

UNITED STATES DISTRICT COURT
SOUTHERN DISTRICT OF NEW YORK

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THE PEOPLE OF THE STATE OF NEW YORK :
by ANDREW M. CUOMO, Attorney :
General of the State of New York, :

Plaintiff, : 09 Civ. 7709 (LMM)

- against - : MEMORANDUM AND ORDER

CHARLES SCHWAB & CO., INC., :

Defendant. :

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McKENNA, D.J.,

1.

This action -- asserting four claims under, respectively, (i) New York Executive Law § 63(12), (ii) New York General Business Law § 352-c(1)(a), (iii) id. § 352-c(1)(c), and (iv) id. § 349, all relating to the allegedly fraudulent and deceptive conduct of defendant in the sale to the investing public of auction rate securities (ARS) -- was filed in the Supreme Court of the State of New York, County of New York, on or about August 17, 2009, and removed to this Court, on or about September 4, 2009, on the ground of diversity of citizenship.

Plaintiff moves for remand pursuant to 28 U.S.C. § 1447, which provides, in part, that: "If at any time before final judgment it appears that the district court lacks subject matter jurisdiction, the case shall be remanded." Id. § 1447(c).

[T]he district courts have diversity jurisdiction where, assuming the requisite amount in controversy, the suit is between "citizens of different States." It is well established that for a case to fit within this section, there must be "complete" diversity. Diversity is not complete if any plaintiff is a citizen of the same state as any defendant.

St. Paul Fire & Marine Ins. Co. v. Universal Builders Supply, 409 F.3d 73, 80 (2d Cir. 2005) (quoting 28 U.S.C. § 1332(a)(1) & Owen Equip. & Erection Co. v. Kroger, 437 U.S. 365, 373 (1978)) (other citation omitted). "[I]t has long been 'established that the "citizens" upon whose diversity a plaintiff grounds jurisdiction must be real and substantial parties to the controversy.' Thus, 'a federal court must disregard nominal or formal parties and rest jurisdiction only upon the citizenship of real parties to the controversy.'" Id. (quoting Navarro Sav. Ass'n v. Lee, 446 U.S. 458, 460-61 (1980)) (other citations omitted).

As noted in St. Paul, the diversity jurisdiction statute also requires the requisite amount in controversy, now \$75,000; 409 F.3d at 80; 28 U.S.C. § 1332(a).

"In Snyder v. Harris, 394 U.S. 332 (1969), the Court stated that, under established law, two or more plaintiffs could aggregate their claims for purposes of satisfying the amount in controversy requirement only 'in cases in which [they] unite to enforce a single title or right in which they have a common or undivided interest.'" Richard H. Fallon, Jr. et al., Hart and

Wechsler's The Federal Courts and the Federal System 1481-82 (5th ed. 2003) (quoting Snyder, 394 U.S. at 335).

Defendant asserts that it is a California corporation with its principal "executive office" in California (Notice of Removal ¶ 5), and that "[p]laintiffs are citizens of the State of New York" (id. ¶ 6). Defendant argues that "[t]he State of New York is not the real party in interest in this case. Where the primary purpose of a suit initiated by the state is to secure redress for an identifiable group of state citizens, those citizens -- and not the state -- are the real parties in interest." (Def. Mem. at 5.) The claimed real parties in interest are, according to defendant, "New York-based Schwab customers who purchased and still hold ARS." (Id.)

2.

The complaint (Notice of Removal, Ex. A) seeks injunctive relief against conduct similar to, or having a purpose and effect similar to, the conduct complained of in the complaint, "to the extent such conduct has any nexus with the New York marketplace" (Compl., ad damnum, ¶ A); an order "that Defendant, pursuant to Articles 22-A and 23-A of the General Business Law and Section 63(12) of the Executive Law and the common law of the State of New York, disgorge all gains and pay all restitution and damages caused, directly or indirectly, by the fraudulent and deceptive acts complained of herein" (id. ¶ B), penalties, costs and

attorneys' fees as provided by law (id. ¶ C); an order requiring defendant to buy back [ARS] from defrauded customers at par (id. ¶ D); and such other equitable relief as may be necessary to redress defendant's violations of New York law (id. ¶ E).

The complaint does not specifically identify the persons on whose behalf restitution and damages are sought. The complaint does refer in its allegations to unnamed persons who are said to reside in New York. (Compl. ¶¶ 55-56, 58-59, 64-66.) The complaint also refers to persons not said to reside in New York. (Id. ¶¶ 57, 60-62, 67-68.)

