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SOUTHERN DISTRICT CIVIL PRACTICE ROUNDUP

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Removal Jurisdiction—A Continuing Conundrum

A defendant's interest in having claims against it heard in federal court is often rivaled only by a plaintiff's interest in maintaining those claims in state court, making litigation over removal a hotly contested, high stakes battle.

The prevalence and intensity of these disputes is fueled by the fact that determining removability can be a tricky business, particularly where there is no explicit federal claim on the face of the state court pleading. Whether federal jurisdiction exists in such cases requires the courts to "delve into the thicket of an oft-visited yet unsettled area of the law."¹

Two recent decisions issued by judges sitting in the U.S. District Court for the Southern District of New York venture into this thicket, addressing, in one case, the removability of a shareholder derivative action predicated in part on a false securities filing, and in the other, the removability of an Article 78 petition alleging a due process violation under the Fourteenth Amendment of the U.S. Constitution.

The General Removal Statute

The general removal statute, 28 USC §1441(a), provides that a defendant may remove a case to federal court if the plaintiff's claims could have been brought there originally. This provision is generally read in conjunction with 28 USC §1331, which grants the federal courts original jurisdiction over actions "arising under" federal law. In most cases that are removed under §1441(a), the jurisdictional basis is relatively clear, because the cause of action at issue is actually created by federal law.²

However, federal question jurisdiction may also exist over actions created by state law, "where the vindication of a right under state law necessarily turn[s] on some construction of federal law."³ The U.S. Supreme Court has recently explained that in order for such a claim



to "arise under" federal law for removal purposes, the federal issue must not only be "necessarily raise[d]" but must also be "actually disputed and substantial."⁴ In addition, before exercising removal jurisdiction over this category of cases, the court must determine that to do so will not disturb the balance of federal and state judicial responsibility or the "normal currents of litigation." Despite the apparent simplicity of this formulation, its application is often highly complicated, requiring an individualized analysis of the state court pleading as well as the particular federal and state interests at stake. The decisions by Southern District Judges Victor Marrero and Michael B. Mukasey discussed below provide some welcome guidance in this surprisingly murky and unpredictable area of the law.

• **Shareholder Derivative Action Not Removable.** The defendants in *Sung v. Wasserstein*,⁵ sought, unsuccessfully, to remove a state court shareholder derivative action challenging the defendants' conduct in connection with an initial public offering. The complaint in that case included claims of breach of fiduciary duty, abuse of control, gross mismanagement, corporate waste, unjust enrichment and negligence. In opposing the plaintiff's remand motion, the defendants argued that the plaintiff's claims, predicated in part on the filing of a false prospectus, arose under the federal securities laws for purposes of the removal statute.

Judge Marrero observed that the existing case law left him without clear or settled answers as to whether the complaint in this

case was removable. He noted that courts have reached somewhat contradictory conclusions as to the role of federal securities laws when analyzing the removability of state law claims. For example, in *Barbara v. New York Stock Exchange, Inc.*,⁶ the U.S. Court of Appeals for the Second Circuit found that the federal issues involved in a complaint that the New York Stock Exchange (NYSE) had committed misconduct in disciplinary proceedings it had instituted against the plaintiff were not substantial enough to support federal question jurisdiction. Judge Marrero found that this decision was "somewhat in conflict" with the Second Circuit's more recent decision in *D'Alessio v. New York Stock Exchange, Inc.*⁷ In that case, the Court of Appeals upheld the removal of state law tort claims against the NYSE for allegedly "concocting a phoney interpretation" of federal securities laws and regulations governing unlawful trading, finding that the relationship between the plaintiff and the defendant was created by federal law and that resolution of his claims required interpretation of federal law.

