

---

## A FAIR SHARE (OF REMOVAL): RESOLVING A CONFLICT BETWEEN THE CLASS ACTION FAIRNESS ACT AND THE SECURITIES ACT

MARINA G. ARONCHIK<sup>1</sup>

Cite as: Marina G. Aronchik, *A Fair Share (of Removal): Resolving a Conflict Between the Class Action Fairness Act and the Securities Act*, 4 SEVENTH CIRCUIT REV. 456 (2009), at <http://www.kentlaw.edu/7cr/v4-2/aronchik.pdf>.

### INTRODUCTION

“The securities markets are crucial to our economic performance as a nation” because they are vital to the success of American private and public sectors.<sup>2</sup> Both private companies and government entities need capital to operate. One of the primary means of raising capital is by issuing securities and selling them to investors.<sup>3</sup> While some securities are traded nationally on exchanges, such as the New York Stock Exchange (“NYSE”), or through the National Association of

---

<sup>1</sup> J.D. candidate, May 2009, Chicago-Kent College of Law, Illinois Institute of Technology; Bachelor of Science in Information Technology Management, *summa cum laude*, December 2004, Christian Brothers University.

<sup>2</sup> S. REP. NO. 104-98, at 50 (1995); *Factbox: What is the municipal bond market?*, REUTERS, Dec. 30, 2008, <http://www.reuters.com/article/reutersEdge/idUSTRE4BT34X20081230> (discussing securities issued in the public sector); WORLD BANK, INTERNATIONAL MONETARY FUND, DEVELOPING GOVERNMENT BOND MARKET: A HANDBOOK 3 (2001).

<sup>3</sup> U.S. DEPT. OF STATE, STOCKS, COMMODITIES AND THE MARKET, <http://usinfo.org/zhtw/DOCS/OutlineEconomy/chap5.html> (last visited April 1, 2009). Consequently, “[i]f the seller's purpose is to raise money for the general use of a business enterprise or to finance substantial investments and the buyer is interested primarily in the profit the note is expected to generate, the instrument is likely to be a ‘security.’” *Reves v. Ernst & Young*, 494 U.S. 56, 67 (1990).

Securities Dealers Automated Quotation system (“Nasdaq”),<sup>4</sup> other securities are traded within limited groups of investors.

Similar to their nationally traded counterparts, non-publicly traded securities range from traditional stocks, bonds, and notes, to more complex instruments, such as mortgage-backed securities.<sup>5</sup> Stocks give the purchaser voting rights and the right to dividends contingent on the issuer's profits.<sup>6</sup> These instruments are freely transferable and they typically appreciate over time.<sup>7</sup> Bonds and notes, on the other hand, do not give investors voting rights or rights to dividends.<sup>8</sup> Rather, they evidence the issuer's promise to repay an extension of credit.<sup>9</sup> Similar to stocks, these instruments are transferable, but their value remains the same over time.<sup>10</sup>

The statutory definition of securities includes a wide range of financial instruments either because it mentions them expressly—such as stock, bonds, and notes—or under the designation of an “investment contract.”<sup>11</sup> An “investment contract” is a transaction where “a person invests. . . money in a common enterprise and is led to expect profits solely from the efforts of the promoter or a third party.”<sup>12</sup> Mortgage-

---

<sup>4</sup> U.S. DEPT. OF STATE, *supra* note 3. Stocks, Commodities and the Market, <http://usinfo.org/zhtw/DOCS/OutlineEconomy/chap5.html> (last visited April 1, 2009).

<sup>5</sup> 15 U.S.C. § 77b(a)(1).

<sup>6</sup> *Landreth Timber Co. v. Landreth*, 471 U.S. 681, 686 (1985) (citing *United Housing Foundation, Inc. v. Forman*, 421 U.S. 837, 851 (1975)).

<sup>7</sup> *Id.*

<sup>8</sup> *Id.*

<sup>9</sup> *Id.*

<sup>10</sup> *Id.*

<sup>11</sup> 15 U.S.C. § 77b(a)(1); *Landreth*, 471 U.S. at 686. Congress “recognized the virtually limitless scope of human ingenuity, especially in the creation of ‘countless and variable schemes devised by those who seek the use of the money of others on the promise of profits,’ *SEC v. W.J. Howey Co.*, 328 U.S. 293, 299 (1946), and determined that the best way to achieve its goal of protecting investors was ‘to define “the term ‘security’ in sufficiently broad and general terms.”’” *Reves v. Ernst & Young*, 494 U.S. 56, 60–61 (1990) (citing *Forman*, 421 U.S. at 847–848 (quoting H.R. REP. No. 85, 73d Cong., 1st Sess., 11 (1933))).

<sup>12</sup> *SEC v. W.J. Howey Co.*, 328 U.S. 293, 299 (1946).

backed securities are “investment contracts” because investors buy them to gain profits from the “efforts of others”—homeowners’ efforts of paying mortgages—thereby participating in a “common enterprise.”

The “common enterprise” involving mortgage-backed securities is rather complex. At the core of this enterprise are individual homeowners who borrow money from banks, mortgage companies, and other mortgage loan originators and offer mortgages as security for these loans. Lenders retain security interests in the homes until the homeowners pay off the loan.<sup>13</sup> But in the meantime, the lenders sell these mortgages to governmental or quasi-governmental entities, such as the Government National Mortgage Association (Ginnie Mae), the Federal National Mortgage Association (Fannie Mae), the Federal Home Loan Mortgage Corporation (Freddie Mac), as well as private financial institutions, such as Countrywide Financial, Lehman Brothers, and Wells Fargo.<sup>14</sup> Governmental and private entities then assemble these mortgages into “mortgage pools” and issue securities that represent claims on the homeowners’ principal and interest payments on their respective loans in the pool, thereby creating a “common enterprise.”<sup>15</sup>

When issuing mortgage-backed securities or other types of securities, entities must comply with the Securities Act’s obligations of disclosure of material information in registration statements, written prospectuses, or even oral communications concerning the sale of securities.<sup>16</sup> To ensure compliance, the Securities Act backs the detailed disclosure obligations by a range of sanctions, including a private cause of action. Among such private actions sanctions are (1) § 11 of the Securities Act, which imposes liability for material misrepresentation or omission in the registration statement;<sup>17</sup> (2)

---

<sup>13</sup> See U.S. Securities & Exchange Comm’n, Mortgage-Backed Securities, June 25, 2007, <http://www.sec.gov/answers/mortgagesecurities.htm>.

<sup>14</sup> *Id.*

<sup>15</sup> *Id.*

<sup>16</sup> 15 U.S.C. §§ 77a–77aa. For a detailed discussion on the Securities Act requirements see ALAN R. PALMITER, SECURITIES REGULATION 77-136 (Aspen Law & Business 1998).

<sup>17</sup> 15 U.S.C. § 77k.

§ 12(a)(2), which permit purchasers of securities to seek rescission if the offering was carried out “by means of a prospectus or oral communication” that is materially false or misleading;<sup>18</sup> and, finally (3) § 15, which permits civil action against “control persons,” such as majority shareholders, directors, or officers of a corporate issuer liable under §§ 11 or 12 of the Securities Act.<sup>19</sup>

Plaintiffs can bring a cause of action under the Securities Act in federal *or* state court: both court systems have jurisdiction over claims alleging violations of the Securities Act.<sup>20</sup> For more than sixty years after the enactment of the Securities Act in 1933, plaintiffs were filing securities claims in federal court. But, in 1995, Congress imposed heightened requirements on class actions alleging violations of the Securities Act *if* such claims were brought in federal court.<sup>21</sup> To avoid having to comply with the heightened requirements, plaintiffs began filing class actions based on the Securities Act in state courts.<sup>22</sup>

In 2007, the trend of state court filings of class actions alleging violations of the Securities Act culminated into a new type of securities litigation: state court filings of class actions alleging violations of the Securities Act with respect to non-publicly traded securities in general and mortgage-backed securities in particular.

The number of lawsuits usually increases when the securities market declines.<sup>23</sup> The market of mortgage-backed securities proved to be no exception. Between 2001 and 2006, the volume of mortgage-backed securities issues exceeded \$1 trillion dollars, peaking at more than \$2 trillion dollars in 2003.<sup>24</sup> But in 2007 and 2008, the “common

---

<sup>18</sup> *Id.* at § 771(a)(2); PALMITER, *supra* note 16, at 171.

<sup>19</sup> 15 U.S.C. § 77o.

<sup>20</sup> *Id.* at § 77v(a).

<sup>21</sup> 15 U.S.C. § 77z-1 (2005).

<sup>22</sup> 69A AM. JUR. 2D *Securities Regulation* § 887 (2008).

<sup>23</sup> 1320 PLI/CORP 265, 267 (2002) (citing Martha Neil, *With the Market Fizzle, a New Round of Securities Suits Take Aim At once High-Flying IPO's*, 88 A.B.A.J. 49 (2002).

