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Standards for Appointing Class Counsel Under Rule 23(g)

2010 Emerging Issues 5369

Standards for Appointing Class Counsel Under Rule 23(g)

By Georgene Vairo

October 26, 2010

SUMMARY: *Sheinberg v. Sorensen* explores the relationship between F.R.C.P. 23(g), appointment of counsel, and F.R.C.P. 23(a)(4), the adequacy of representation requirement for class certification. The majority held that the question of adequacy of class counsel should not be considered in deciding whether to certify a class, because Rule 23(g) requires that a district court's certification decision must precede the appointment of class counsel.

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ARTICLE: Georgene Vairo on *Sheinberg v. Sorensen*

Summary. *Sheinberg v. Sorensen*, 606 F.3d 130, 2010 U.S. App. LEXIS 10922 (3d Cir. May 28, 2010) explores the relationship between Fed. R. Civ. P. 23(g), concerning appointment of counsel, and Fed. R. Civ. P. 23(a)(4), concerning the adequacy of representation requirement for class certification. In *Sheinberg*, the majority of a Third Circuit panel held that the question of adequacy of class counsel should not be considered in deciding whether to certify a class, because Rule 23(g) requires that a district court's certification decision must precede the appointment of class counsel. The dissent believed that under an abuse of discretion standard, the district court order decertifying the class should have been affirmed because of the inadequate counsel provided by class counsel.

Facts and Procedural Background. The plaintiffs, former employees of the defendant, sought damages for violation of the Fair Labor Standards Act, ERISA, and other federal and state statutes. The district court initially certified the action as a class action, but five years later decertified the class, citing numerous errors by class counsel in conducting the action, including the failure to send class notice. After obtaining new counsel, the plaintiffs moved to recertify the class, but the district court denied this motion, finding that the new counsel had continued the pattern of errors and omissions. The plaintiffs then brought this interlocutory appeal under Rule 23(f).

Standards for Appointing Class Counsel Under Rule 23(g). The majority began by noting that questions concerning the adequacy of class counsel were traditionally analyzed under the "adequate representation" requirement of Rule 23(a)(4)-that is, the court considered the adequacy of both the class representatives and class counsel in determining whether to certify a class. However, Rule 23(g), added to the class action rule in 2003, requires that "a court that certifies a class must appoint class counsel." Thus, the majority ruled, the plain language of Rule 23(g) requires that a district court's decision to certify a class must precede the appointment of class counsel.

Rule 23(g) lists four factors that must be considered once a district court proceeds to the stage of appointing class counsel: (1) the work counsel has done in identifying or investigating potential claims in the action, (2) counsel's experience in handling class actions, other complex litigation, and the types of claims asserted in the action, (3) counsel's knowledge of the applicable law, and (4) the resources that counsel will commit to representing the class. The district court must also ensure that class counsel will fairly and adequately represent the interests of the class, and may consider any other pertinent matters in order to do so.

A district court's inquiry is further aided by broad discretion to order potential class counsel to provide information on any subject pertinent to the appointment and to issue further orders in connection with the appointment. The court may also order the proffered counsel to propose terms for attorney's fees and nontaxable costs and may include provisions for fees and costs in the appointing order. If one applicant seeks appointment, the court may appoint that applicant only if the applicant is adequate, and if more than one adequate applicant seeks appointment, the court must appoint the applicant best able to represent the interests of the class.

Finally, the Third Circuit observed that, as Rule 23(g) requires any "court that certifies a class [to] appoint class counsel," it is applicable to the appointment of counsel following both class certifications and class recertifications.

District Court Failed To Apply Rule 23(g). The Third Circuit concluded that "[t]o our mystification, however, in this case neither the parties nor the District Court so much as recognized the existence of the rule. As a result, the District Court failed to consider the factors enumerated in Rule 23(g) in its opinion denying recertification." Ordinarily, a district court's failure to follow Rule 23(g) would be a sufficient basis on which to vacate the denial of recertification as an abuse of discretion. Here, however, the plaintiffs neither objected to the district court's error below nor raised it in their brief on appeal. Accordingly, any error had been waived.

