d Cir. 2006) (summary order).
6. See *Estate of Pew v. Cardarelli*, No. 5:05-cv-1317, 2006 WL 3524488 (N.D.N.Y. Dec. 6, 2006).
7. *Estate of Pew*, 2008 WL 2042809 at * 1 (internal quotations omitted).
8. Id. at *4. CAFA also contains exceptions, not relevant here, relating to a "covered security" under the Securities Act of 1933 and relating to "the internal affairs or governance of a corporation or other form of business enterprise and aris[ing] under or by virtue of the laws of the State in which such corporation or business enterprise is incorporated or organized." 28 U.S.C. §1453(d)(1)-(2).
9. *Estate of Pew*, 2008 WL 2042809 at *2 (emphasis in original) (discussing *Morgan v. Gay*, 466 F.3d 276 (3d Cir. 2006); *Miedema v. Maytag Corp.*, 450 F.3d 1322 (11th Cir. 2006); *Amalg. Transit Union Local 1309 v. Laidlaw Transit Servs. Inc.*, 435 F.3d 1140 (9th Cir. 2006); *Pritchett v. Office Depot Inc.*, 420 F.3d 1090 (10th Cir. 2005)).
10. Id. at *4. The dissent criticized the majority's conclusion that the statute was ambiguous. See id. at *8.
11. Id. at *5. As noted, §1332(d)(9)(C) contains parallel language relating to federal jurisdiction.
12. *Estate of Pew*, 2008 WL 2042809 at * 6.
13. Id.
14. Id. at *7 (quotations omitted).

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