<sup>24</sup> SECURITIES INDUSTRY AND FINANCIAL MARKETS ASSOCIATION, *ISSUANCE OF AGENCY MORTGAGE-BACKED SECURITIES* (Dec. 31, 2006), <http://www.sifma.net/story?id=297>.

enterprise” of mortgages suffered a setback when the growing number homeowners were unable to pay principal or interest on their loans, and their homes—securities for the loans—were decreasing in value. Thus, seeking to recover losses on their mortgage-backed securities,<sup>25</sup> investors began filing in class actions alleging violations of the Securities Act with respect to these non-publicly traded securities, and increasingly doing so in state courts.<sup>26</sup>

It became important for defendants to remove these claims to federal court. A civil action is removable to a district court that has subject matter jurisdiction over the case, unless another federal statute bars such removal.<sup>27</sup> Federal courts have federal question and, in some cases, diversity of citizenship jurisdiction over class actions alleging violations of the Securities Act.<sup>28</sup> But, it is unclear whether another federal statute bars removal of class actions alleging violations of the Securities Act with respect to non-publicly traded securities. Section 22 of the Securities Act bars removal of claims arising under the Securities Act.<sup>29</sup> But the removal provision of the Class Action Fairness Act (“CAFA”), which Congress enacted in 2005, broadly

---

<sup>25</sup> *2008 Activity Is at Its Highest Level Since 2004*, NEWS RELEASE, Jan. 6, 2009, STANFORD LAW SCHOOL SECURITIES CLASS ACTION CLEARINGHOUSE, [http://securities.stanford.edu/scac\\_press/20090106\\_YIR08\\_Press\\_Release.pdf](http://securities.stanford.edu/scac_press/20090106_YIR08_Press_Release.pdf); see also Paul Karlsgodt, *Troubled Economic Times Can Push the Market for Class Actions. But Can You Afford to Take on These Cases?* Suemagazine.com, available at [http://securities.stanford.edu/clearinghouse\\_research/2008\\_YIR/20090106\\_YIR08\\_Full\\_Report.pdf](http://securities.stanford.edu/clearinghouse_research/2008_YIR/20090106_YIR08_Full_Report.pdf). For a discussion on why plaintiffs prefer to litigate in state courts, while defendants favor federal courts, see Thomas E. Willging and Shannon R. Wheatman, *Attorney Choice of Forum in Class Action Litigation: What Difference Does it Make?*, 81 NOTRE DAME L. REV. 591, 593.

<sup>26</sup> H.R. REP. NO. 105-640, at \*10 (1998)

<sup>27</sup> See 28 U.S.C. § 1441(a).

<sup>28</sup> The Securities Act expressly grants federal courts jurisdiction over claims arising under the Securities Act. 15 U.S.C. § 77v(a). Additionally, a federal court may have another basis for exercising jurisdiction under diversity of citizenship. See 28 U.S.C. §§ 1332(a), (d)(2).

<sup>29</sup> The Securities Act provides a narrow exception to such removal bar, but that exception does not apply to class actions alleging violations of the Securities Act with respect to non-publicly traded securities. See 15 U.S.C. §§ 77v(a), 77p(c).

permits removal of class actions.<sup>30</sup> Therefore the removal provisions of the Securities Act and CAFA conflict. On the one hand, permitting removal of a class action alleging violations of the Securities Act with respect to non-publicly traded securities conflicts with the Securities Act's prohibition on removal of claims arising under the Securities Act.<sup>31</sup> But, on the other hand, *prohibiting* removal of such claim appears to contradict CAFA, which generally permits removal of class actions.<sup>32</sup>

Given the growing number of state court filings of class actions alleging violations of the Securities Act with respect to non-nationally traded securities in general and mortgage-backed-securities in particular,<sup>33</sup> it is important to determine whether the Securities Act bars removal of these claims. To provide a background for answering this question, Part I of this article explains the general framework of removal and the conflicting provisions of the Securities Act and the Class Action Fairness Act. Next, Part II discusses the Ninth Circuit's holding in *Luther v. Countrywide* that the Securities Act bars removal of a class action alleging violations of the Securities Act with respect to mortgage-backed securities. Part III analyzes the Seventh Circuit's decision in *Katz v. Gerardi*, in which the court disagreed with *Luther* and held that the Securities Act does not bar removal of class actions that allege violations of the Securities Act with respect to non-publicly traded securities. Finally, Part IV analyzes and expands on the reasoning of the *Luther* and *Katz* courts, concluding that the Seventh

---

<sup>30</sup> The CAFA removal provision has some exceptions, none of which apply to non-publicly traded securities. See 28 U.S.C. § 1453(b) (removal provision); 28 U.S.C. § 1453(d) (exceptions to the removal provision).

<sup>31</sup> See 15 U.S.C. § 77v(a).

<sup>32</sup> See 28 U.S.C. § 1453.

<sup>33</sup> *2008 Activity Is at Its Highest Level Since 2004*, NEWS RELEASE, Jan. 6, 2009, Stanford Law School Securities Class Action Clearinghouse, [http://securities.stanford.edu/scac\\_press/20090106\\_YIR08\\_Press\\_Release.pdf](http://securities.stanford.edu/scac_press/20090106_YIR08_Press_Release.pdf); see also Paul Karlsogdt, *Troubled Economic Times Can Push the Market for Class Actions. But Can You Afford to Take on These Cases?* Suemagazine.com, available at [http://www.bakerlaw.com/files/Uploads/Documents/News/Articles/LITIGATION/Karlsogdt-Sue\\_Magazine\\_1-09.pdf](http://www.bakerlaw.com/files/Uploads/Documents/News/Articles/LITIGATION/Karlsogdt-Sue_Magazine_1-09.pdf).

Circuit decided correctly that the Securities Act does not bar removal of class actions alleging violations of the Securities Act with respect to non-publicly traded securities.

## I. BACKGROUND

To determine whether the Securities Act bars removal of class actions alleging violations of the Securities Act with respect to non-publicly traded securities, it is important to understand the removal framework of 28 U.S.C. § 1441, which governs removal of cases from state to federal court, provides that “*any* civil action brought in a State court of which the district courts of the United States have original jurisdiction, may be removed by the defendant. . . [e]xcept as otherwise expressly provided by Act of Congress.”<sup>34</sup> Thus, to remove a class action alleging violations of the Securities Act with respect to non-publicly traded securities, defendant must show that (1) the district court has jurisdiction over such action; and (2) another statute does not bar removal of the claim.<sup>35</sup>

Federal courts have at least one, and, possibly, more, bases for jurisdiction over class actions based on the Securities Act. Federal question jurisdiction gives federal courts power to hear claims arising under the “laws of the United States.”<sup>36</sup> The Securities Act is a federal law.<sup>37</sup> Therefore, federal courts have federal question jurisdiction over claims arising under the Securities Act. Additionally, the Securities Act expressly gives federal (and state) courts jurisdiction over claims arising under that statute.<sup>38</sup> Finally, class actions alleging violations of the Securities Act may satisfy the diversity-of-citizenship requirements

---

<sup>34</sup> 28 U.S.C § 1441.

<sup>35</sup> *See id.*

<sup>36</sup> *Id.* at § 1441(b).

<sup>37</sup> 15 U.S.C. §§ 77a–77aa.

<sup>38</sup> *Id.* at § 77v(a).

of 28 U.S.C. § 1332(a) or 28 U.S.C. § 1332(d)(2), thereby providing another basis for federal court jurisdiction of such cases.<sup>39</sup>

The issue of whether another federal statute bars removal of class actions alleging violations of the Securities Act with respect to non-publicly traded securities is more complex. To understand why this question is complex, it is necessary to examine the removal provisions of the Securities Act and the Class Action Fairness Act (“CAFA.”)

### A. *The Securities Act*

The Securities Act generally prohibits removal of claims arising under the Securities Act, although it does not specifically address class actions. Section 22(a) of the Securities Act provides: “[e]xcept as provided in section 77p(c) [of title 15], no case arising under . . . subchapter [I]<sup>40</sup> and brought in any State court of competent jurisdiction shall be removed to an court of the United States.”<sup>41</sup>

Section 77p(c)—that § 22(a) references as an exception to the Securities Act’s prohibition of removal—does not apply to class actions arising under the Securities Act with respect to non-publicly traded securities.<sup>42</sup> Section 77p(c) provides:

Any covered class action<sup>43</sup> brought in any State court involving a *covered security*, as set forth in subsection

---

<sup>39</sup> CAFA expanded federal court jurisdiction over “any civil action in which the matter in controversy exceeds. . .\$5,000,000, and is a class action in which. . .any member of a class of plaintiffs is a citizen of a State different from any defendant.” 28 U.S.C. § 1332 (d)(2).

<sup>40</sup> Subchapter I of the Securities Act applies to all domestic securities, which include non-publicly traded securities at issue in this article.

<sup>41</sup> 15 U.S.C. § 77v(a) (emphasis added).

<sup>42</sup> *Id.* at § 77p(c).

<sup>43</sup> A “covered class action” is “any single lawsuit” or “any group of lawsuits filed in. . .the same court and involving common questions of law or fact” that seeks “damages on behalf of more than 50 persons.” 15 U.S.C § 77p(f)(2)(A).

(b),<sup>44</sup> shall be removable to the Federal district court for the district in which the action is pending, and shall be subject to subsection (b).<sup>45</sup>

For the purposes of § 77p(c), a “covered security” is a security “listed. . . on the New York Stock Exchange or the American Stock Exchange, or. . . the Nasdaq Stock Market[, or]. . . a national securities exchange.”<sup>46</sup> Because non-nationally traded securities are not listed on the New York Stock Exchange, the American Stock Exchange, Nasdaq, or another national securities exchange, these securities are not “covered securities.”<sup>47</sup> Thus, the exception under § 77p(c) to the Securities Act's removal ban does not apply to class actions alleging violations of the Securities Act involving non-nationally traded securities.<sup>48</sup> But the issue is whether § 22(a) bars removal of these claims after the enactment of the Class Action Fairness Act, which contains a removal provisions that generally permits removal of class actions.