Nevertheless, the Third Circuit vacated the district court judgment. The court's refusal to recertify the class had been premised on the notion that new counsel, like prior counsel, had committed numerous errors in prosecuting the case and had therefore proved inadequate. The district court thus had concluded that declining to recertify the class was the best way to protect the class itself. However, the district court had not actually undertaken any analysis to determine whether the class interests would be harmed. The district court not only failed to follow Rule 23(g) but also failed to apply the alternative standard it had identified for determining the adequacy of counsel to the facts before it. Moreover, nothing in the existing record of this case demonstrated that counsel's performance necessarily was harmful to the class.

Accordingly, the Third Circuit vacated the denial of recertification and remanded so that the district court could consider the plaintiffs' motion in light of Rule 23(g).

Dissent. A dissenting judge agreed that Rule 23(g) requires a district court to decide whether to certify a class prior to the appointment of class counsel, and also that the failure to raise this Rule 23(g) argument constituted waiver. The dissent, however, took the view that class counsel's errors, such as failing to provide class members with notice of class certification, did in fact severely prejudice the interests of the putative class members, and that the district court therefore did not abuse its discretion by denying the motion to recertify.

Commentary. On the one hand, the majority is correct that the appointment of counsel issue is technically separate from the adequacy of representation issue. But, as a requirement for class certification, the court needs to have some confidence that the counsel representing the class is competent enough to provide adequate representation. It is not at all clear that when Rule 23 was amended in 2003 that the intent was to completely remove the issue of the competence of class counsel from the Rule 23(a)(4) adequacy of representation issue. Rather, its purpose was to heighten scrutiny of class counsel, building on the courts' experience under Rule 23(a)(4) in evaluating the adequacy of class counsel in addition to the adequacy of the class representative. In other words, Rule 23(g) was designed to fine tune the class selection process to ensure that the class counsel will adequately represent the class, and to provide guidance to the district court when making the determination whether there is one or multiple applicants for class counsel.

Indeed, the Civil Rules Advisory Committee Note to Rule 23(g), which accompanied it when it was adopted in 2003, states:

Subdivision (g) is new. It responds to the reality that the selection and activity of class counsel are often critically important to the successful handling of a class action. Until now, courts have scrutinized proposed class counsel as well as the class representative under Rule 23(a)(4). This experience has recognized the importance of judicial evaluation of the proposed lawyer for the class, and this new subdivision builds on that experience rather than introducing an entirely new element into the class certification process. Rule 23(a)(4) will continue to call for scrutiny of the proposed class representative, while this subdivision will guide the court in assessing proposed class counsel as part of the certification decision. This subdivision recognizes the importance of class counsel, states the obligation to represent the interests of the class, and provides a framework for selection of class counsel. The procedure and standards for appointment vary depending on whether there are multiple applicants to be class counsel. The new subdivision also provides a method by which the court may make directions from the outset about the potential fee award to class counsel in the event the action is successful.

It would be a waste of time for a court to certify a class without knowing whether competent counsel existed - either in the form of the attorneys representing the class or who might come forward to represent the class. Thus it is important to note the practical distinction between what the majority decided and what the dissent thought should have happened. The majority did not explain the mechanics of the exercise it was requiring the district court to engage in. In vacating the denial of recertification and ordering a reconsideration under Rule 23(g), the court seems to be inviting the district court to reconsider whether - notwithstanding the competence of counsel - the class is certifiable, and then decide whether counsel seeking the recertification meets the test of Rule 23(g). The dissent essentially is saying: "Enough is enough" - no class ought to be recertified because the new counsel is as bad as the last, dooming class certification. It may well be that on reconsideration, the district court will decide that the class ought to be recertified, but that counsel fails the Rule 23(g) test and will not adequately represent the class. However, that leaves the door open for other counsel - should they be aware of the case - to come in and make the case that they meet the test of Rule 23(g).

