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SOUTHERN DISTRICT CIVIL PRACTICE ROUNDUP

Expert Analysis

The Outer Edge Of Edge Act Jurisdiction

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In our April column, we discussed recent limits on the scope of diversity jurisdiction set by the U.S. District Court for the Southern District of New York. Since then, the U.S. Court of Appeals for the Second Circuit, followed closely by Southern District Judge Jed S. Rakoff, have announced limits on a more obscure form of subject matter jurisdiction arising under the Edge Act, 12 U.S.C. Section 632, which provides for original and removal jurisdiction in cases involving international banking transactions by federally chartered banks or their extraterritorial subsidiaries. In *Dexia v. Bear Stearns*,[1] Rakoff, sua sponte, reversed his own earlier decision upholding Edge Act jurisdiction, after the Second Circuit called for a narrow reading of that statute's jurisdictional grant in its own recent decision in *American International Group v. Bank of America*.[2]

The Edge Act

The Edge Act dates to early in the 20th century but has recently taken on increasing prominence in post-financial crisis lawsuits involving residential mortgage-backed securities (RMBSs). Enacted in 1919 to put American banks doing business abroad on even footing with their offshore and foreign competitors, the Edge Act authorized the creation of federally chartered banking corporations to be regulated by the Federal Reserve instead of by local and state regulatory authorities. As part of the Glass-Steagall Act in 1933, Congress added Section 632 to the Edge Act—a provision intended to provide predictability and uniformity for corporations chartered under the Edge Act by conferring original and removal federal jurisdiction in certain cases involving Edge Act corporations. Specifically, Section 632 provides:

> Notwithstanding any other provision of law, all suits of a civil nature at common law or in equity to which any corporation organized under the laws of the United States shall be a party, arising out of transactions involving international or foreign banking, or banking in a dependency or insular possession of the United States, or out of other international or foreign financial operations, either directly or through the agency, ownership, or control of branches or local institutions in dependencies or insular possessions of the United States or in foreign countries, shall be deemed to arise under the laws of the United States, and the district courts of the United States shall have original jurisdiction of all such suits; and any defendant in any such suit may, at any time before the trial thereof, remove such suits from a State court into the district court of the United States for the proper district by following the procedure for the removal of causes otherwise provided by law.[3]

Although the densely layered Section 632 has been called confusing and "perhaps ambiguous,"[4] courts have consistently agreed that, in order to qualify for federal jurisdiction, a suit must (1) be civil, (2) have as a party a federally chartered Edge Act corporation, and (3) arise out of one of the three enumerated types of offshore transactions or operations.[5] Courts have generally interpreted the "arising out of" provisions broadly, finding even tenuous connections to international banking and finance sufficient.[6] Recent litigation has turned on the precise nature of the nexus required between the federally chartered party and the underlying foreign banking or financial activity for a case to qualify for Edge Act jurisdiction.

Recent RMBS Litigation

This issue came to the fore in two recent opinions from the Southern District of New York involving suits over RMBSs. In the first case, *American International Group v. Bank of America*,[7] plaintiffs sued a number of underwriters, sponsors, depositors and originators of RMBSs in state court alleging claims under the Securities Act of 1933 (which ordinarily are not removable), and various common law claims for fraud and misrepresentation. Defendants removed the case to the federal court under the Edge Act.[8]

On plaintiffs' motion to remand the case to state court, defendants argued that the suit met the requirements of Section 632 because Bank of America is a federally chartered bank and because a small proportion of the RMBSs at issue (four out of 349 RMBSs as to which claims were asserted) involved mortgages on properties in dependencies and insular possessions of the United States. Plaintiffs countered that Bank of America—the only nationally chartered entity defendant for Edge Act purposes—was not a party to any of the claims on the particular RMBSs involving territorial mortgages.