### *B. The Class Action Fairness Act*

Unlike the removal provision of the Securities Act enacted in 1933,<sup>49</sup> the removal provision of the Class Action Fairness Act

---

<sup>44</sup> BRIAN E. PASTUSZENSKI ET AL., STATE COURT SECURITIES CASES: PREEMPTION AND STAYS OF DISCOVERY UNDER THE SECURITIES LITIGATION UNIFORM STANDARDS ACT, SJ084 ALI-ABA 825, 840 (2004) (explaining that the statutory reference to subsection (b) has caused a number of circuit splits and disagreements among federal district courts. The majority of the courts have interpreted it to modify “covered class actions.” Therefore, to meet the requirements of 15 U.S.C. § 77p(c), a covered class action must satisfy the requirements of 15 U.S.C. § 77p(b), which, in turn, requirements that the claim be brought under state law. See 15 U.S.C. § 77p(b)).

<sup>45</sup> 15 U.S.C. § 77p(c).

<sup>46</sup> *Id.* at § 77r(b).

<sup>47</sup> *See id.*

<sup>48</sup> *Id.* at § 77p(c).

<sup>49</sup> *See id.* at § 77v(a).

(“CAFA”) enacted in 2005, addresses removal of class actions.<sup>50</sup> CAFA provides:

[I]n general[.]. . .[a] *class action may be removed* to a district court of the United States in accordance with section 1446. . .without regard to whether any defendant is a citizen of the State in which the action is brought, except that such action may be removed by any defendant without the consent of all defendants.<sup>51</sup>

Section 1446—that the CAFA removal provision references—requires compliance with certain removal procedures.<sup>52</sup> For example, to remove a civil action, a defendant must file in the district court a notice of removal signed pursuant to Rule 11 of the Federal Rules of Civil Procedure<sup>53</sup> and promptly after doing so, the defendant must give written notice of removal to the adverse parties and to the state court.<sup>54</sup>

Although the CAFA removal provision contains exceptions, none of them apply to class actions alleging violations of Securities Act with respect to non-publicly traded securities.<sup>55</sup> Knowledge of these exceptions, however, is helpful in interpreting whether the CAFA removal provision “trumps”<sup>56</sup> the Securities Act’s ban on removal. 28 U.S.C. § 1453(d) provides that the CAFA removal provision:

[S]hall not apply to any class action that solely involves (1) a *claim concerning a covered security*. . .; (2) a claim that relates to the internal affairs or

---

<sup>50</sup> See 28 U.S.C. § 1453(b).

<sup>51</sup> *Id.* at § 1453(b); see JOSEPH M. MCLAUGHLIN, MCLAUGHLIN ON CLASS ACTIONS § 12:6 (2008).

<sup>52</sup> 28 U.S.C. § 1446.

<sup>53</sup> *Id.* at § 1446(a).

<sup>54</sup> *Id.* at § 1446(d).

<sup>55</sup> See *id.* at § 1453(d).

<sup>56</sup> *Luther v. Countrywide Home Loans Servicing*, No. 2:07-CV-08165-MRP(MANx), 2008 U.S. Dist. LEXIS 26534, at \*8 (C.D. Cal. Feb. 28, 2008).

governance of a corporation. . .; or (3) a claim that relates to the rights, duties. . ., and obligations relating to. . .any security.<sup>57</sup>

Class actions alleging violations of the Securities Act with respect to non-covered securities do not concern “internal affairs or governance of a corporation;” they do not involve rights, duties, or obligations relating to a security. Therefore, exceptions under §§ 1453(d)(2) and (3) do not apply.

Although § 1453(d)(1) addresses securities, it indicates the CAFA removal provision does not apply to claims involving “*covered* securities;” it is silent with regard to non-publicly traded securities, which are not “covered securities.”<sup>58</sup> CAFA’s silence with respect to non-covered securities raises several questions. Therefore, the issue is whether the Securities Act bars removal of class actions alleging violations of the Securities Act with respect to non-publicly traded securities even though the CAFA removal provision generally permits removal of class actions. The Ninth Circuit and the Seventh Circuits have answered this question differently.

## II. THE NINTH CIRCUIT HOLDS THAT THE SECURITIES ACT BARS REMOVAL OF CLASS ACTIONS ALLEGING VIOLATIONS OF THE SECURITIES ACT WITH RESPECT TO NON-PUBLICLY TRADED SECURITIES

To determine whether the Securities Act bars removal of class actions alleging violations of the Securities Act with respect to non-publicly traded securities, it is helpful to consider how courts have resolved the conflict between the removal provisions of CAFA and the Securities Act. The Ninth Circuit was the first federal appellate court to consider this “novel set of removal issues under the securities law.”<sup>59</sup>

---

<sup>57</sup> 28 U.S.C. § 1453(d) (emphasis added).

<sup>58</sup> *See id.* at § 1453.

<sup>59</sup> *Luther*, 2008 U.S. Dist. LEXIS 26534, at \*4.

*A. Fact and Procedural History of Luther v. Countrywide*

On November 14, 2007, David H. Luther filed a class action complaint in Los Angeles County Superior Court against Countrywide Home Loans Servicing LP, CWALT, Inc. (“CWALT”), a subsidiary of Countrywide Financial Corporation, several other affiliates and subsidiaries of Countrywide Financial Corporation, multiple alternative loan trusts, and various underwriters.<sup>60</sup> At the heart of the lawsuit was a type of mortgage-backed securities, pass-through certificates,<sup>61</sup> which CWALT had issued.<sup>62</sup> Between January 2005 and January 2007, Luther had acquired, together with other persons and entities on behalf of which he was suing, hundreds of billions of dollars worth of these securities.<sup>63</sup> From the vantage point of 2007, plaintiff argued that “the risk of the investments was much greater than represented by the registration statements and prospectus supplements [for the mortgage-backed securities], which omitted and misstated the credit worthiness of the underlying mortgage borrowers.”<sup>64</sup> Thus, according to Luther, the registration statements and prospectus supplements for the mortgage pass-through certificates were false and misleading.<sup>65</sup> Because “the value of the certificates ha[d] substantially declined [after] many of the underlying mortgage loans became

---

<sup>60</sup> *Id.* at \*1. For the definition of an underwriter see 15 U.S.C. § 77b(a)(11).

<sup>61</sup> Pass-through certificates are a basic type of mortgage-backed security that entitles the holder to a pro-rate share of all principal and interest payments made on the pool of loan assets. U.S. Securities & Exchange Commission, *Mortgage-Backed Securities*, SEC.GOV, June 25, 2007, <http://www.sec.gov/answers/mortgagesecurities.htm>.

<sup>62</sup> *Luther*, 2008 U.S. Dist. LEXIS 26534, at \*1.

<sup>63</sup> *Luther v. Countrywide Home Loans Servicing*, 533 F.3d 1031, 1032 (9th Cir. 2008).

<sup>64</sup> *Id.* at 1033.

<sup>65</sup> *Id.*

uncollectible,”<sup>66</sup> Luther was seeking damages under §§ 11,<sup>67</sup> 12(a)(2),<sup>68</sup> and 15<sup>69</sup> of the Securities Act.<sup>70</sup>

On December 14, 2007, the defendants removed Luther's class action federal court pursuant to several statutes: 28 U.S.C. § 1441(a), the statute governing removal generally, 28 U.S.C. § 1446, a provision that sets out removal procedures, and, implicitly, 28 U.S.C. § 1453, the CAFA removal provision that requires compliance with the above-mentioned 28 U.S.C. § 1446.<sup>71</sup> Defendants based removal jurisdiction on diversity of citizenship, 28 U.S.C. § 1332, as amended by CAFA.<sup>72</sup> Luther filed a motion to remand the case back to state court, arguing that CAFA did not apply.<sup>73</sup>

### *B. Decision of the District Court*

On February 28, 2008, the United States District Court for the Central District of California granted the plaintiff's motion to remand the case to state court.<sup>74</sup> The court held that the prohibition on removal in the Securities Act “trumps” the general removal provision in 28 U.S.C. § 1441(a)<sup>75</sup> for two reasons.<sup>76</sup> First, “[n]one of the[] concerns” behind the enactment of CAFA resonate in the Securities Act cases.<sup>77</sup> But the only Congressional concern the court discussed

---

<sup>66</sup> *Id.*

<sup>67</sup> 15 U.S.C. § 77k.

<sup>68</sup> *Id.* at § 77l(a)(2).

<sup>69</sup> *Id.* at § 77o.

<sup>70</sup> *Luther*, 553 F.3d at 1033.

<sup>71</sup> *Luther v. Countrywide Home Loans Servicing*, No. 2:07-CV-08165-MRP(MANx), 2008 U.S. Dist. LEXIS 26534, at \*2 (C.D. Cal. Feb. 28, 2008).

<sup>72</sup> *Id.*

<sup>73</sup> *Id.*

<sup>74</sup> *Id.* at \*1, \*11–\*12.

<sup>75</sup> 28 U.S.C. § 1441 provides that “[e]xcept as otherwise expressly provided by Act of Congress, any civil action brought in a State court of which the district court[.] . . .ha[s]. . . jurisdiction, may be removed.”

<sup>76</sup> *Luther*, 2008 U.S. Dist. LEXIS 26534, at \*1, \*8.