In other words, the majority's approach leaves the door open to a future recertification while the dissent's does not. Although the Advisory Committee Note does not prioritize the Rule 23(a)(4) inquiry as the majority ruled, the Rule 23(g) inquiry can be harmonized with the Rule 23(a)(4) inquiry. While deciding whether to recertify, the district court can consider simultaneously the additional requirements for class counsel set forth in Rule 23(g). The majority is correct that Rule 23(g) requires heightened scrutiny of class counsel. The point here is that scrutiny can "build on" and take place as a part of the Rule 23(a)(4) inquiry.

RELATED LINKS: For further information, see Moore's Federal Practice:

- 5 Moore's Federal Practice (3d ed.) § 23.25[3];
- 5 Moore's Federal Practice (3d ed.) § 23.120

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Exploring the Securities Exceptions to CAFA Jurisdiction

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Exploring the Securities Exceptions to CAFA Jurisdiction

By Georgene Vairo

October 26, 2010

SUMMARY: *Greenwich Fin. Servs. Distressed Mortgage Fund 3 LLC v. Countrywide Fin. Corp.*, involved an important statutory exception to federal jurisdiction under CAFA. The Second Circuit carefully defined the scope of the exceptions to CAFA jurisdiction and CAFA appellate jurisdiction set out in 28 U.S.C. §§ 1332(d)(9)(C) and 1453(d)(3) for suits that relate to the rights, duties, and obligations relating to or created by or pursuant to any security.

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ARTICLE: Georgene Vairo on *Greenwich Fin. Servs. Distressed Mortgage Fund 3 LLC v. Countrywide Fin. Corp.*

Summary. *Greenwich Fin. Servs. Distressed Mortgage Fund 3 LLC v. Countrywide Fin. Corp.*, 603 F.3d 23, 2010 U.S. App. LEXIS 8088 (2d Cir. Apr. 20, 2010), involved an important statutory exception to federal jurisdiction under the Class Action Fairness Act of 2005 ("CAFA"). The Second Circuit carefully defined the scope of the exceptions to CAFA jurisdiction and CAFA appellate jurisdiction set out in 28 U.S.C. §§ 1332(d)(9)(C) and 1453(d)(3) for suits that relate to the rights, duties, and obligations relating to or created by or pursuant to any security.

Facts and Procedural Background. The defendants were affiliated corporations in the mortgage business: a holding company, a subsidiary that originated loans to individual consumers, and another subsidiary that serviced the loans. To raise money to lend to consumers, the lending subsidiary entered into a number of securitization transactions, in which it sold mortgages to specially created trusts, which received payment of interest and principal from mortgage borrowers. The trusts in turn sold certificates to investors. These securities entitled their owners to repayments of their principal, as well as interest payments. The trusts entered into agreements with the servicing subsidiary to administer the mortgages on their behalf. The terms of these securitization transactions, as well as the rights and duties of the parties to them, were laid out in contracts known as "pooling and servicing agreements." The certificate holders were not parties to these agreements.

Seven states filed lawsuits accusing the defendants of predatory lending. The defendants settled these suits, but were required by the settlement to modify the terms of many of the mortgages owned by the trusts, thereby decreasing the value of the certificates.

The plaintiffs in the *Greenwich* case were the holders of the certificates issued by the trusts. They filed a class

action in state court, seeking a declaratory judgment requiring the defendants to repurchase the modified loans from the trusts at a price equal to their unpaid principal plus any accrued interest. They cited language from the pooling and servicing agreements in support of this remedy.

The defendants removed the action from state court to federal district court, citing diversity jurisdiction under the Class Action Fairness Act, 28 U.S.C. § 1332(d)(2), as well as federal question jurisdiction under 28 U.S.C. § 1331. The plaintiffs moved to remand. They did not dispute that the basic requirements for CAFA jurisdiction were met, but argued that their suit fell within an exception to CAFA for actions that related "to the rights, duties (including fiduciary duties), and obligations relating to or created by or pursuant to any security" [28 U.S.C. § 1332(d)(9)(C)]. The district court agreed and remanded, and the defendant petitioned to file the present appeal pursuant to 28 U.S.C. § 1453(c), which authorizes the courts of appeals to hear at their discretion appeals from orders granting or denying motions to remand class actions.

