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California Court of Appeal Holds That State Courts Have Jurisdiction Over Securities Act Class Actions Unless the Action Is a "Covered Class Action" and Involves a "Covered Security" Under SLUSA

In *Luther v. Countrywide Financial Corp.*, No. B222889, 2011 WL 1879242 (Cal. App. 2d Dist. May 18, 2011), the California Court of Appeal for the Second District reversed the dismissal of a class action asserting a claim under Section 11 of the Securities Act of 1933 ("Securities Act"), 15 U.S.C. § 77k. The trial court had sustained a demurrer on the ground that the court lacked jurisdiction by operation of the federal Securities Litigation Uniform Standards Act of 1998 ("SLUSA"). The Court of Appeal interpreted SLUSA to establish exclusive federal court jurisdiction only over "covered class actions" that involve a defined "covered security." Because the securities in this case did not fit within that definition, the Court held, the state court had concurrent jurisdiction over the case. The *Luther* decision draws a fine distinction in SLUSA between class actions that may be removed to federal court and class actions as to which the federal courts have exclusive jurisdiction, thereby distinguishing decisions from other jurisdictions that appeared, at least on their face, to reach a contrary conclusion.

In *Luther*, investors who had purchased mortgage-backed securities from Countrywide Financial Corporation ("Countrywide") filed a class action complaint in California Superior Court against Countrywide and certain of its officers alleging that they made false and misleading statements in registration statements and prospectus supplements related to the securities they had purchased. Plaintiffs' complaint was based exclusively on alleged violations of the Securities Act.

The Securities Act, as originally enacted, provided for concurrent jurisdiction in state and federal courts and barred removal of claims filed in state court. In 1998, in an attempt to address perceived abuses in securities class actions, Congress enacted SLUSA to, among other things, amend the Securities Act to vest federal courts with exclusive jurisdiction over certain Securities Act class actions. Defendants demurred to the complaint by invoking SLUSA, arguing that the state court lacked jurisdiction because plaintiffs' lawsuit was a "covered class action" over which the federal courts had exclusive jurisdiction. The California Superior Court for the County of Los Angeles sustained the demurrer.

The Court of Appeal reversed. The Court began by observing that in order for a class action to be subject to exclusive federal jurisdiction under SLUSA, it must be a "covered class action" *and* implicate a "covered security." To support its conclusion, the Court examined the language of Section 22(a) of the Securities Act, 15 U.S.C. § 77v(a), which

states:

> The district courts of the United States and the United States courts of any Territory shall have jurisdiction of offenses and violations under [the Securities Act] and under the rules and regulations promulgated by the Commission in respect thereto, and, concurrent with State and Territorial courts, except as provided in Section 16 [15 USC § 77p] of this title with respect to covered class actions . . . .

Applying the rules of statutory construction, the Court then noted that Section 22 (i) does not say that there is an exception to concurrent jurisdiction for all covered class actions; (ii) references Section 16 in its entirety (which requires both a "covered class action" and a "covered security" for exclusive federal jurisdiction); and, (iii) reading the statute as a whole, Section 16 specifies that a lawsuit must involve a "covered security" for it to be removable to federal court. On this basis, the Court reasoned that:

> Nothing . . . in section [16] describes this case, and . . . nothing in section [16] puts this case into the exception to the rule of concurrent jurisdiction . . . the fact that the case is not precluded and can be maintained, but cannot be removed to federal court if it is filed in state court, tells us that the state court has jurisdiction to hear the action.

Although defendants cited *dicta* from several federal district court decisions that supported their argument that all "covered class actions" are subject to exclusive federal jurisdiction (*see*, *e.g.*, *Knox v. Agria Corp.*, 613 F. Supp. 2d 419 (S.D.N.Y. 2009)), the Court of Appeal distinguished each because they all involved "covered securities" and concerned removal jurisdiction. The Court also countered by citing contrary authorities.

The Court recognized that that "SLUSA was enacted to stem the shift from federal to state courts and to prevent certain State private securities class action lawsuits alleging fraud from being used to frustrate the objectives of" the Private Securities Litigation Reform Act of 1995. Nonetheless, the Court held, "an intent to prevent certain class actions does not tell us that this class action, or all securities class actions must be brought in federal court."

In *Luther*, the parties did not dispute that the action was a "covered class action" which did not concern a "covered security." Under the Court of Appeal's interpretation of SLUSA, this was dispositive for purposes of the exclusivity of federal jurisdiction.

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