<sup>77</sup> *Id.* at \*8.

was that of "'mak[ing] it harder for plaintiffs[. . .] to 'game the system' by trying to defeat diversity jurisdiction.'"<sup>78</sup> Before the adoption of CAFA, for a district court to have jurisdiction over a class action, the amount in controversy had to be \$75,000—which was not an issue in most claims—and complete diversity of citizenship among all plaintiffs and defendants, which was considerably more difficult to achieve in cases involving a multitude of parties.<sup>79</sup> The "'gam[ing] [of] the system'" or "artful pleading," occurred by adding parties solely based on their State of citizenship or alleging an amount in controversy that did not trigger the \$75,000 threshold.<sup>80</sup> Congress was concerned with the "artful pleading" that plaintiffs used to manipulate the system.<sup>81</sup>

By enacting CAFA, Congress sought to remedy "'a technical glitch'" in the diversity jurisdiction statute, because of which class action cases were usually excluded from federal court.<sup>82</sup> With regard to this Congressional purpose, the court noted, correctly, "regardless of the diversity of the parties or the amount sought, concurrent jurisdiction was always present. . . so long as the case was brought under the Securities Act."<sup>83</sup> Therefore, the court concluded that "the apparent motivation[] for the enactment of CAFA [] was largely irrelevant. . . in [Securities] Act cases."<sup>84</sup>

Next, the court turned to the "basic principle of statutory construction that a statute dealing with a narrow, precise, and specific subject [was] not submerged by a later enacted statute covering a more generalized spectrum."<sup>85</sup> Under such canon, "[w]here there [was] *no*

---

<sup>78</sup> *Id.* at \*6 (citing S. Rep. 109-14, 2005 U.S.C.C.A.N. 3, 6).

<sup>79</sup> Compare 28 U.S.C. § 1332(a) with 28 U.S.C. § 1332(d)(2). See *Luther*, 2008 U.S. Dist. LEXIS 26534, at \*6–\*7 (citing 151 CONG. REC. S1079 (daily ed. Feb. 8, 2005) (statement of Sen. Dodd)).

<sup>80</sup> *Luther*, 2008 U.S. Dist. LEXIS 26534, at \*6–\*7 (citing 151 CONG. REC. S1079 (daily ed. Feb. 8, 2005) (statement of Sen. Dodd)).

<sup>81</sup> *Id.* at \*7.

<sup>82</sup> *Id.* at \*7 (quoting 2005 U.S.C.C.A.N. at 7).

<sup>83</sup> *Id.* at \*8.

<sup>84</sup> *Id.*

<sup>85</sup> *Id.* at \*9.

*clear intention* otherwise, a specific statute [is] not. . .controlled or nullified by a general one, regardless of the priority of enactment."<sup>86</sup> In *Luther*, the defendants "argu[ed] that an affirmative expression of [Congress's] intent to make [Securities Act claims] removable. . .was its failure to create a discrete exception that would preserve non-removability of [the Securities] Act claims."<sup>87</sup> Although this argument was ultimately "unavailing,"<sup>88</sup> it created doubt in the mind of the court with respect to removal of the case.<sup>89</sup> But because the court "continue[d] to harbor significant doubt that CAFA provide[d] removal jurisdiction in the fact of the [Securities] Act's absolute prohibition on removal,"<sup>90</sup> it remanded the case to state court.<sup>91</sup>

Generally, a district court's order remanding a removed case back to state court is not appealable.<sup>92</sup> But a permission to appeal can be sought and granted in certain cases."<sup>93</sup> In *Luther*, the defendants sought,<sup>94</sup> and the Ninth Circuit granted, such permission to appeal the district court's remand order.<sup>95</sup>

---

<sup>86</sup> *Id.* (citing *Radzanower v. Touche Ross & Co.*, 426 U.S. 148, 153 (1976)).

<sup>87</sup> *Id.* (citing Defendants' Opposition to Motion to Remand at 19, *Luther*, No. 2:07-CV-08165-MRP(MANx), 2008 U.S. Dist. LEXIS 26534 (C.D. Cal Feb 28, 2008)).

<sup>88</sup> *Id.*

<sup>89</sup> *Id.* at \*10 (noting that "federal jurisdiction '[had to be] rejected if there [was] any doubt as to the right of removal.'" (emphasis added)).

<sup>90</sup> *Id.*

<sup>91</sup> *Id.* at \*12. Because the court concluded that CAFA conflicted with the non-removal provision of the Securities Act, it declined to address the applicability of CAFA's exceptions to the complaint at bar. *Id.* at \*10.

<sup>92</sup> *Luther v. Countrywide Home Loans Servicing*, 533 F.3d 1031, 1033 (9th Cir. 2008) (citing 28 U.S.C. §§ 1447(d), 1453(c)(2)).

<sup>93</sup> *Id.*

<sup>94</sup> *Id.* at 1033.

<sup>95</sup> *Id.* (citing 28 U.S.C. § 1453(c)(2)).

*C. Decision of the Ninth Circuit*

After *de novo* review,<sup>96</sup> on July 16, 2008, the Ninth Circuit affirmed the decision of the district court.<sup>97</sup> Similar to the lower court, the Ninth Circuit briefly addressed the legislative purpose behind the adoption of CAFA.<sup>98</sup> It noted that Congress enacted CAFA, in part, to "restore the intent of the framers of the United States Constitution by providing for Federal court consideration of interstate cases of national importance under diversity jurisdiction."<sup>99</sup> But the court did not discuss whether its holding that the Securities Act prohibited removal of the class at bar advanced such legislative purpose, which it did not.<sup>100</sup>

The court then turned to the "basic principle of statutory construction that a statute dealing with a narrow, precise, and specific subject is not submerged by a later enacted statute covering a more generalized spectrum."<sup>101</sup> The court found that the removal provision of the Securities Act was "the more specific statute" because it "applie[d] to the narrow subject of securities cases."<sup>102</sup> CAFA, "on the other hand, appli[ed] to a 'generalized spectrum' of class actions." Without explaining how the court identified the more specific of the two statutes, the Ninth Circuit concluded that the "narrow, precise, and specific. . . [Securities Act] [was] not submerged by later enacted [CAFA]."<sup>103</sup>

Earlier in the decision, the court noted that "[i]n general, removal statutes are strictly construed against removal. . . and any doubt is

---

<sup>96</sup> *Id.*

<sup>97</sup> *Id.* at 1033–34.

<sup>98</sup> *Id.* at 1034.

<sup>99</sup> *Id.* (citing Pub. L. No. 109-2).

<sup>100</sup> *Id.* at 1033–34.

<sup>101</sup> *Id.* at 1034 (citing *Radzanower v. Touche Ross & Co*, 426 U.S. 148, 153 (1976)).

<sup>102</sup> *Id.*

<sup>103</sup> *Id.*

resolved against removability."<sup>104</sup> But the court did not make clear whether it applied this doubt-resolving canon to conclude that "by virtue of. . .the Securities Act,. . .Luther's state court class action alleging only violations of the Securities Act. . .was not removable."<sup>105</sup>

### III. THE SEVENTH CIRCUIT HOLDS THAT THE SECURITIES ACT DOES NOT BAR REMOVAL OF CLASS ACTIONS ALLEGING VIOLATIONS OF THE SECURITIES ACT WITH RESPECT TO NON-PUBLICLY TRADED SECURITIES

In *Katz v. Gerardi*, the Seventh Circuit disagreed with the *Luther* court<sup>106</sup> and the district court,<sup>107</sup> which had adopted the reasoning of *Luther*.<sup>108</sup> Because the court's holding conflicted with the Ninth Circuit's decision in *Luther*,<sup>109</sup> Judge Easterbrook's opinion was circulated before release to all judges in active service; none of the judges favored a hearing *en banc*.<sup>110</sup>

#### A. Facts and Procedural History

The case began on May 9, 2008, when Jack P. Katz ("Katz") filed a class action lawsuit in the Circuit Court of Cook County, Illinois, alleging violations of the Securities Act with respect non-publicly traded securities.<sup>111</sup> The nature of the securities at issue is relative complex. Originally, Katz and other class members had contributed real estate (or interests in real estate) to the Archstone-Smith Operating

---

<sup>104</sup> *Id.* (citing *Shamrock Oil & Gas Corp. v. Sheets*, 313 U.S. 100, 108-09 (1941); *Gaus v. Miles, Inc.*, 980 F.2d 564, 566 (9th Cir. 1992)).

<sup>105</sup> *Id.*

<sup>106</sup> *Id.* at 1033-34.

<sup>107</sup> *Katz v. Gerardi*, No. 1:08cv04035, 2008 WL 4376815, at \*4-\*5 (N.D. Ill. Sept. 23, 2008) (citing *Luther v. Countrywide Home Loans Servicing*, No. 2:07-CV-08165-MRP(MANx), 2008 U.S. Dist. LEXIS 26534, at \*6-\*7 (C.D. Cal. Feb. 28, 2008)).

<sup>108</sup> *Katz v. Gerardi*, 552 F.3d 558, 563 (7th Cir. 2009).

<sup>109</sup> *Luther*, 533 F.3d at 1033-34.

<sup>110</sup> *Katz*, 552 F.3d at 562.

<sup>111</sup> *Katz*, 2008 WL 4376815, at \*1.