Appellate Jurisdiction Under CAFA. The court began with a recitation of the burdens of proof, ruling that the plaintiff seeking a remand bears the burden of proving an exception to CAFA jurisdiction. The Second Circuit then turned to a more formidable issue - the intersection between CAFA's appellate jurisdictional provisions and its exceptions. As a general rule, an order to remand is not appealable [see 28 U.S.C. § 1447(d)]. However, when CAFA expanded the jurisdiction of federal courts over most class actions, it also expanded the jurisdiction of the courts of appeals to hear appeals of orders remanding or refusing to remand class actions to state courts [see 28 U.S.C. § 1453(c)]. The appellate provision contains an exception to appellate jurisdiction that is identical to that within CAFA's jurisdictional and exceptions provisions [see 28 U.S.C. § 1332(d)(9)(C)]. Thus, a court of appeals does not have jurisdiction of any class action that solely involves "a claim that relates to the rights, duties (including fiduciary duties), and obligations relating to or created by or pursuant to any security (as defined under section 2(a)(1) of the Securities Act of 1933 (15 U.S.C. 77b(a)(1)) and the regulations issued thereunder)" [28 U.S.C. § 1453(d)].

Because the two exceptions were identical, the court construed them together. This meant that if the court of appeals found that the exceptions did not apply, the district court would have jurisdiction under CAFA and the court of appeals would have jurisdiction to hear the appeal and reverse the remand order. Conversely, if the exceptions did apply, the district court would not have jurisdiction and therefore properly remanded the case, and the court of appeals would not have jurisdiction to hear the appeal and would be required to dismiss it, leaving the remand order intact.

This situation also meant that the court of appeals could examine only the claim of CAFA jurisdiction, not the additional claim of federal question jurisdiction. If the exceptions applied, the court of appeals would lack jurisdiction to consider the alternative grounds for jurisdiction.

Comment. Although the court's analysis of what it can and cannot do depending on whether CAFA jurisdiction exists makes sense, there is one trap for the wary. The courts of appeals have, indeed, held that CAFA's appellate provision applies only to CAFA remand orders [see *Patterson v. Dean Morris, LLP*, 448 F.3d 736, 742-743 (5th Cir. 2006) (CAFA's appellate provision not available to review otherwise non-reviewable decision to equitably remand; state court class action had commenced before effective date of CAFA, so CAFA was inapplicable); *Wallace v. Louisiana Citizens Property Ins. Corp.*, 444 F.3d 697, 700 (5th Cir. 2006) (CAFA appellate provision not applicable when removal was based on provision in Multiparty, Multiforum Trial Jurisdiction Act (MMTJA), not CAFA, and motion to remand expressly disavowed any reliance on CAFA); *Saab v. Home Depot U.S.A., Inc.*, 469 F.3d 758 (8th Cir. 2006)].

However, the courts of appeals have also held that once an appeal is granted to review a CAFA question, the court of appeals has jurisdiction to review non-CAFA issues as well [see *Coffey v. Freeport McMoran Copper & Gold*, 581 F.3d 1240 (10th Cir. 2009)]. Indeed, the *Greenwich* court suggested that was the case as well [see 603 F.3d 23, 28 n. 4 (appellate court may review non-CAFA issues)].

In other words, the appellate court has jurisdiction until it doesn't. If the court of appeals grants permission to appeal, and determines that it will review a non-CAFA issue, all will seem well and good. However, if in ruling on the

CAFA question, the court of appeals determines that the district court lacked jurisdiction, then the court of appeal's jurisdiction to review the non-CAFA issue would evaporate.

If the non-CAFA issue is an otherwise non-reviewable issue, such as a remand on other subject matter grounds, that result makes sense. But, if the other issue might otherwise be reviewable, it is problematic.

Moreover, the *Greenwich* court did not distinguish between an order remanding, or not, on the issue whether CAFA's basic jurisdictional provisions were met, on the one hand, and those in which the district court remanded because one of CAFA's exceptions applied. Indeed, in *Greenwich*, there was no argument with respect to whether CAFA jurisdiction existed. Rather, the question was whether one of CAFA's statutory exceptions applied. The question is whether CAFA's exceptions are jurisdictional in nature or not. An good argument can be made that the exception at issue in *Greenwich* is jurisdictional - CAFA provides that its jurisdictional provisions "do not apply" to class actions involving the rights, duties and obligations relating to securities. [28 U.S.C. § 1332(d)(9)(c).] In other words, CAFA jurisdiction does not extend to such cases in the first place. So, there would be no federal jurisdiction when a CAFA exception like that is the issue.

