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CLASS ACTIONS

The Effect of the Second Circuit's Decision in BlackRock On the Scope of CAFA's 'Securities Exception' to Removability



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In *BlackRock Financial Management Inc.*[1] *v. Segregated Account of AMBAC Assurance Corp.*, the Second Circuit held that the Class Action Fairness Act of 2005 (''CAFA'') did not permit removal to federal court of a securities-related ''mass action'' filed in state court.[2] Defendants (and occasionally plaintiffs) in securities cases sometimes rely on CAFA to remove class actions and mass actions to federal court. At first glance, *BlackRock* appeared to take a broad view of CAFA's so-called ''securities exception'' to removability and to limit parties' ability successfully to remove securities class actions and mass actions under CAFA.

However, a close reading of the Second Circuit's decision suggests that the Court did not expand the scope of CAFA's securities exception. Rather, the Court's holding was entirely consistent with the narrow construction of that exception in prior Second Circuit decisions and probably will not significantly alter parties' ability to remove securities-related class actions or mass actions.

CAFA and its Exceptions

CAFA's enactment in 2005 provided an alternative to the Securities Litigation Uniform Standards Act of 1998 (''SLUSA'')[3] for removal of securities cases. One of Congress's goals in enacting CAFA was 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.''[4] To that end, CAFA expanded federal diversity

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[2] 673 F.3d 169, 173 (2d Cir. 2012).

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[3] Historically, although the Securities Act of 1933 (the ''1933 Act'') provided federal and state courts with concurrent jurisdiction over 1933 Act claims, a plaintiff's choice of forum was determinative because the 1933 Act barred removal of cases filed in state courts. By 1998, however, Congress—believing that plaintiffs increasingly were bringing securities class actions in state courts to circumvent the reforms that had been enacted three years earlier in the Private Securities Litigation Reform Act—enacted SLUSA, in part to provide a mechanism for removal of securities class actions filed in state court and covered by the 1933 Act. The scope of removal under SLUSA has been frequently litigated.

[4] *Estate of Pew v. Cardarelli*, 527 F.3d 25, 26 (2d Cir. 2008).

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jurisdiction by permitting removal of class actions or ''mass actions'' with at least $5 million in controversy and ''minimal'' diversity of citizenship, subject to three exceptions designed '' 'to keep purely local matters and issues of particular state concern in the state courts.' ''[5] In other words, where CAFA's minimal diversity and amount-in-controversy requirements are satisfied, an action brought in state court is removable unless one of CAFA's three exceptions applies, in which case the federal district court lacks jurisdiction and must remand the action to state court.[6]

The first of these exceptions is known as the SLUSA exception and applies to claims ''solely'' involving ''covered'' securities under SLUSA.[7] This exception provides that SLUSA rather than CAFA governs the removability of claims covered by SLUSA.[8]

The second exception bars removal of actions involving the ''internal affairs or governance of a corporation'' under a state's corporate law.[9]

The third exception—known as the ''securities exception'' and the one at issue in *BlackRock*—bars removal of 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 (as defined under section 2(a)(1) of the Securities Act of 1933 (15 U.S.C. 77b(a)(1)) and the regulations issued thereunder).''[10]

Considered Three Times

Since CAFA's passage, the Second Circuit has considered the scope of CAFA's securities exception three times.[11] In the first decision to address this issue, *Estate of Pew v. Cardarelli*, the Second Circuit held that the securities exception did not apply, and therefore reversed the district court's order remanding the action to state court.[12] The plaintiffs in *Cardarelli* filed a putative class action in New York state court against officers of an issuer of debt certificates alleging that the officers failed to disclose, when marketing the certificates, that the issuer was insolvent.[13] The defendants removed the action to federal court, and the plaintiffs moved to remand on the ground that the case fell within CAFA's securities exception to removal.[14] The district court granted the plaintiffs' motion and ordered that the case be remanded to state court, rejecting the defendants' contention that the securities exception bars removal only of claims ''based on [plaintiffs'] rights as securities *holders*'' such as ''voting rights, rights to receive dividends, rights upon liquidation, or any other claim arising from their ownership of the Certificates.''[15]

The Second Circuit reversed in a split decision. In an opinion by Chief Judge Dennis Jacobs, the Court explained that the plaintiffs' contention that the securities exception barred removal of any action that relates to a security was inconsistent with the limiting terms in the statutory language of the securities exception.[16] The Second Circuit held that claims that '' 'relate[] to the rights . . . and obligations' 'created by or pursuant to' a security must be claims grounded in the terms of the security itself.''[17] The plaintiffs' claims did not fall within the securities exception (and therefore were removable) because the claims alleged that the certificates were fraudulently marketed and therefore did not seek to enforce the rights of certificate holders *as holders*.[18] In reaching its decision, the Court pointed to CAFA's legislative history to support its contention that the exception ''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.''[19]