Trust or its predecessor, Charles E. Smith Residential Realty L.P.<sup>112</sup> In exchange, they received limited partnership interests in the Archstone-Smith Operating Trust.<sup>113</sup> The general partner in the Archstone-Smith Operating Trust was the Archstone-Smith Trust, both a publicly traded corporation and a Real Estate Investment Trust ("REIT.")<sup>114</sup>

By having a REIT as a general partner, limited partnerships, such as the Archstone-Smith Operating Trust, gain the status of an Umbrella Real Estate Investment Trust ("UPREIT").<sup>115</sup> Archstone REIT, like the Archstone UPREIT, "engaged primarily in the acquisition, development, redevelopment, operations and long-term ownership of apartment communities in the United States."<sup>116</sup> Together, they "owned or had an ownership position in 348 communities, representing 88,011 [apartments]."<sup>117</sup>

By contributing real estate to the Archstone UPREIT as opposed to the Archstone REIT, plaintiffs not only received limited partnership interests in the entity, but also gained significant tax and liquidity advantages.<sup>118</sup> Contributions of property to a REIT are taxable in the amount equal to the excess of the value of the stock received over the basis of the property contributed.<sup>119</sup> By contributing real estate to the Archstone UPREIT, plaintiffs received tax-deferred treatment of the transactions, avoiding tax liability.<sup>120</sup> They also enjoyed liquidity of their limited partnership interests. Although A-1 Units were not traded publicly, plaintiffs could convert them into the common stock of

---

<sup>112</sup> *Id.*

<sup>113</sup> *Id.*

<sup>114</sup> Complaint ¶ 45, *Katz v. Gerardi*, No. 08CH17172 (Ill. Cir. Ct. Cook County May 9, 2008).

<sup>115</sup> *Id.* at ¶ 40.

<sup>116</sup> *Id.* at ¶ 46.

<sup>117</sup> *Id.* at ¶ 46.

<sup>118</sup> *Id.* at ¶ 49.

<sup>119</sup> *Id.* at ¶¶ 21, 39.

<sup>120</sup> *Id.* at ¶ 7.

Archstone REIT, which was publicly traded on the New York Stock exchange.<sup>121</sup>

Katz argued that the holders of A-1 Units lost both tax and liquidity advantages because of a subsequent merger between the Archstone UPRET and the Archstone REIT with the Tishman-Lehman Partnership, a partnership sponsored by Tishman Speyer and Lehman Brothers Holdings.<sup>122</sup> The merger led to the registration and issuance of new securities, Series O Preferred Units.<sup>123</sup> Holders of the old securities could exchange their A-1 Units for Series O Preferred Units or sell them for cash.<sup>124</sup> Katz chose the latter option.<sup>125</sup> But he argued that by accepting the cash offer, he lost the tax benefits he had expected when contributing real estate to the Archstone UPREIT and, together with other A-1 Unit holders, incurred capital gains that had "resulted in millions of dollars of tax" liability.<sup>126</sup> Further, Katz argued that if the holders had converted their A-1 units into Series O Preferred Units, they would have forfeited their liquidity advantages because Series O units were not going to be publicly traded for at least five years after the merger.<sup>127</sup>

Thus, Katz filed a class action lawsuit against the Archstone UPREIT, Archstone REIT, the directors and trustees of Archstone REIT, as well as Tishman Speyer and Lehman Brothers Holdings alleging violations of the Securities Act with respect to the Series O Preferred Units, which were, at least initially, non-publicly traded securities. According to the plaintiff, "the Prospectus and Registration statement issued pursuant to the merger agreement contained false and

---

<sup>121</sup> *Id.* at ¶ 47.

<sup>122</sup> *Id.* at ¶¶ 8, 9, 59, 75.

<sup>123</sup> *Katz v. Gerardi*, 552 F.3d 558, 563 (7th Cir. 2009).

<sup>124</sup> Complaint ¶¶ 7, 8, 67, *Katz v. Gerardi*, No. 08CH17172 (Ill. Cir. Ct. Cook County May 9, 2008).

<sup>125</sup> *Id.* at ¶ 7.

<sup>126</sup> *Id.*

<sup>127</sup> *Id.* at ¶ 8.

misleading information about the merger."<sup>128</sup> Additionally, the transactions "resulting in the A-1 unit holders exchanging their A-1 units for cash and/or new securities were solicited through false and misleading prospectuses and the securities were issued by way of a materially false and misleading registration statement."<sup>129</sup> Thus, plaintiff based his claims on §§ 11,<sup>130</sup> 12(a)(2),<sup>131</sup> and 15<sup>132</sup> of the Securities.<sup>133</sup>

On July 16, 2008, defendant removed Katz's class action to federal court, the United States District Court for the Northern District of Illinois.<sup>134</sup> A few days later, on July 23, 2008, Katz filed a motion to remand the case to state court.<sup>135</sup>

### *B. Decision of the District Court*

On September 23, 2008, the United States District Court granted the motion to remand the case to state court.<sup>136</sup> First, the court considered whether the Securities Act applied to the case at bar.<sup>137</sup> The defendants argued it did not because even though Katz "ha[d] cast his claims as arising under the [Securities] Act, he [did] not have a viable claim under the [statute]."<sup>138</sup> To maintain a claim under the Securities

---

<sup>128</sup> Katz v. Gerardi, No. 1:08cv04035, 2008 WL 4376815, at \*1 (N.D. Ill. Sept. 23, 2008).

<sup>129</sup> Complaint ¶ 10, Katz v. Gerardi, No. 08CH17172 (Ill. Cir. Ct. Cook County May 9, 2008).

<sup>130</sup> 15 U.S.C. § 77k.

<sup>131</sup> *Id.* at § 77l(a)(2).

<sup>132</sup> *Id.* at § 77o.

<sup>133</sup> Complaint ¶ 11, Katz v. Gerardi, No. 08CH17172 (Ill. Cir. Ct. Cook County May 9, 2008).

<sup>134</sup> Notice of Removal, Katz v. Gerardi, No. 1:08cv04035, 2008 WL 4376815 (July 16, 2008).

<sup>135</sup> Plaintiff's Motion to Remand, Katz v. Gerardi, No. 1:08cv04035, 2008 WL 4376815 (July 23, 2008).

<sup>136</sup> *Katz*, 2008 WL 4376815, at \*5.

<sup>137</sup> *Id.* at \*3-4.

<sup>138</sup> *Id.* at \*3 n.3.

Act, "[a person] must be a purchaser or acquiror of securities."<sup>139</sup> Because Katz received cash for his A-1 units, defendants argued, he "neither 'acquired' nor 'purchased a 'security' as required in those provisions."<sup>140</sup> Katz disagreed, arguing that he was a purchaser of securities because "his A-1 shares were effectively changed by the merger into A-1 Units with inferior economic rights."<sup>141</sup> Although the court "[did] not. . . find Katz's argument factually persuasive," it concluded that the "the state court [was] the proper forum for the alleged claims to be determined. . . even if. . . Katz alleged. . . claims under the [Securities] Act to avoid removal under [the Securities Act]."<sup>142</sup>

The court's conclusion that the state court was the proper forum for the securities class action at bar was based on *Luther*.<sup>143</sup> The court found persuasive the Ninth Circuit's reliance on the canon of statutory construction favoring specific statutes over general statutes.<sup>144</sup> Thus, like the *Luther* court, the district court concluded that "Section 22(a), the more specific statute governing securities actions, control[led] this situation, not the CAFA, which generally governs large class actions."<sup>145</sup> Accordingly, the court remanded the class action to state court.<sup>146</sup>

On October 6, 2008, the defendants filed a petition for permission to appeal pursuant to CAFA,<sup>147</sup> and the Seventh Circuit granted their petition.<sup>148</sup>

---

<sup>139</sup> *Id.* at \*3.

<sup>140</sup> *Id.*

<sup>141</sup> *Id.*

<sup>142</sup> *Id.* at \*4.

<sup>143</sup> *Id.*

<sup>144</sup> *Id.*

<sup>145</sup> *Id.*

<sup>146</sup> *Id.* at \*5.

<sup>147</sup> Petition for Permission to Appeal, *Katz v. Gerardi*, 552 F.3d 558 (Oct. 6, 2008). CAFA provides for discretionary appellate review of district court orders granting or denying motions for remand. *See* 28 U.S.C. § 1453(c)(1)

<sup>148</sup> *Katz v. Gerardi*, 552 F.3d 558, 563 (7th Cir. 2009).

### C. Seventh Circuit's Decision

On January 5, 2009, the Seventh Circuit reversed the district court's order to remand Katz's class action.<sup>149</sup> The Seventh Circuit disagreed with the district court's conclusion that plaintiff can foreclose removal simply by invoking the Securities Act.<sup>150</sup> Writing for the panel, Judge Easterbrook noted that "it cannot be right to say that a pleader's choice of language always defeats removal."<sup>151</sup> As defendants pointed out, "[o]nly purchasers of securities may pursue [private] actions under the [Securities] Act."<sup>152</sup> Because "Katz (and other members of his class) sold securities for cash. . . he did not buy any new security."<sup>153</sup> Thus, Katz did not necessarily have a private right of action under the Securities Act.<sup>154</sup> But the Seventh Circuit then concluded "it [was] possible for a private party to suffer an injury covered by the securities laws even though there is no private right of action."<sup>155</sup>

Because "it was best to assume that Katz's complaint [was] not *just* artful pleading," the court considered whether the Securities Act "insulated" all claims under the Securities Act from removal under CAFA.<sup>156</sup> The Seventh Circuit acknowledged that CAFA and the Securities Act were "incompatible; one or the other had to yield."<sup>157</sup> To determine which of the statutes had to yield, the court turned to the

---

<sup>149</sup> *Id.* at 563.