On the other hand, when a court decides not to exercise its CAFA jurisdiction because the home state or local controversy applies under 28 U.S.C. § 1332(d)(4) or declines to exercise jurisdiction under 28 U.S.C. § 1332(d)(3), such decisions are arguably not jurisdictional in nature. CAFA jurisdiction exists, but the court may not exercise it. In such circumstances, the court of appeals arguably ought to have jurisdiction to review non-CAFA issues. For example, if the district court in *Greenwich* had decided to remand based on the home-state exception, but decided to retain the case under the alternate federal question ground, it would serve efficiency purposes for the court of appeals to decide the issue then, rather than waiting for an appeal after the final judgment was entered under 28 U.S.C. § 1291.

Exploring the Securities Exceptions to CAFA Jurisdiction. Moving to the merits, the court of appeals noted that it had previously examined the scope of the § 1332(d)(9)(C) and § 1453(d)(3) exceptions to CAFA jurisdiction in *Estate of Pew v. Cardarelli* [527 F.3d 25 (2d Cir. 2008)]. In that case the court had determined that, despite broad language that would seem to exempt any claim that "relates to . . . any security," the exception could not have been intended to cover all securities claims, no matter their nature. Such an understanding of the provision would render superfluous the phrase "rights, duties (including fiduciary duties), and obligations relating to or created by or pursuant to," which plainly was intended to limit the scope of the exception. Additionally, it would render superfluous § 1332(d)(9)(A), which exempts from CAFA jurisdiction any class action that solely involves a claim concerning a security covered under the Securities Act of 1933.

In *Cardarelli*, the court focused on the fact that the exception only applied to suits seeking to enforce "rights, duties, [and] obligations relating to or created by or pursuant to" securities, and determined that this language was intended to differentiate claims based either on the terms of the instruments that create and define securities or on the duties imposed on persons who administer securities, from claims based on rights arising from independent sources of state law. The key distinction between suits that were immune from removal under CAFA and those that were not is that immune suits sought to enforce the rights of the securities holders as holders. In *Cardarelli*, however, plaintiffs' claim sought to enforce their rights not as holders, but as purchasers; they asserted that the transaction in which they had acquired the notes was tainted by fraud. Thus, the claims did not seek to enforce rights, duties, or obligations that were pursuant to or created by the securities, but rather rights granted to consumers by a statute. Plaintiffs' suit was therefore removable under CAFA.

In the present case, in contrast, plaintiffs sought enforcement of their rights as holders rather than as purchasers of securities. They sued under a provision of the pooling and servicing agreements that in their view required the defendants to repurchase certain loans from the trusts. Thus, the asserted right arose from the deal instruments themselves, not from an extrinsic provision of state law such as the consumer fraud statute that formed the basis of the action in *Cardarelli*. Because the claims in the present suit related to "the rights, duties . . . and obligations relating to or created by or pursuant to" their certificates, the suit was not removable under CAFA.

The court of appeals admitted that the plaintiffs sued not to enforce a term of the certificates themselves, but rather to enforce a term of the pooling and servicing agreements. However, this did not mean that the claims were not pursuant to or created by the security. The principle stated in *Cardarelli* was that the exception of §§ 1332(d)(9)(C) and 1453(d)(3) applies to suits that enforce "the terms of instruments that create and define securities," and that it does not apply to suits to enforce rights that are "superimposed by a state's corporation law or common law." A certificate holder's rights might be enumerated in an instrument other than the security itself, but this was immaterial. Securities are created and defined not simply by their own text, but also by any number of deal instruments executed between various parties. This may include documents such as certificates of incorporation and bond indentures, or the agreements at issue in the present case.

