

## SECOND CIRCUIT REVIEW

## Expanding the Scope of ‘Securities-Related’ Exception to the Class Action Fairness Act

By Martin Flumenbaum and Brad S. Karp

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In *Krasner v. Cedar Realty Trust, et al.*, -- F.4th --, 2023 WL 7517017 (2d Cir. Nov. 14, 2023), the U.S. Court of Appeals for the Second Circuit considered whether the securities-related exception to the federal jurisdiction conferred by the Class Action Fairness Act (CAFA) prohibited removal to federal court of a class action alleging aiding and abetting the breach of fiduciary duties and tortious interference claims.

In a unanimous decision authored by Chief Judge Debra Livingston and joined by Circuit Judges Beth Robinson and Maria Araújo Kahn, the panel held that the CAFA exception applied and that the case was therefore properly remanded to state court.

This decision is another instance where the Second Circuit has adopted a relatively expansive interpretation of the securities related exception, and its decision may lead to other circuits following a similar approach.

**Class Action Fairness Act**

Although federal courts generally only hear cases when there is complete diversity of jurisdiction or



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a federal question, CAFA expanded the jurisdiction of federal courts to hear class actions where the class has more than 100 members, the amount in controversy is larger than five million dollars, and there is minimal diversity. The purpose of CAFA was to authorize federal courts to hear class actions of national importance.

But CAFA simultaneously carved out exceptions to that authority. One of the exceptions is the securities-related exception. The securities-related exception prohibits the removal from state to federal court of claims that “relate[] to the rights, duties (including fiduciary duties), and obligations relating to or created by or pursuant to any security.” 28 U.S.C. §1453(d)(3).

Before *Krasner*, the Second Circuit considered the scope of the exception in three key cases between 2008 and 2012. Each case in the trilogy further defined the scope of the securities-related exception.

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## Second Circuit's Trilogy of CAFA Decisions

In *Estate of Pew v. Cardarelli*, 527 F.3d 25 (2d Cir. 2008), the Second Circuit first addressed the scope of the securities-related exception in general terms. The court noted that the securities-related exception could not include “any and all claims that relate to a security,” because that would render several sections of CAFA superfluous.

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Rather, after considering the language of CAFA and the legislative history, the court held that the securities-related exception only applied to claims that were rooted in the terms of the instruments that created the security, and not, as was the case in *Cardarelli*, claims that were imposed or arose out of a state consumer fraud statute.

Next, in *Greenwich Financial Services Distressed Mortgage Fund 3 v. Countrywide Financial*, 603 F.3d 23 (2d Cir. 2010), the Second Circuit considered whether the securities-related exception applied to the enforcement of a term in a pooling and service agreement (PSA).

Countrywide created and managed a series of residential mortgage-securitization trusts. The trusts sold certain securities represented by certificates that allowed investors to receive payments from the mortgages. The PSA governed the creation of the trusts and securities and set out the rights of and duties owed to the security holders, but the security holders were not parties to the PSA. The security holders sought to enforce a term in the PSA requiring Countrywide to repurchase the loans that were pooled to create the securities.

Although the securities holders were not parties to the PSA and the certificates they purchased did

not contain the provision they sought to enforce, the Second Circuit still held that the securities-related exception applied. The court explained that the securities-related exception does not require that the term sought to be enforced appear in the security itself. Rather, if there are several agreements that create a security, a security holder can enforce rights and terms in any of the instruments that created the security.

Importantly, the securities-related exception applies even if the security holder is not a party to the agreement they are seeking to enforce. Thus, in *Greenwich*, the Second Circuit adopted a more expansive interpretation of the securities-related exception.

Finally, in *BlackRock Financial Management v. Segregated Account of AMBAC Assurance*, 673 F.3d 169 (2d Cir. 2012), the Second Circuit considered whether a case that was brought by a trustee, as opposed to a security holder, fell within the securities-related exception.

The Bank of New York Mellon (BNYM) served as the trustee for several residential mortgage-securitization trusts. There were several complaints that the mortgage service providers were in breach of a PSA, and in order to avoid litigation, the parties negotiated a settlement. BNYM filed a petition in state court asking that court to confirm that it had authority to enter into the settlement and had acted in good faith in doing so. After the petition was filed, one security holder removed the action to federal court.

The Second Circuit held that because the lawsuit involved the interpretation of the PSA, which created securities, the case fell within the securities-related exception. The court therefore interpreted the exception more broadly for a second time.

### The District Court and Second Circuit's Decision in ‘Krasner’

In October 2022, a putative class action was filed in New York State Court by Plaintiff Krasner against

Cedar Realty Trust and its former directors alleging Maryland state law claims for breach of contract, breach of fiduciary duty, tortious interference with contract and aiding and abetting the breach of contract. Defendants removed the case to federal court under CAFA, and the plaintiff moved to remand it back to state court.

The district court remanded the case to state court. See *Krasner v. Cedar Realty Trust*, 2023 WL 3057387 (E.D.N.Y. Apr. 24, 2023). The district court held that the defendants failed to establish that there were more than 100 class members. The court also noted that several exceptions to federal jurisdiction appeared to apply, including the securities-related exception. Defendants appealed the decision to the Second Circuit.

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The Second Circuit focused on whether the securities-related exception applied. (Since the securities-related exception applied, the Second Circuit did not consider the district court's decision on the numerosity requirement).

The circuit relied on the precedent from *Cardarelli*, *Greenwich* and *BlackRock* to establish the principles (a) that the security holder needs to bring a claim that is grounded in terms of the security itself for the exception to apply, (b) that the security holder does not need to be a party to a contract for

the securities-related exception to apply, and (c) that a duty imposed by state law as a result of the underlying security still falls within the scope of the exception. Against this backdrop, the Second Circuit held that the claims fell within the securities-related exception.

As there was no doubt that the securities-related exception applied to the breach of fiduciary duty claims and breach of contract claims, the circuit focused on the claim that defendants aided and abetted the breach of fiduciary duty and the claim that defendants tortiously interfered with a contract.

The Second Circuit concluded that the aiding and abetting claim fell within the exception because proving the aiding and abetting claim requires proof that another party breached fiduciary duties that were owed to security holders. Similarly, the tortious interference claim required proof of a breach of a contract that created the securities holders' rights.

## Conclusion

The Second Circuit's decision further expands the scope of the securities-related exception. While the exception is not boundless, the Second Circuit's interpretation of the securities-related exception allows more cases to be remanded to state court. The Second Circuit's trilogy of securities-related cases has been considered and used by other courts of appeals. See, e.g., *Dominion Energy, Inc. v. City of Warren Policy & Fire Retirement Sys.*, 928 F.3d 325 (4th Cir. 2019). Thus, with the latest decision in *Krasner*, we may see other courts of appeal interpret the securities-related exception more broadly.