Similarly, Judge Marrero also observed that district courts considering remand motions in derivative actions arising out of conduct also giving rise to federal securities litigation had reached opposite conclusions "seemingly based not on distinctions in factual circumstances but on differing applications of the various 'arising under' tests."⁸ He was, however, able to distill from the applicable precedents an approach for assessing whether the role of federal law in state created claims is sufficient to sustain removal jurisdiction: "Even if a right or remedy plaintiff asserts and claims is grounded on state law, if on close examination, that cause of action stands or falls on the application of some federal doctrine or law, there is federal question jurisdiction over the claim."⁹

The Complaint in 'Sung'

In applying this formulation to the plaintiff's complaint in *Sung*, Judge Marrero held that although the defendants' filing of an allegedly false prospectus may have been a predicate for plaintiff's breach of fiduciary duty claim, it is not an "element upon which the [plaintiff's] claim stands or falls." He reasoned that directors' duties to their corporations are

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governed by state law, concluding that the fact that their allegedly misleading statements “were made in a federally required document does not change the inquiry whether, standing alone, they were false or misleading as a necessary element of a cause of action under state law.” He acknowledged that resolution of the federal securities issues in plaintiff’s favor would strengthen his claims, but found that it would be a “stretch to say that resolution of contested federal issues is necessary to the adjudication of any claims found in the complaint.”¹⁰ Accordingly, he granted the plaintiff’s motion to remand the action to state court.¹¹

Article 78 Proceeding

A defendant faced with an arguably removable state court action must tread a fine line between removing the case improperly (and possibly incurring imposition of the costs and attorney’s fees of remand litigation¹²) and waiting too long to remove, thereby waiving the right to remove at any later point. The defendants in *Casale v. Metropolitan Transportation Authority*,¹³ got caught in precisely this bind, so that their attempt to remove an action after an amended pleading added a clearly removable claim was thwarted by their failure to remove the initial pleading, where there was a less apparent, yet legally sufficient basis for removal.

The dispute in *Casale* arose out of the Metropolitan Transportation Authority’s decision to terminate the plaintiff as its deputy director of security. He initially commenced an Article 78 proceeding in New York State Supreme Court, alleging that the termination was arbitrary and capricious, in bad faith and contrary to law, and that in stating the reasons for that termination, the defendants had disseminated defamatory information in violation of the plaintiff’s Fourteenth Amendment rights under the U.S. Constitution. He sought back pay, reinstatement, and a name-clearing hearing to “vindicate his Fourteenth Amendment right not to be deprived of his liberty interest in order to demonstrate the falsity of the stigmatizing charges made by respondents....” Following a decision by the Second Circuit holding that a plaintiff who had been denied a name-clearing hearing could seek compensatory damages under 42 USC §1983, the plaintiff filed an amended petition, creating a hybrid special proceeding and plenary action asserting claims for damages under §1983. Defendants then sought to remove the case to federal court based on the addition of the §1983 claim.

Plaintiff sought to remand the action to state court, arguing that the defendants’ notice of removal was untimely because it was filed more than 30 days after their receipt of the original Article 78 petition. In opposing that motion, the defendants were put in the somewhat ironic position of having to argue against the removability of the original petition, in

order to avoid a finding that they had waived their right to remove. Judge Mukasey disagreed, holding that the original petition could properly have been removed and that the defendants had thus waived their removal right.

Specifically, Judge Mukasey was unpersuaded by the defendants’ suggestion that an Article 78 proceeding is not a “civil action” within the meaning of the general removal statute and 28 USC §1331. Citing *City of Chicago v. International College of Surgeons*,¹⁴ and *Freeman v. Burlington Broadcasters, Inc.*,¹⁵ he noted that a federal constitutional challenge to an administrative action falls squarely within the court’s original jurisdiction, regardless of the nature of

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the state law provenance of the claim or the technicalities of local procedure, such as what the action or pleading is called.