Similarly, it did not matter that the certificate holders were not themselves parties to the pooling and servicing agreements. The focus of the inquiry is on the source of the right that the plaintiffs' claims seek to enforce. A claim that seeks enforcement of a right that arises from an appropriate instrument falls within the exception of §§ 1332(d)(9)(C) and 1453(d)(3), regardless of whether the plaintiff is a party to the instrument.

The court of appeals also rejected the defendants' contention that remand of the action to state court would defeat the legislative purpose of CAFA, which is to provide federal jurisdiction to class actions "of national importance." While CAFA dramatically expanded federal jurisdiction over class actions, this generalized legislative purpose cannot override the clear meaning of §§ 1332(d)(9) and 1453(d), which plainly allow some large class actions to remain in state court. "If Congress meant the consideration of a class action's importance to the nation as a whole to trump these limiting provisions, it would have indicated that intent. Congress wisely chose not to leave it to the federal courts to assert jurisdiction over whatever class actions seemed to judges to be 'of national importance'-a standard much too amorphous to admit of consistent judicial application-but instead to define concrete criteria for federal jurisdiction under CAFA, and to use specific language to define exceptions to that jurisdiction. We are governed by that language and not by defendants' self-serving assertion of the 'national importance' of this litigation."

The court of appeals concluded that the plaintiffs' claim related to the rights, duties, and obligations relating to or created by or pursuant to a security. Accordingly, the case fell within the exception to appellate jurisdiction, and the court dismissed for lack of appellate jurisdiction.

Commentary. The Second Circuit has backed off from its approach in *Cardarelli*. *Cardarelli* seems consistent with Congress' desire to expand federal jurisdiction through CAFA. But, it is more important to honor the language of CAFA and the *Greenwich* court got it right. CAFA's exceptions were a product of political compromise and exceptions such as the one in issue in *Greenwich* were the product of such compromise. It is one of the "Delaware Carve-outs" designed to allow state courts to interpret state corporate law. It is important that CAFA not allow federal courts to overreach and adjudicate state-claim-based cases that ought to be litigated in state court.

RELATED LINKS: For further information, see Moore's Federal Practice:

- 5 Moore's Federal Practice (3d Ed.) § 23.63[2][a];
- 15 Moore's Federal Practice (3d Ed.) § 102.26[1][a][ii];
- 16 Moore's Federal Practice (3d Ed.) § 107.15[13][b][i][B].

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Is an LLC an Unincorporated Association for CAFA Citizenship Purposes?

2010 Emerging Issues 5361

Is an LLC an Unincorporated Association for CAFA Citizenship Purposes?

By Georgene Vairo

October 19, 2010

SUMMARY: *Ferrell v. Express Check Advance of SC LLC*, examines a relatively straightforward issue, but a case of first impression for the courts of appeals, under the Class Action Fairness Act of 2005. *Ferrell* involves the question whether a limited liability company is considered an "unincorporated association" for CAFA citizenship purposes. The Fourth Circuit correctly held that it should be.

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ARTICLE: Georgene Vairo on *Ferrell v. Express Check Advance of SC LLC*

Summary. *Ferrell v. Express Check Advance of SC LLC*, 591 F.3d 698, 2010 U.S. App. LEXIS 424 (4th Cir. Jan. 8, 2010), examines a relatively straightforward issue, but a case of first impression for the courts of appeals, under the Class Action Fairness Act of 2005 ("CAFA"). CAFA provides that for the purposes of determining minimal diversity jurisdiction, "an unincorporated association shall be deemed to be a citizen of the State where it has its principal place of business and the State under whose laws it is organized" [28 U.S.C. § 1332(d)(10)]. *Ferrell* involves the question whether a limited liability company is considered an "unincorporated association" for CAFA citizenship purposes. The Fourth Circuit correctly held that it should be.

Procedural Background and Issue. *Ferrell* involved a typical CAFA scenario. A citizen of South Carolina filed a class action in South Carolina state court against a limited liability company (LLC) and others, alleging that their "payday loans" violated South Carolina law. All of the parties, with the possible exception of the LLC, were citizens of South Carolina. The LLC removed the case to federal court under the Class Action Fairness Act (CAFA) [see 28 U.S.C. § 1453(b)]. The district court remanded the case, finding that the LLC was also a citizen of South Carolina, so the minimal diversity requirements for CAFA jurisdiction were not met. The Fourth Circuit affirmed.