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Plaintiffs argued that the federally chartered entity must itself conduct, directly or indirectly, the foreign or territorial transactions at issue in order to support jurisdiction under the Edge Act. Southern District Judge Barbara S. Jones rejected that argument, "[un]convinced that the Edge Act requires a perfect match between the particular entity involved in the territorial transaction and the party against whom the claim is brought."[9] She found that the federally chartered corporation need not be the party that is directly connected to the foreign transactions so long as both an Edge Act entity and Edge Act transaction are present in the case. Citing the federal courts' "virtually unflagging obligation…to exercise the jurisdiction given them,"

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she denied the plaintiffs' motion to remand the case to state court.[10]

Rakoff took a similar approach in his initial decision in *Dexia*,[11] noting that of the 250,000 mortgages underlying the RMBS at issue in that case, 18 were on loans in the U.S. Virgin Islands—an insular possession of the United States. Those loans were securitized in an RMBS for which a wholly owned subsidiary of nationally chartered JPMorgan Chase Bank had acted as sponsor and seller. Citing Judge Jones' *AIG* opinion, he held that "it is irrelevant whether JPMorgan Chase Bank itself issued the mortgages in the Virgin Islands…[because] JP Morgan Chase Bank would face liability on the international banking transactions that supply jurisdiction under the Edge Act."[12] After denying plaintiffs' motion to remand, Rakoff promptly granted summary judgment to the defendants on the claims of two of the three plaintiffs in the case.[13]

The *Dexia* defendants' victories were short-lived. Noting that "[t]hose who don't believe in ghosts have never been in court, where legal claims are regularly seen rising from the grave," Rakoff resurrected the dismissed plaintiffs' claims and remanded them to state court, finding he had no jurisdiction to hear the claims in light of the Second Circuit's reversal of Judge Jones' decision denying the motion to remand in *AIG*.[14]

Second Circuit Opinion in 'AIG'

Noting that Jones had "wisely" certified for interlocutory appeal her decision denying remand in *AIG*, "so as to avoid the risk of conducting an extensive trial which might be mooted by a higher court's subsequent determination that remand…was required," the Second Circuit vacated that order, finding that the case did not qualify for Edge Act jurisdiction.[15]

The court framed the issue on appeal as the purely legal question of "whether the offshore banking transaction out of which the suit must arise must be a transaction of the Edge Act corporation that must be a party to the suit, or whether any offshore banking transaction suffices, regardless of whether that corporation was involved in it."[16] Plaintiffs/appellants argued that the plain meaning of the statute required that the suit arise out of international or foreign banking or financial operations conducted by the federally chartered party "either directly or through the agency, ownership, or control of branches or local institutions in dependencies or insular possessions of the United States or in foreign countries."

Parsing the structure of the statute, defendants/appellees in turn argued that the requirement of direct or extraterritorial subsidiary involvement modified only the immediately preceding clause, which addressed suits "arising…out of other international or foreign financial operations," and did not more generally limit all of the enumerated transactions that give rise to Edge Act jurisdiction.

Judge Pierre Leval, writing for the panel, looked both to the linguistic and grammatical structure of the statute and to its stated purpose. First, he observed that the key limiting words "either directly or through the agency, ownership, or control of branches or local institutions" in U.S. territories or foreign jurisdictions "necessarily refer to an actor taking some action." Because the only actor named in the statute is the nationally chartered corporation, he concluded that the federally chartered entity must be the actor engaged in the foreign transaction for the statute to apply. Second, he focused on the insertion of a comma between the list of foreign transactions supporting jurisdiction and the "either directly, or through the agency" clause. Without a comma, that clause could be read to modify only the last of the enumerated transactions. But under principles of grammatical as well as statutory construction, the court held that the presence of the comma meant that the clause clarifies that jurisdiction will extend to all three types of transactions whether they are conducted by the entity directly or by its foreign or territorial branch or subsidiary.

> The Second Circuit panel in 'AIG' held that "in order for [Section 632's] grant of federal jurisdiction and removability to apply, the suit must have a federally chartered corporation as a party, and the suit must arise out of an offshore banking or financial transaction of that federally chartered corporation."

Finally, the court concluded that it made "perfect sense" that the statute assuring federally chartered banks access to the federal courts be understood "to give that access in suits relating to the activities the [Edge] Act seeks to promote, to wit, the banks' engagements in offshore banking transactions." Ultimately, the panel held that both the "most literal interpretation" and "the one Congress apparently intended" pointed to the same conclusion: that "in order for [Section 632's] grant of federal jurisdiction and removability to apply, the suit must have a federally chartered corporation as a party, and the suit must arise out of an offshore banking or financial transaction of that federally chartered corporation."[17] The court therefore vacated Judge Jones' order with directions to remand the case to state court.