Judge Mukasey similarly rejected the defendants’ argument that there was no federal question jurisdiction over the original petition because the Fourteenth Amendment contains no private right of action. He acknowledged that in its recent decision in *Grable*, the Supreme Court noted that the absence of a congressionally created private right of action is relevant to the analysis of whether federal question jurisdiction exists when violations of federal law serve as predicates to state law claims. He went on to find that the concerns expressed in *Grable*—that failure to create a statutory private right of action suggests a less-substantial federal interest, and that the assertion of federal question jurisdiction in such cases might disrupt the “normal currents of litigation”—were not present in this case. He noted that the federal question here was a constitutional rather than a statutory one. He further reasoned that Congress’ decision to enact §1983 as the federal mechanism for enforcing Fourteenth Amendment rights did not render those rights insubstantial when they served as the predicate for a state law claim, nor would permitting removal of that claim threaten to affect normal currents of litigation. He concluded that the fact that “a federal statute defines how private actors can enforce pre-existing constitutional rights...does not imply that disputes over those rights do not ‘arise under the Constitution’ when they occur in the setting of a state cause of action.”¹⁶

Having determined that the original petition was removable, Judge Mukasey went on to find that it contained sufficient facts to permit the

defendants to “intelligently ascertain” its removability. In reaching that conclusion, he observed that although the legal basis for removability may not have been entirely clear, that lack of clarity resulted from the unsettled legal issues discussed above, and not from the plaintiff having held back some fact that made the basis for removability ambiguous. He concluded that having failed to remove the original petition, the defendants were time-barred from removing the amended proceeding which asserted the §1983 claim.¹⁷

Conclusion

The decisions in *Sung* and *Casale* illustrate that while the general principles governing removal are well-established, their application in many cases is highly particularized and case-specific. These cases also underscore the degree to which questions of removability demand careful attention by plaintiffs in crafting their state court pleadings and by defendants in combing those pleadings early on for any possible basis for removal.

1. *Sung v. Wasserstein*, 2006 WL 398179, at *3 (S.D.N.Y. Feb. 17, 2006) (Marrero, J.).

2. See *Merrell Dow Pharm. Inc. v. Thompson*, 478 U.S. 804, 808 (1986).

3. *Sung v. Wasserstein*, 2006 WL 398179, at *2 (quoting *Franchise Tax Bd. v. Constr. Laborers Vacation Trust*, 463 U.S. 1, 9 (1983)).

4. *Grable & Sons Metal Prod., Inc. v. Darue Eng’g & Mfg.*, 125 S. Ct. 2363, 2368, 2371 (2005).

5. 2006 WL 398179.

6. 99 F3d 49 (2d Cir. 1996).

7. 258 F3d 93 (2d Cir. 2001).

8. 2006 WL 398179, at *9 (comparing *Gargiulo v. Decker*, 2005 WL 755771 (C.D.Cal. March 30, 2005) (remand granted), with *Wietschner v. Gilmartin*, 2003 U.S. Dist. LEXIS 18997 (D.N.J. Jan. 14, 2003) (remand denied)).

9. *Id.* at *10.

10. *Id.* at *11.

11. Judge Marrero also rejected defendants’ argument that removal was proper under the Securities Litigation Uniform Standards Act of 1998 (SLUSA), holding that SLUSA’s definition of a “covered class action” did not include a shareholder derivative action. See generally *Merrill Lynch, Pierce, Fenner & Smith, Inc. v. Dabit*, 2006 WL 694137 (U.S. Sup. Ct. March 21, 2006) (in class action asserting claims that defendants had fraudulently induced plaintiffs to retain rather than to purchase or sell securities, SLUSA pre-empts claims notwithstanding absence of federal law private remedy).

12. See 28 USC §1447(c) (providing that an order remanding an improperly removed action “may require payment of just costs and any actual expenses, including attorney fees, incurred as a result of the removal”).

13. 2005 WL 3466405 (S.D.N.Y. Dec. 19, 2005).

14. 522 U.S. 156 (1997).

15. 204 F3d 311 (2d Cir. 2000).

16. 2005 WL 3466405, at *7.

17. Judge Mukasey also considered, and rejected, the defendants’ argument that the addition of the §1983 claim so substantially changed the nature of the case that it revived the defendants’ expired right of removal under the narrow, judge-made “revival doctrine.” See *Wilson v. Intercollegiate (Big Ten) Conference*, 668 F.2d 962, 965-66 (7th Cir.), cert. denied, 459 U.S. 831 (1982).