CAFA Minimal Diversity Requirement and the Citizenship of Unincorporated Entities. Unlike the traditional diversity basis for jurisdiction, CAFA requires only minimal diversity: if any member of a class of plaintiffs is a citizen of a state different from any defendant, there is minimal diversity and CAFA jurisdiction potentially exists [28 U.S.C. § 1332(d)(2)(A)]. For purposes of determining citizenship under CAFA, "an unincorporated association shall be deemed to be a citizen of the State where it has its principal place of business and the State under whose laws it is organized" [28 U.S.C. § 1332(d)(10)].

The Supreme Court has ruled in several cases that, in determining the citizenship of partnerships and other unincorporated entities, the court must look to the citizenship of each partner or member [*see, e.g., Carden v. Arkoma Assocs.*, 494 U.S. 185, 197, 110 S. Ct. 1015, 108 L. Ed. 2d 157 (1990) (limited partnership)]. This "*Carden*" rule, because it expands the number of parties whose citizenship counts for traditional diversity purposes, leads to many cases in which complete diversity is destroyed. To facilitate the exercise of federal jurisdiction in the class action context, however, §1332(d)(10) treats partnerships and other unincorporated entities the same as corporations under § 1332(c). CAFA thus provides: "For purposes of this subsection and section 1453, an unincorporated association shall be deemed to be a citizen of the State where it has its principal place of business and the State under whose laws it is organized" [28 U.S.C. § 1332(d)(10)]. Decreasing the number of citizenships of an unincorporated entity or partnership increases the likelihood that there is minimal diversity between a plaintiff class and a defendant partnership or unincorporated association.

Are LLC's "Unincorporated Associations?" The issue in *Ferrell* was whether the citizenship of the defendant LLC was to be determined under § 1332(d)(10) or under the non-CAFA rule that the citizenship of an LLC is determined by the citizenship of its members. There was some ambiguity because Congress expressly referred to "an unincorporated association" in § 1332(d)(10). Is an LLC an "unincorporated association"? The Fourth Circuit considered CAFA's provision concerning the citizenship of "unincorporated associations" against the backdrop of jurisprudence concerning citizenship of business entities.

There are two lines of cases, one holding that corporations should be deemed citizens of the State where they were incorporated, because the shareholders could conclusively be presumed to be citizens of that state [*see Marshall v. Baltimore & Ohio Railroad Co.*, 57 U.S. 314, 327-329, 14 L. Ed. 953 (1854)], and the other holding that artificial entities other than corporations are not citizens, so the citizenship of their members controls whether diversity jurisdiction exists [*see Chapman v. Barney*, 129 U.S. 677, 9 S. Ct. 426, 32 L. Ed. 800 (1889)]. The Supreme Court has often characterized any business entity that is not a corporation as an "unincorporated association" [*see, e.g., United Steelworkers of Am. v. R.H. Bouligny, Inc.*, 382 U.S. 145, 149-150, 86 S. Ct. 272, 15 L. Ed. 2d 217 (1965)], so the Fourth Circuit recognized the second line of cases as establishing a categorical rule governing all "unincorporated associations" [*see New York State Teachers Ret. Sys. v. Kalkus*, 764 F.2d 1015, 1017 (4th Cir. 1985)]. In 1958, Congress expanded the citizenship of corporations, but not unincorporated associations, to include not only the state of incorporation, but also the state of the corporation's principal place of business [*see 28 U.S.C. § 1332(c)*]. In 2005, Congress similarly expanded citizenship for "unincorporated associations" with respect to cases that fall within the scope of CAFA [*see 28 U.S.C. § 1332(d)(10)*].