<sup>150</sup> *Id.* at 560. The court was responding to the district court's statement that "the state court [was] the proper forum for the alleged claims to be determined. . . *even if*. . . Katz alleged. . . claims under the [Securities] Act to avoid removal under [the Securities Act]." *Katz*, 2008 WL 4376815, at \*4.

<sup>151</sup> *Katz*, 552 F.3d at 560.

<sup>152</sup> *Id.*

<sup>153</sup> *Id.*

<sup>154</sup> *See id.* at 561.

<sup>155</sup> *Id.*

<sup>156</sup> *Id.*

<sup>157</sup> *Id.*

canons of statutory construction.<sup>158</sup> Among such canons is the principle that “the older law *yields* to the newer.”<sup>159</sup> But “Luther [held] that things are otherwise for [the Securities Act] because. . .an older law *maintains its vitality* when it is more specific than a newer one.”<sup>160</sup>

The Seventh Circuit disagreed, noting that “canon favoring preservation of specific statutes arguably affected by newer, more general statutes works [*only*] when one statute is a *subset* of the other.”<sup>161</sup> But—as Luther “failed to recognize”—the Securities Act was not a subset of CAFA.<sup>162</sup> Therefore, the court could not apply the canon favoring the specific law over general because it could not determine whether the Securities Act is more specific or more general than CAFA.<sup>163</sup> The removal provision of the Securities Act “covers only securities actions, but it includes. . .single-investor suits as well as class actions[;]. . .[CAFA], by contrast, covers only large, multi-state class actions.” Therefore, there [was] no answer to. . .a question [of whether] the [Securities] Act was more specific because it dealt only with securities law, or CAFA was more specific because it dealt only nationwide class actions.”<sup>164</sup>

Even though the canon did not aid the court's statutory interpretation, the language of CAFA “told” the court how the new removal rule applied to securities actions. Section § 1453(b) provides:

[I]n 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, except that such action may be

---

<sup>158</sup> *Id.* (emphasis added).

<sup>159</sup> *Id.* (emphasis added).

<sup>160</sup> *Id.* (emphasis added).

<sup>161</sup> *Id.* at 561–62.

<sup>162</sup> *Id.*

<sup>163</sup> *Id.*

<sup>164</sup> *Katz*, 552 *F.3d* at 561–62.*Id.*

removed by any defendant without the consent of all defendants.<sup>165</sup>

Thus, the court concluded that § 1453(b) “allows removal of any class action brought within federal jurisdiction.”<sup>166</sup> Next, the court analyzed § 1453(d), which contains the list of exceptions to applicability of the CAFA removal provision:

*This section shall not apply to any class action that solely involves (1) a claim concerning a covered security. . .; (2) a claim that relates to the internal affairs or governance of a corporation. . .; or (3) a claim that relates to the rights, duties. . ., and obligations relating to. . .any security.*<sup>167</sup>

According to the Seventh Circuit, “claims listed in this list are not removable. Other securities class actions are removable if they meet CAFA requirements.”<sup>168</sup> To read § 22(a) as barring removal of a class action not involving a claim listed in § 1453(d), as plaintiff suggests, “would be to make most of § 1453(d) pointless.”<sup>169</sup> Because § 1453(d) “left *no doubt* about how the [Securities] Act. . .and CAFA fit together,” the court found no reason to use doubt-resolving canons of statutory construction.<sup>170</sup>

Although the Seventh Circuit had “no doubt” that the Securities Act did not bar removal of class actions alleging violations of the Securities with respect to non-covered securities, the court noted that “there was some *incongruity* in removing a securities action under

---

<sup>165</sup> 28 U.S.C. § 1453(b); JOSEPH M. McLAUGHLIN, McLAUGHLIN ON CLASS ACTIONS § 12:6 (2008).

<sup>166</sup> *Katz*, 552 F.3d at 562 (citing 28 U.S.C. § 1453(b)).

<sup>167</sup> *Id.* (citing 28 U.S.C. § 1453(b)).

<sup>168</sup> *Id.*

<sup>169</sup> *Id.*

<sup>170</sup> *Id.*

[CAFA].”<sup>171</sup> The “incongruity” arose from the fact CAFA created a “species of *diversity-of-citizenship* jurisdiction,” but it permitted removal of claims—such as class actions alleging violations of the Securities Act—over which federal courts have federal question jurisdiction.<sup>172</sup> Despite such “incongruity,” the court concluded, “both the principal [CAFA] removal rule and [its] exceptions show[ed] that [CAFA] applies to claims that arise under federal law (provided that minimal diversity is present).”<sup>173</sup>

Finally, the court considered whether § 1453(d) exceptions prevented removal of Katz's class action.<sup>174</sup> First, the court concluded that the A-1 Unites in Archstone were not “covered securities” because they did not trade nationally; therefore, § 1453(d)(1) exception did not apply.<sup>175</sup> Second, Katz did not characterize his claim as dealing with corporate internal affairs; therefore, § 1453(d)(2) did not apply.<sup>176</sup> Finally, § 1453(d)(3) exempts from operation of CAFA claims relating “to the rights, duties. . . , and obligations relating to. . . any security.”<sup>177</sup> The parties disagreed as to whether § 1453(d)(3) applied, and the court remanded the case to the district court for a hearing at which the parties could “elaborate on their positions.”<sup>178</sup> The Seventh Circuit noted that unless § 1453(d)(3) prevented removal under CAFA, the defendants removal of Katz's class action alleging violations of the Securities Act with respect to non-publicly traded securities was proper under CAFA, and the district court had to decide the case on its merits.<sup>179</sup>

---

<sup>171</sup> *Id.*

<sup>172</sup> *Id.*

<sup>173</sup> *Id.*

<sup>174</sup> *Id.* at 562–63.

<sup>175</sup> *Id.*

<sup>176</sup> *Id.*

<sup>177</sup> *Id.*

<sup>178</sup> *Id.* at 563.

<sup>179</sup> *Id.*

#### IV. SEVENTH CIRCUIT RESOLVES CORRECTLY THE CONFLICT BETWEEN REMOVAL PROVISION OF CAFA AND THE SECURITIES ACT

In *Katz v. Gerardi*,<sup>180</sup> the Seventh Circuit decided correctly that the Securities Act does not bar removal of class actions alleging violations of the Securities Act with respect to non-publicly traded securities. The United States Supreme Court has held repeatedly that “[t]he starting point for interpretation of a statute ‘is the language of the statute itself.’”<sup>181</sup> Thus, the Seventh Circuit was correct to both analyze the language of the CAFA removal provision and to criticize *Luther* for failing to “analyze this language or even acknowledge its existence.”<sup>182</sup>

But, when interpreting the statute, the duty of the court is to “find [an] interpretation [that] can most fairly be said to be imbedded in the statute, in the sense of being most harmonious with its *scheme and with the general purposes* that Congress manifested.”<sup>183</sup> Accordingly, courts consider the legislative history of the statute to clarify or confirm understanding of the statutory language.<sup>184</sup> When determining whether the Securities Act bars removal of class actions alleging violations of the Securities Act with respect to non-publicly traded

---

<sup>180</sup> *Id.*

<sup>181</sup> *Kaiser Aluminum & Chemical Corp. v. Bonjorno*, 494 U.S. 827, 835 (1990) (quoting *Consumer Product Safety Commission v. GTE Sylvania, Inc.*, 447 U.S. 102, 108 (1980)).

<sup>182</sup> *Katz*, 552 F.3d at 562.

<sup>183</sup> *C.I.R. v. Engle*, 464 U.S. 206, 217 (1984) (citing *NLRB v. Lion Oil Co.*, 352 U.S. 282, 297 (1957) (Frankfurter, J., concurring in part and dissenting in part) (emphasis added)).

<sup>184</sup> *See e.g., Vermilya-Brown Co. v. Connell*, 335 U.S. 377, 386 (1948) (noting that “words generally have different shades of meaning, and are to be construed if reasonably possible to effectuate intent of lawmakers and meaning in particular instances is to be arrived at not only by consideration of words themselves but by considering context [and] purposes of law”); *United States v. Choice*, 201 F.3d 837, 841 (6th Cir. 2000) (explaining that the plain language of the statute is the starting point for statutory interpretation, but that the structure and language of the statute as a whole can aid in interpreting the plain meaning and that legislative history can be looked to if the statutory language is unclear).

securities, neither *Katz* nor *Luther* considered adequately the legislative history of CAFA and the Securities Act. The Seventh Circuit was silent on CAFA's legislative purpose. The district court and the Ninth Circuit in *Luther* appeared to recognize the importance of legislative history.<sup>185</sup> But their analysis of Congress's purposes for the enactment of CAFA was incomplete: the courts discussed only the reasons for expansion of federal court jurisdiction over class actions, not the purposes behind the CAFA removal provision.<sup>186</sup>

An in-depth look at the legislative purpose behind the enactment of the CAFA removal provision reveals that it is best served by holding—as the Seventh Circuit did in *Katz v. Gerard*<sup>187</sup>—that the Securities Act does not bar removal of class actions alleging violations of the Securities Act with respect to non-nationally traded securities. *Luther's* approach of applying the Securities Act's removal bar to such claims, on the other hand, impedes Congress's goals. Additionally, nothing in the legislative history of the Securities Act evidences a Congressional intent to prohibit removal of *class actions* alleging violations of the Securities Act with respect to non-publicly traded securities. Therefore, the appropriate way to resolve the conflict between the removal provisions of CAFA and the Securities Act is to hold that the Securities Act does not bar removal of class actions alleging violations of the Securities Act with respect to non-nationally traded securities; thus, such claims are removable if they otherwise meet CAFA removal requirements.