Following *Cardarelli*, district courts in the Second Circuit narrowly construed the securities exception and rejected plaintiffs' efforts to remand.[20] But in *Greenwich Financial Services Distressed Mortgage Fund 3, LLC v. Countrywide Financial Corp.*, the district court granted plaintiffs' motion to remand, holding that the securities exception barred removal of a putative class action by holders of residential mortgage-backed securities (''RMBS'') seeking to force defendants to repurchase certain mortgage loans that failed to comply with certain provisions of pooling and servicing agreements (''PSAs'') governing the securities.[21] The district court held that under *Cardarelli*, the plaintiffs were seeking to vindicate their rights as ''holders'' even though the terms they sought to enforce were in the PSAs rather than in the certificates themselves. The district court found it ''hard to see how the PSAs do not constitute instruments that create and define plaintiffs' certificates.''[22]

Defendants appealed to the Second Circuit, which held that the securities exception did not apply and dismissed the appeal of the district court's remand order.[23]

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[5] *Id.* at 30 (quoting *Lowery v. Ala. Power Co.*, 483 F.3d 1184, 1194 (11th Cir. 2007)).

[6] *See* 28 U.S.C. § 1332(d)(2), (9). Although a party opposing remand generally bears the burden of demonstrating that federal jurisdiction is proper, ''once the general requirements of CAFA jurisdiction are established, plaintiffs have the burden of demonstrating that remand is warranted on the basis of one of the enumerated exceptions.'' *Greenwich Fin. Servs. Distressed Mortg. Fund 3, LLC v. Countrywide Fin. Corp.*, 603 F.3d 23, 26 (2d Cir. 2010).

[7] 28 U.S.C. § 1332(d)(9)(A) (original jurisdiction); *id.* § 1453(d)(1) (appellate jurisdiction).

[8] *Id.* §§ 1332(d)(9)(A), 1453(d)(1).

[9] *Id.* § 1332(d)(9)(B) (original jurisdiction); *id.* § 1453(d)(2) (appellate jurisdiction).

[10] *Id.* § 1332(d)(9)(C) (original jurisdiction); *id.* § 1453(d)(3) (appellate jurisdiction).

[11] Although remand orders generally are not appealable, CAFA expanded appellate jurisdiction to the same extent as CAFA's expansion of original jurisdiction. *See* 28 U.S.C. § 1453(d); *Cardarelli*, 527 F.3d at 29 n.1.

[12] 527 F.3d 25 (2d Cir. 2008).

[13] *Id.*

[14] *Estate of Pew v. Cardarelli*, No. 5:05-CV-1317, 2006 BL 414 (N.D.N.Y. Dec. 6, 2006).

[15] *Id.*

[16] *Cardarelli*, 527 F.3d at 31-32.

[17] *Id.* (quoting 28 U.S.C. § 1453(d)(3)).

[18] *Id.*

[19] *Id.* at 32 (quoting S. Rep. 109-14 at 45).

[20] *See, e.g., Puglisi v. Citigroup Alternative Invs. LLC*, No. 08 CV 9774 (NRB), 2009 BL 116110 (S.D.N.Y. May 27, 2009); *N.J. Carpenters Vacation Fund v. Harborview Mortg. Loan Trust 2006-4*, 581 F. Supp. 2d 581 (S.D.N.Y. 2008).

[21] 654 F. Supp. 2d 192 (S.D.N.Y. 2009).

[22] *Id.* at 196.

[23] *Greenwich*, 603 F.3d at 27. The Second Circuit dismissed the appeal (rather than affirm the district court's decision) because its conclusion that the securities exception did not apply meant that the Second Circuit lacked appellate jurisdiction under 28 U.S.C. § 1453(d)(3). *Id.*

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The Second Circuit held that the plaintiffs sought to enforce ''their rights as *holders* rather than as purchasers of securities'' and rejected defendants' argument that the securities exception was limited to actions to enforce terms that appear only in the certificates themselves.[24] Rather, the Court explained that the *Cardarelli* analysis turns on whether an action seeks to ''enforce 'the terms of instruments that create and define securities,' '' regardless of whether those terms appear in the certificates or in ''any number of deal instruments executed between various parties'' such as '' 'certificates of incorporation and bond indentures.' ''[25] Therefore, the Court concluded that the ''right to force [the defendants] to repurchase the loans arises from the deal instruments themselves, not from an extrinsic provision of state law, such as a consumer fraud statute.''[26]

Although the Second Circuit concluded in *Greenwich Financial Services* that the security exception applied, and therefore that the Court lacked appellate jurisdiction to review the district court's order, the Court's holding was based on the conclusion that the rights of securities holders as holders could arise from various instruments aside from the securities themselves. The Court did not expand the scope of the securities exception, and the Court's holding was consistent with the framework it laid out in *Cardarelli* that the securities exception should be narrowly construed.