Jurisdiction in 'Dexia'

The Second Circuit's ruling in *AIG* also prompted Rakoff to revisit his February order denying remand in the *Dexia* case. The defendants' removal notice had relied on the fact that 18 of the properties underlying the loans in question were originated in the Virgin Islands. Following the reversal of *AIG*, Rakoff held that because those loans were originated by a non-party to the suit, the nexus required by *AIG* between the federally chartered corporate party and the foreign transaction was lacking.[18]

The defendants advanced the alternative argument that because a domestic JPMorgan Chase subsidiary, as sponsor and seller of the RMBS in question, had evaluated, selected and purchased the mortgages included in the securitization, and because another wholly owned U.S. subsidiary had serviced the foreign mortgages, these activities constituted foreign banking transactions sufficient to support Edge Act jurisdiction. Rakoff rejected that argument for two independent reasons. First, highlighting the importance of including all possible jurisdictional facts in a removal notice, because the defendants had premised Edge Act removal solely on the origination of the 18 mortgages in the Virgin Islands, he found that he could not consider the "newly referenced" involvement of JPMorgan subsidiaries in the handling of those mortgages in determining whether jurisdiction was proper.[19]

Second, he noted that JPMorgan Chase was not itself alleged to have engaged in the newly referenced foreign transactions. Because those activities were handled by domestic, rather than foreign subsidiaries of the bank, Rakoff found no basis for jurisdiction under the Edge Act, which requires either that the federally chartered bank engage directly in the requisite foreign transaction, or that it do so through a foreign—not a domestic—agent or subsidiary.

Conclusion

Defendants in complex securities cases often find the federal courts more hospitable than state courts—at least, as was the case in *Dexia* originally—for the short stay before dismissal of those claims. For a time, it looked as though defendants in RMBS cases had found in the Edge Act a jurisdictional key to the federal courts, and the district courts seemed willing to give the act a broad reading to oblige those defendants. With that avenue now closed, it will be interesting to see what other creative paths defendants try to chart in their efforts to get before the federal courts.

1. 2013 WL 2136508 (S.D.N.Y. May 17, 2013) (Rakoff, J.).
2. 712 F.3d 775 (2d Cir. 2013).
3. 12 U.S.C. §632.
4. *Am. Int'l Grp. v. Bank of Am.*, 712 F.3d 775 (2d Cir. 2013).
5. See, e.g., *Allstate Ins. v. CitiMortgage,* 2012 WL 967582 (S.D.N.Y. March 13, 2012) (Sullivan, J.).
6. *In re Lloyd's American Trust Fund Litig.*, 928 F.Supp. 333, 340 (S.D.N.Y. 1996) (Sweet, J.) (collecting cases).
7. 820 F.Supp.2d 555 (S.D.N.Y. 2011) motion to certify appeal granted, reconsideration denied, 2011 WL 6778473 (S.D.N.Y. Dec. 20, 2011) (Jones, J.).
8. Defendants also asserted as a basis for removal that the case was "related to" the bankruptcy proceedings of various sponsors of some of the RMBS or their parent companies. They argued that certain defendants had indemnification and/or contribution claims they were entitled to assert against the bankruptcy estates, bringing the case within the court's "related to" bankruptcy jurisdiction under 28 U.S.C. §1334(b) and making the case removable under 28 U.S.C. §1452(a). Judge Jones did not address this argument.
9. Id. at 558.
10. Id. (quoting *Colorado River Water Conservation Dist. v. United States*, 424 U.S. 800 (1976)).
11. 2013 WL 636897 (S.D.N.Y. Feb. 21, 2013) (Rakoff, J.).
12. Id. at *2.
13. 2013 WL 1320803 (S.D.N.Y. April 3, 2013) (Rakoff, J.).
14. 2013 WL 2136508 at *1.
15. *Am. Int'l Grp. v. Bank of Am.*, 712 F.3d 775.
16. Id.
17. Id.
18. 2013 WL 2136508.
19. Id. at *3 (citing *In re Methyl Tertiary Butyl Ether ("MTBE") Products Liab. Litig.*, 488 F.3d 112, 124 (2d Cir. 2007)). Significantly, Judge Rakoff had relied on this relationship, and the fact that JPMorgan Chase would be liable for its subsidiaries' conduct in his initial decision finding jurisdiction under the Edge Act.