### A. Legislative History of CAFA

CAFA's legislative history supports the conclusion that the Securities Act does not bar removal of class actions alleging violations of the Securities Act with respect to non-nationally traded securities.

---

<sup>185</sup> *Luther v. Countrywide Home Loans Servicing*, 533 F.3d 1031, 1034 (9th Cir. 2008); *Luther v. Countrywide Home Loans Servicing*, No. 2:07-CV-08165-MRP(MANx), 2008 U.S. Dist. LEXIS 26534, at \*7–\*8 (C.D. Cal. Feb. 28, 2008).

<sup>186</sup> *Luther*, 533 F.3d at 1034; *Luther*, 2008 U.S. Dist. LEXIS 26534, at \*7–\*8.

<sup>187</sup> *Katz*, 552 F.3d at 563.

In *Luther*, the district court indicated that Congress enacted CAFA, in part, to “make it harder for plaintiffs to. . .defeat diversity jurisdiction” in class actions.<sup>188</sup> But as the court correctly noted, even before the enactment of CAFA, federal courts had jurisdiction over cases arising under the Securities Act.<sup>189</sup> Because the Securities Act is a federal statute, claims arising under the Securities Act fall within federal question jurisdiction of the district courts.<sup>190</sup> Therefore, CAFA’s expansion of federal court diversity jurisdiction over class actions is “irrelevant” to securities class actions.<sup>191</sup>

But when enacting the CAFA removal provision, Congress sought to only expand federal courts’ jurisdiction over class actions, but also to ensure that class actions were *litigated* in federal court. Congress articulated three reasons why federal courts, not state courts, should hear these cases: (1) federal courts help protect federal interest in interstate commerce; (2) federal courts ensure compliance with appropriate litigation procedures; and (3) federal courts help avoid duplicative litigation.<sup>192</sup> These legislative goals apply to class actions alleging violations of the Securities Act with respect to non-publicly traded securities. Therefore, they are best served by holding that the Securities Act does not bar removal of class actions alleging violations of the Securities Act. On the other hand, if courts interpret the Securities Act as barring removal of class actions involving securities, these claims, unlike other class actions, cannot be litigated in federal court, thereby impeding Congress’s goals.

### 1. Protecting Federal Interest in Interstate Commerce

The United States Supreme Court has recognized that federal court is the appropriate forum for cases that have ramifications for

---

<sup>188</sup> *Luther*, 2008 U.S. Dist. LEXIS 26534, at \*6.

<sup>189</sup> *Id.* at \*8.

<sup>190</sup> 28 U.S.C. § 1441(b).

<sup>191</sup> *Luther*, 2008 U.S. Dist. LEXIS 26534, at \*8.

<sup>192</sup> Julia B. Strickland et al., *2007 Overview of the Class Action Fairness Act*, 761 PLI/Lit 11, at \*15–\*16 (2007).

interstate commerce: the Court has “frequently had occasion to show. . . the existence of federal supervision over interstate commerce, and the consequent obligation upon the federal courts to protect that right of control from encroachment on the part of the states.”<sup>193</sup> Congress believed that class actions have “significant implications for the national economy.”<sup>194</sup> As the Ninth Circuit noted—but seemed to ignore when remanding Luther's claim to state court—Congress enacted CAFA, in part, to “restore the intent of the framers of the United States Constitution by providing for Federal court consideration of *interstate cases of national importance* under diversity jurisdiction.”<sup>195</sup> Congress understood that class actions “usually involve large amounts of money and many plaintiffs.”<sup>196</sup> Further, there is a “growing trend. . . to bring huge class actions on behalf of hundreds of thousands or even millions of [plaintiffs].”<sup>197</sup> Therefore, Congress concluded that “the federal courts are the appropriate forums to decide most interstate class actions.”<sup>198</sup>

These concerns resonate with class actions alleging violations of the Securities Act with respect to non-nationally traded securities. First, these cases have significant ramifications for interstate commerce. The United States Supreme Court has acknowledged that “private securities litigation [is] an indispensable tool with which defrauded investors can recover their losses.”<sup>199</sup> Recent state court filings of class actions alleging violations of the Securities Act with respect to non-publicly traded securities “involve large amounts of money and many plaintiffs.” *Katz v. Gerardi* involved “hundreds, if

---

<sup>193</sup> New York, L E & W R Co v. Com. of Pennsylvania, 158 U.S. 431, 437 (1895).

<sup>194</sup> S. REP. NO. 109-14, at 11 (2005).

<sup>195</sup> Luther v. Countrywide Home Loans Servicing, 533 F.3d 1031, 1034 (9th Cir. 2008) (citing Pub. L. No. 109-2).

<sup>196</sup> S. REP. NO. 109-14, at 27(2005).

<sup>197</sup> *Id.*

<sup>198</sup> *Id.*

<sup>199</sup> Merrill Lynch v. Dabit, 547 U.S. 71, 81 (2006).

not thousands of similarly situated A-1 Unit holders”<sup>200</sup> seeking, at minimum, “rescissory damages for their exchange[s]” of A-1 Units for \$60.75 each.<sup>201</sup> In *Suffolk v. Plumbers' Union Local No. 12 Pension Fund*, a class action filed in state court and alleging violations of the Securities Act with respect to non-publicly traded securities, “plaintiff believe[d] that there [were] thousands members in the proposed Class,”<sup>202</sup> all seeking rescissory damages.<sup>203</sup> Thus, class actions alleging violations of the Securities Act with respect to non-publicly traded securities have significant ramifications for interstate commerce and, therefore, fall within the category of cases that Congress intended for federal, not state courts, to hear. Therefore, the Congress's goal of protecting the federal interest in interstate commerce is best served by holding that the Securities Act does not bar removal of class action alleging violations of the Securities Act with respect to non-publicly traded securities.

## 2. Ensuring Compliance with Proper Litigation Procedures

Another reason for the enactment of the CAFA removal provision was to “minimize the class action abuses taking place in state courts.”<sup>204</sup> More specifically, Congress noted that federal court judges “were [more] careful than [some of] their state court counterparts about applying the procedural requirements that govern class actions.”<sup>205</sup> Thus, Congress enacted CAFA to remedy state courts'

---

<sup>200</sup> Complaint ¶ 89, *Katz v. Gerardi*, No. 08CH17172 (Ill. Cir. Ct. Cook County, Ill. May 9, 2008).

<sup>201</sup> Complaint ¶ 113, *Katz*, No. 08CH17172 (Ill. Cir. Ct. Cook County May 9, 2008).

<sup>202</sup> Complaint ¶ 26, *Suffolk v. Plumbers' Union Local No. 12*, No. 08-0544-BLS (Mass. Super. Ct. Jan. 31, 2008).

<sup>203</sup> Complaint at ¶¶ 27–28, *Suffolk v. Plumbers' Union Local No. 12*, No. 08-0544-BLS (Mass. Super. Ct. Jan. 31, 2008).

<sup>204</sup> S. REP. NO. 109-14, at 27 (2005).

<sup>205</sup> *Id.* at 14.

“often inadequate supervision over [class action] litigation procedures.”<sup>206</sup>

There are two levels of concern with respect to litigation procedures for class actions alleging violations of the Securities Act with respect to non-publicly traded securities. First, because of the large number of parties, which, oftentimes are citizens of different states, state courts understandably may have difficulty ensuring “inadequate supervision over litigation procedures” in these cases.<sup>207</sup>

The second concern with respect to litigation procedures in securities class actions is that state courts do not have power to enforce heightened procedural requirements that Congress enacted in 1995 specifically for securities class actions.<sup>208</sup> That year, Congress found that plaintiffs had been abusing the Securities Act to bring meritless claims “to harass and cajole settlements out of businesses that had done nothing wrong.”<sup>209</sup> Therefore, existing litigation procedures—even if adequately supervised—were insufficient to thwart plaintiffs’ abuse of securities class actions.<sup>210</sup>

To remedy the problem, Congress enacted the Private Securities Litigation Reform Act (“PSLRA”), creating new procedures for “private action arising under [the Securities Act] brought as a plaintiff class action pursuant to the Federal Rules of Civil Procedure.”<sup>211</sup> The PSLRA imposed heightened procedural requirements for many aspects of securities class action litigation, including certification of a class representative,<sup>212</sup> appointment of lead plaintiff,<sup>213</sup> notices to plaintiffs,

---

<sup>206</sup> S. REP. NO. 109-14, *Id.* at 4 (2005).

<sup>207</sup> Complaint ¶¶ 12–33, *Katz v. Gerardi*, No. 08CH17172 (Ill. Cir. Ct. Cook County May 9, 2008).

<sup>208</sup> 15 U.S.C. § 77z-1.

<sup>209</sup> STATE COURT SECURITIES CASES: PREEMPTION AND STAYS OF DISCOVERY UNDER THE SECURITIES LITIGATION UNIFORM STANDARDS ACT 830 (Am. Law Inst. 2004).

<sup>210</sup> *Id.*

<sup>211</sup> 15 U.S.C. § 77z-1 (emphasis added); see 14 WILLIAM MEADE FLETCHER, FLETCHER CYCLOPEDIA OF THE LAW OF CORPORATIONS § 6831.50 (2008).

<sup>212</sup> 15 U.S.C. § 77z-1(a)(2).