In *BlackRock*, the Second Circuit recently had a third occasion to consider the scope of the securities exception. The case arose from a highly publicized settlement agreement between Bank of New York Mellon (''BNY Mellon'') as trustee for 530 RMBS trusts and a group of institutional investors in the certificates issued by those trusts who had complained to BNY Mellon that mortgages sold into the trusts failed to comply with the various representations and warranties in PSAs and that the servicer of the mortgages failed to comply with its obligations set forth in the PSAs.[27] The settlement agreement was contingent on BNY Mellon obtaining court approval.[28] BNY Mellon therefore filed an Article 77 proceeding in New York state court seeking a judgment that it had the authority to enter into the settlement agreement on behalf of the trusts and the trusts' beneficiaries and that it had done so in good faith.[29] Another group of investors opposed to the settlement agreement intervened and removed the action to federal court.[30]

The district court denied BNY Mellon's motion to remand, explaining that the ''pivotal question'' under *Cardarelli* and *Greenwich Financial Services* was whether a plaintiff's claims arise under the ''terms of an instrument that creates or defines securities'' as opposed to ''under an independent source of state or federal law.''[31]

In the district court's view, the question of whether BNY Mellon was authorized to enter into the settlement depended upon the scope of duties owed by trustees under New York common law, and not just upon BNY Mellon's obligations under the terms of the PSAs.[32] Therefore, the district court held that the securities exception did not apply because the claims did not relate solely to the rights, duties, and obligations ''relating to or created by or pursuant to'' the underlying securities.[33]

The Second Circuit reversed and instructed the district court to remand the action to state court. The Court first explained that BNY Mellon had filed the action to obtain ''a construction of the PSA and an instruction that its planned course of action complies with its obligations under that document and the law of trusts.''[34] Then, having ''characterized the claim as a declaration authorizing the exercise of a trustee's powers,'' the Court concluded that CAFA's securities exception applied because BNY Mellon was seeking a declaration that it had ''complied with its 'duties . . . and obligations' arising from the PSA and its 'fiduciary duties' superimposed by state law.''[35]

The Second Circuit explained that ''duties superimposed by state law as a result of the relationship created by or underlying the security fall within the plain meaning of [CAFA's securities exception], which expressly references 'duties (including fiduciary duties).' ''[36] The Court therefore concluded that because BNY Mellon's authority to enter into the settlement agreement arose from the trustee's duties set forth in the PSA, the securities exception applied and the action should be remanded to state court.[37]

The Court emphasized that it was not ruling on the question of whether the underlying claims being settled would be removable under CAFA, but rather on whether CAFA permitted removal of an action relating to whether BNY Mellon acted within its authority as trustee under the PSA to enter into a settlement agreement of those claims.[38]

Narrow Construction Maintained

Although the Second Circuit held in *BlackRock* that the securities exception applied and remanded the action to state court, *BlackRock* does not appear to diverge from the narrow construction of the securities exception established in *Cardarelli* and *Greenwich Financial Services*.

Rather, *BlackRock* maintains that CAFA's securities exception applies only to actions that solely involve claims relating to rights, duties, or obligations related to or created by securities, regardless of whether the claims arise from the terms that appear in the securities themselves or in other deal instruments, and even if the rights, duties, and obligations are based on independent sources of state law. Accordingly, *BlackRock* probably will not significantly alter parties' ability to remove securities class actions or mass actions, whether in the RMBS context or otherwise.

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[24] *Id*. at 29.
[25] *Id*. (quoting *Cardarelli*, 527 F.3d at 33).
[26] *Id*.
[27] *BlackRock*, 673 F.3d at 174.
[28] *Id*.
[29] *Id*.
[30] *Id*.
[31] *Bank of N.Y. Mellon v. Walnut Place LLC*, 819 F. Supp. 2d 354, 363 (S.D.N.Y. 2011).
[32] *Id*.
[33] *Id*. at 365.
[34] *BlackRock*, 673 F.3d at 177.
[35] *Id*. at 178 (quoting 28 U.S.C. § 1453(d)(3)).
[36] *Id*. at 179 (quoting 28 U.S.C. § 1453(d)(3)).
[37] *Id*. at 180.
[38] *Id*. at 179.