Defendant does not identify the amounts in controversy of the persons on whose behalf plaintiff seeks restitution other than to say that "[p]laintiffs demand, inter alia, disgorgement and restitution for 'hundreds of millions' of dollars worth of ARS sales." (Notice of Removal ¶ 9 (quoting Compl. ¶ 74 & citing Compl., Prayer for Relief).)¹

The record at present presents a number of open questions relating to whether or not complete diversity is present. Defendant states in the notice of removal that its principal "executive office" is in California (Notice of Removal ¶ 5); it

¹ In paragraph 68 of the complaint, it is alleged that one of defendant's customers borrowed \$400,000 for a home restoration project and invested that amount in a Schwab money market fund, to learn later that the money was invested in ARS. That does not identify an amount in controversy, however. Defendant says that it sold "millions of dollars of [ARS] to the investing public." (Compl. ¶ 74.) Again, that does not identify an amount in controversy.

does not, however, as far as the Court can find, state that California is its principal place of business. See 28 U.S.C. § 1332(c)(1). The record is not clear that all of the persons for whom the action seeks monetary relief are "citizens" of New York. See id. § 1332(a)(1). It is not clear whether the persons for whom the action seeks monetary relief could aggregate their damages, or, if they cannot, whether any -- or if any -- which have claims of \$75,000 or more. See id.

It is entirely possible that these gaps could be remedied by further submissions (and perhaps limited discovery), but there are other reasons indicating that there is no diversity, and the issues mentioned need not be reached.

3.

Defendant does not appear to disagree with the proposition that "[t]here is no question that a State is not a 'citizen' for purposes of the diversity jurisdiction." Moor v. County of Alameda, 411 U.S. 693, 717 (1973). Defendant argues, however, that:

The New York Attorney General, Andrew M. Cuomo, as the nominal party, is not the real party in interest in this dispute. The Attorney General seeks by his suit to obtain restitution on behalf of certain New York customers of Schwab who purchased Auction Rate Securities . . . through their Schwab accounts, the real parties in interest.

(Notice of Removal ¶ 7.)

"Rule 17(a) of the Federal Rules of Civil Procedure requires that '[e]very action shall be prosecuted in the name of the real party in interest.' This means that an 'action must be brought by the person who, according to the governing substantive law, is entitled to enforce the right.'" Oscar Gruss & Son, Inc. v. Hollander, 337 F.3d 186, 193 (2d Cir. 2003) (quoting Fed. R. Civ. P. 17(a); 6A Charles Alan Wright et al., Federal Practice and Procedure § 1543 (2d ed. 1990)). The Attorney General of the State of New York is authorized by New York statute to pursue on behalf of the State the claims alleged in the complaint. (See Pl. Mem. at 9-17.) Defendant does not refute this proposition, but argues that there is an exception: "Where, as here, the primary purpose of the state's suit is to seek restitution for an identifiable group of investors the state is not the real party in interest, and the case may be removed to federal court." (Def. Mem. at 2.)

Just such an argument as defendant makes here was rejected in New York v. General Motors Corp., where the district court denied remand and concluded that:

[r]ecovery of damages for aggrieved consumers is but one aspect of the case. The focus is on obtaining wide-ranging injunctive relief designed to vindicate the State's quasi-sovereign interest in securing an honest marketplace for all consumers. That recovery on behalf of an identifiable group is also sought should not require this Court to ignore the primary purpose of the action and to characterize it as one brought solely for the benefit of a few private parties.

547 F. Supp. 703, 706-07 (S.D.N.Y. 1982) (citation and footnote omitted), see also West Virginia v. Morgan Stanley & Co., 747 F. Supp. 332, 338 (S.D. W. Va. 1990) ("So long as the state is more than a nominal or formal party and has a real interest, pecuniary or otherwise, in the outcome of the litigation, it has been held that the State is a real party to the controversy and removal on diversity grounds is improper." (citations omitted)).

Defendant, in response, extracts the proposition that "[w]here the state's role is to collect proceeds that would then be distributed to state citizens, it is not the real party in interest" (Def. Mem. at 6) from In re Baldwin-United Corp., 770 F.2d 328 (2d Cir. 1985). In Baldwin-United, the district court, in a multi-district litigation including more than 100 federal securities actions, entered, for the purpose of facilitating settlement, a preliminary injunction against the commencement of actions against any of the defendants in the multi-district matter which might affect the right of any plaintiff or class member in that matter. A number of states objected to the injunction, and appealed, raising, among other arguments, the issue whether the injunction offended the Eleventh Amendment sovereign immunity of the states. 770 F.2d at 340. The Court of Appeals, in rejecting the Eleventh Amendment argument, noted that "certain types of actions involving state interests may nonetheless be heard in federal court." Id. One such exception, the court said, was

"actions instituted by state officials in a representative capacity." Id. at 341.

[W]hen the state merely asserts the personal claims of its citizens, it is not the real party in interest and cannot claim *parens patriae* standing. Thus, when relief against such representative actions by the state is sought, the state's sovereign immunity is not a bar.

Id. (citations omitted).