<sup>213</sup> *Id.* at § 77z-1(a)(3).

recovery by plaintiffs,<sup>214</sup> discovery rules,<sup>215</sup> sanctions for abusive litigation,<sup>216</sup> and defendant's right to written interrogatories.<sup>217</sup> To prevent abuses of the securities class action scheme, Congress raised the standard for adequacy threshold for class representatives in securities fraud class litigation and required certification by each named plaintiff of knowledge of and accuracy of the complaint.<sup>218</sup> Further, the PSLRA dictated that “all discovery. . . be stayed during the pendency of any motion to dismiss.”<sup>219</sup> It also required that notice to class members of a proposed settlement specify the average amount of damages per share and the attorney fee award sought, and in some cases, even limited plaintiff's recovery to his or her pro rate share.<sup>220</sup> Because the PSLRA applies only to claims filed “pursuant to the Federal Rules of Civil Procedure,”<sup>221</sup> state courts do not have power to enforce these requirements. But if class actions alleging violations of the Securities Act with respect to non-publicly traded securities are removable to federal court, class action plaintiffs would have to comply with these heightened standards. Therefore, by holding that the Securities Act does not bar removal of class action alleging violations of the Securities Act with respect to non-publicly traded securities—the Seventh Circuit's holding in *Katz*<sup>222</sup>—would further Congress's goal of preventing abusive securities class actions. Additionally, it would further Congress's purpose behind the enactment of CAFA: inadequate supervision of other litigation procedures with respect to class actions. On the other hand, a holding

---

<sup>214</sup> *Id.* at § 77z-1(a)(4).

<sup>215</sup> *Id.* at § 77z-1(b).

<sup>216</sup> *Id.* at § 77z-1(c).

<sup>217</sup> *Id.* at § 77z-1(d).

<sup>218</sup> *Id.* at § 77z-1(a)(2).

<sup>219</sup> *Id.* at § 77z-1(b)(1).

<sup>220</sup> 14 WILLIAM MEADE FLETCHER, FLETCHER CYCLOPEDIA OF THE LAW OF CORPORATIONS § 6866.10 (2008).

<sup>221</sup> 15 U.S.C § 77z-1.

<sup>222</sup> *Katz v. Gerardi*, 552 F.3d 558, 563 (7th Cir. 2009).

to the contrary—like the Ninth Circuit's holding in *Luther*<sup>223</sup>—would impede both Congressional goals.

### 3. Avoiding Duplicate Claims

Finally, by enacting the CAFA removal provision, Congress sought to prevent plaintiffs from filing duplicative claims. These filings of “expensive and predatory copy-cat cases” were possible because state courts do not have a mechanism to consolidate these cases.<sup>224</sup> Therefore, plaintiffs could “force defendants to litigate the same case in multiple jurisdictions, driving up consumer costs.”<sup>225</sup> But 2005—the time of the enactment of CAFA—was not the first time Congress expressed concern with the filing of parallel claims.

Seven years earlier, Congress acknowledged that the filing of parallel securities class actions became an issue in private securities litigation after the enactment of the PSLRA.<sup>226</sup> The PSLRA, among other things, imposed a discovery stay during pending motions to dismiss.<sup>227</sup> To avoid such a federal discovery stay, plaintiffs pursued initial stages of litigation in state courts.<sup>228</sup> In 1998, Congress attempted to curb the filing of parallel class actions claims alleging

---

<sup>223</sup> *Luther v. Countrywide Home Loans Servicing*, 533 F.3d 1031, 1034 (9th Cir. 2008).

<sup>224</sup> S. REP. NO. 109-14, at 15 (2005).

<sup>225</sup> *Id.*

<sup>226</sup> Gareth T. Evans, *The 1998 Securities Litigation Uniform Standards Act (SLUSA) and Discovery in Parallel State Court Actions*, PLI § 4:6.1 (2006); H.R. REP. NO. 105-640, at \*10–\*11 (1998).

<sup>227</sup> 15 U.S.C. § 77z-1(b).

<sup>228</sup> *Ten Things We Know & Ten Things We Don't Know About the Private Securities Litigation Reform Act of 1995: Hearing Before the Subcommittee on Securities of the Committee on Banking, Housing, and Urban Affairs* (1997) (joint written testimony of Joseph A. Grundfest and Michael A. Perino). Although there could be unrelated reasons for plaintiffs to seek state courts, commentators have largely discounted those. *A Census of Securities Class Action Litigation After the Private Securities Litigation Reform Act of 1995: Hearing Before the S. Subcomm. on Securities of the Committee on Banking, Housing, and Urban Affairs* (1997) (written testimony of Michael A. Perino).

violations of the Securities Act by enacting the Securities Litigation Uniform Standards Act (“SLUSA”), an exception to the Securities Act’s removal ban for claims arising under the Securities Act. But because of the narrow scope of the SLUSA exception—which some commentators have suggested was a “drafting blunder”<sup>229</sup>—plaintiff continued filing parallel claims. In *Katz*, for example, plaintiffs filed claims in both the Circuit Court of Cook County, an Illinois state court, and the United States District Court for the District of Colorado, a federal court.<sup>230</sup> In fact, in *Katz*, plaintiff “candidly admit[ed]. . . that. . . a nearly-identical [suit]. . . filed on behalf of the *same* putative plaintiff class against the *same* defendants and based on the *same* facts. . . ha[d] been pending for months. . . [in the] District of Colorado.”<sup>231</sup>

The fact that Congress voiced concern over duplicative filing of class actions again in 2005 demonstrates that it remained unsatisfied with SLUSA’s failure to remedy the problem with respect to securities class actions. To advance Congress’s goal courts should hold that the Securities Act does not bar removal of class action alleging violations of the Securities Act with respect to non-publicly traded securities. A holding to the contrary would inhibit the goal that Congress has repeatedly stated it wanted to achieve. Accordingly, not only the language, but also the legislative history of CAFA supports the Seventh Circuit’s conclusion that the Securities Act does not bar removal of class actions alleging violations of the Securities Act with respect to non-publicly traded securities.

### *B. The Securities Act Did Not Contemplate Class Actions*

Holding that the Securities act does not bar removal of class actions alleging violations of the Securities Act is not inconsistent with

---

<sup>229</sup> Harold S. Bloomenthal, *Securities Litigation – Up Close and Personal* (pt. 2), 31 No. 2 Securities and Federal Corporate Law Report 1 (2009).

<sup>230</sup> *Stender v. Gerardi*, No. 1:07-cv-02503-EWN-MJW (D. Colo. filed Dec. 30, 2007).

<sup>231</sup> Reply in Support of Motion to Transfer at 1, *Katz v. Gerardi*, No. 08CH17172 (Ill. Cir. Ct. Cook County, Ill. Aug. 6, 2008).

the Securities Act. Congress enacted the Securities Act's removal ban in 1933, at the time when the class actions did not yet exist. The Federal Rule of Civil Procedure rule governing federal court class actions<sup>232</sup> was adopted in 1938.<sup>233</sup> But, even after the adoption of that rule, class action lawsuits were serving primarily as tools for civil rights litigants seeking injunctions in discrimination cases.<sup>234</sup> Although in the 1980s, class actions expanded to mass torts,<sup>235</sup> the concept of securities class actions "that are a familiar part of today's legal landscape [of securities law] did not arise until 1996."<sup>236</sup> At that time, Federal Rule of Civil Procedure 23 was "substantially amended to expand the availability of the device."<sup>237</sup> Thus, as the history of class actions indicates, Congress could not have intended to prohibit removal of securities class actions when enacting the removal provision of the Securities Act. Accordingly, holding that the Securities Act does not bar removal of class actions alleging violations of the Securities Act with respect to non-publicly traded securities is not inconsistent with the Securities Act.

#### CONCLUSION

In *Katz v. Gerardi*, the Seventh Circuit correctly concluded that the Securities Act does not bar removal of class actions alleging violations of the Securities Act with respect to non-publicly traded securities.<sup>238</sup> Therefore, defendants can remove class actions alleging violations of the Securities Act with respect to non-publicly traded securities on the basis of the general removal provision, 28 U.S.C. § 1441, and the CAFA removal provision, 28 U.S.C. § 1453(b).

---

<sup>232</sup> FED. R. CIV. P. 23.

<sup>233</sup> See also S. REP. NO. 109-14, at 6 (2005).

<sup>234</sup> *Id.*

<sup>235</sup> *Id.*

<sup>236</sup> *Id.*

<sup>237</sup> *Id.*

<sup>238</sup> *Katz v. Gerardi*, 552 F.3d 558, 563 (7th Cir. 2009).

Further, for a removal under CAFA to be proper, defendants must comply with the removal procedures of 28 U.S.C. § 1446.<sup>239</sup>

Permitting removal of class actions alleging violations of the Securities Act with respect to non-publicly traded securities, such as mortgage-backed securities, is consistent with the language and the legislative history of the Class Action Fairness Act. Further, providing a federal forum for these claims advances important public policy goals. It strikes the appropriate balance between ensuring that (1) “defrauded investors [can] recover their losses” from purchases of non-publicly traded securities where issuers violated the Securities Act; (2) both plaintiffs and defendants follow appropriate litigation procedures; (3) defendants do not suffer an unfair burden by having to defend duplicative litigation in several courts; and (4) the federal interest in interstate commerce is protected by having the federal court hear these claims. In sum, holding that the Securities Act does not bar removal of class actions alleging violations of the Securities Act with respect to non-publicly traded securities helps create a “fair [non-publicly traded] share.”

---

<sup>239</sup> See 28 U.S.C. § 1453(b).