Merrill Lynch, Pierce, Fenner & Smith, Inc. v. Cavicchia, 311 F. Supp. 149 (S.D.N.Y. 1970), also relied on by defendant, again involves an Eleventh Amendment sovereign immunity issue. Actions had been commenced both in New York (by the Attorney General of the State of New York) and in New Jersey (by private parties) in which orders had been entered placing the property of one Cavicchia in the custody of a court-appointed receiver (New York) or the court itself (New Jersey). Two stakeholder brokerage firms that held money and securities in accounts for Cavicchia, in which both New York and New Jersey claimed an interest, commenced statutory interpleader actions, "seeking judgment restraining all the defendants" -- including New York -- "from commencing or prosecuting any suit against plaintiffs to recover the securities here involved and requiring defendants to interplead and settle among themselves the right to this property." 311 F. Supp. at 151-52 (footnote omitted). The State of New York (and the receiver) moved for dismissal of the stakeholders' actions on Eleventh Amendment grounds. The district court concluded that

the maximum extent of the interest of the state in the deposited property is that it be held safely in the custody of a court-appointed receiver until such time as intervening residents establish their valid claims therein and the remainder thereof, if any, is returned to the defendant. Those residents who have been defrauded are the parties with real interests in the sequestered property, and it is these people whom the Attorney General represents.

Id. at 157-58. The State, the court found, could not demonstrate that it was the real party in interest. "The state's general governmental interest in the prevention of fraudulent securities activity notwithstanding, such a demonstration cannot be made in the case at hand. This litigation does not in any way affect state revenues, state property, state contracts, or any activity by the state as a political entity." Id. at 158-59.² Dismissal was denied.

The district court in Merrill Lynch, see 311 F. Supp. 154-55, and defendant also (Def. Mem. passim), cite Missouri, Kansas, & Texas Ry. v. Missouri R.R. & Warehouse Comm'rs, 183 U.S. 53 (1901). The question there was whether a Kansas railroad, sued in a Missouri court to compel compliance with an order of Missouri railroad commissioners with respect to rates and charges, could remove the case to a federal court against the argument that the real party in interest was the State of Missouri. The Supreme

² The court also noted that allowing New York to pursue its Martin Act claim would not expose the stakeholders to double liability because the district court could determine the claims of all parties under 28 U.S.C. § 2361. Id. at 160.

Court found that the real parties in interest were the commissioners, not the State:

[T]he party named in the record as plaintiff is the real party plaintiff, and ... the voluntary assumption by the state of the costs in some contingencies of the litigation, or the indirect and remote pecuniary results which may follow from a disobedience of the orders of the court, do not make it the party to whom alone the relief sought inures, and in whose favor a decree for the plaintiff will effectively operate.

183 U.S. at 61. Removal was approved.

4.

While the issue is not free of some difficulties, the Court concludes that New York State is the real party in interest, and that removal was thus not available. “[A] State is not a “citizen” for purposes of the diversity jurisdiction.” Moor, 411 U.S. at 717.

The exception which defendant advocates should not be applied here.

To begin with, a district court, out of “considerations of comity,” should be as “reluctant” as the Supreme Court “to snatch cases which a State has brought from the courts of that State, unless some clear rule demands it.” See Franchise Tax Bd. v. Constr. Laborers Vacation Trust for S. Cal., 463 U.S. 1, 21 n.22 (1983).

Defendant has not shown that a “clear rule demands” removal. Id. Baldwin-United and Cavicchia are not removal, but

sovereign immunity cases, and, while Missouri, Kansas, & Texas Ry. is a removal case, it was decided on the ground that the actual plaintiffs were the commissioners named as such in the complaint. This Court remains aware that in Cavicchia, Judge Lasker suggested that the precise meaning of "real party in interest" in the different contexts of removal and sovereign immunity "should be founded on consistent principles of construction," 311 F. Supp. at 156, but most respectfully disagrees. The particular objectives of the removal statutes, on the one hand, and the Eleventh Amendment, on the other, as well as the factual contexts of the case law, need to be kept in mind.

Here -- focusing on Title 28 issues, and leaving the Eleventh Amendment, which is not implicated, to the side -- it is clear that New York is the real party in interest, i.e., "the person who, according to the governing substantive law, is entitled to enforce the right.'" Oscar Gruss & Son, 337 F.3d at 193. It is not disputed that, under New York law, New York may pursue the claims asserted under New York law alleged in the complaint.

All of the claims in the complaint are focused on the same alleged conduct, illegal under New York law, on the part of defendant. As in General Motors, "[t]he purpose of seeking this wide-ranging relief is not merely to vindicate the interests of a few private parties. Rather, it is to take a step toward eliminating fraudulent and deceptive business practices in the

marketplace." 547 F. Supp. at 705. "The State's goal of securing an honest marketplace in which to transact business is a quasi-sovereign interest. As such, it is sufficient to preclude characterizing the state as a nominal party without a real interest in the outcome of this lawsuit." Id. at 705-06 (citations omitted).


Nor does it make sense in cases, such as the present one, in which a state seeks both injunctive relief against illegal business practices and restitution for victims, to engage in an attempt to characterize one or the other as primary, as if the purposes can be separated from each other. It is completely understandable that a state should, at the same time, seek to prevent the recurrence of harmful conduct in the future and to remedy the damage it has caused in the past.

* * *

Motion for remand granted. The Clerk is directed to remand this action to the New York State Supreme Court, New York County.

Dated: January 19, 2010

SO ORDERED.



Lawrence M. McKenna
U.S.D.J.