Given this history, the Fourth Circuit read 28 U.S.C. § 1332(d)(10) "to respond to the categorical distinction that the Supreme Court created between corporations and unincorporated associations." The court also noted that the statute itself uses "unincorporated" as the counterpart to "incorporated," suggesting two mutually exclusive classes of business enterprises and indicating that if an LLC is not a corporation, it is an unincorporated association. Thus, the court agreed with the district court that the citizenship of an LLC is that of the state under whose laws it is organized and the state where it has its principal place of business.

The Fourth Circuit rejected the LLC's argument that an "unincorporated association" in § 1332(d)(10) was intended to refer only to those non-corporate entities that lack a distinct legal identity under the law of the state in which they are organized. The LLC reasoned that "unincorporated association," as used in § 1332(d)(10), must mean something different than "other form of business enterprise," as used in 28 U.S.C. § 1332(d)(9)(B) and § 1453(d)(2). In the LLC's opinion, the latter, as the broader of the two, was the term Congress used to refer to all non-corporate entities, while "unincorporated association" refers only to a narrower subset of non-corporate business forms, a class that excludes entities having a distinct legal identity under the law of the state in which they are organized. The Fourth Circuit disagreed, reasoning that the phrase "a corporation or other form of business enterprise" in § 1332(d)(9)(B) and § 1453(d)(2) includes "corporation" as an example of "business enterprise," so the term "business enterprise" includes *both* corporations and any other form of business enterprise. In other words, Congress used "business enterprise" as the broadest term and subdivided it into two subclasses, corporations and non-corporate entities, which it referred to as

"unincorporated association[s]."

Commentary. The Fourth Circuit was correct to rule that an LLC is an unincorporated association for CAFA purposes. Congress intended to expand federal jurisdiction over class actions and surely adopted § 1332(d)(10) to reduce the likelihood that minimal diversity jurisdiction would be destroyed by the joinder of a non-incorporated business entity. Indeed, other courts agree [*See, e.g., Bond v. Veolia Water Indianapolis, LLC, 571 F. Supp. 2d 905, 912 (S.D. Ind. 2008)*] (CAFA unincorporated association provision applies to LLC's)].

Determining the LLC's Principal Place of Business. The Fourth Circuit then had to determine the LLC's citizenship. In *Ferrell*, the defendant LLC, Express Check, had a sole member, QC Financial Services, a resident of both Missouri and Kansas. All other parties were South Carolina citizens. The court determined that Express Check's principal place of business was not Kansas, where four high-level officers lived. Rather, the court determined that the LLC's citizenship was South Carolina because it made loans, had store locations and most of its employees were in South Carolina. Thus, minimal diversity between the South Carolina plaintiff and the LLC defendant in *Ferrell* did not exist, and removal under CAFA was improper.

At the time *Ferrell* was decided, the circuits were split with respect to the proper test for determining a business's principal place of business, and at the time, the Fourth Circuit used two tests: (1) the "nerve center" test, i.e., from what state do the officers direct, control, and coordinate the corporation's activities; and (2) the "place of operations" test, i.e., in what state does the bulk of corporate activity take place [*see Peterson v. Cooley, 142 F.3d 181, 184 (4th Cir. 1998)*]. The Fourth Circuit concluded that these same tests should be used to determine the principal place of business of an unincorporated association under CAFA. However, at that time, the nature of the business determined which of the two tests to use. The "place of operations" test presumes the existence of physical operations by which a corporation's presence in different states can be measured. It is used when a company has multiple centers of manufacturing, purchasing, or sales. The "nerve center" test applies when the company engages primarily in the ownership and management of investment assets such as debt or equities, so the company is not geographically bound.

The Fourth Circuit then turned to the question of this LLC's citizenship. The LLC was organized under the laws of Tennessee, so it was a citizen of Tennessee, which was consistent with diversity jurisdiction existing over the case under CAFA. The remaining question was whether its principal place of business was South Carolina, which would make it a citizen of that state as well, destroying diversity jurisdiction.

The LLC's sole member was a Missouri corporation with a principal place of business in Kansas, and all the stock of that corporation was owned by a Kansas corporation that also had its principal place of business in Kansas. However, the LLC made payday loans from stores located solely in South Carolina. Its top four officers, who were also officers of the Missouri corporation, were located in Kansas, but all other LLC employees were located in South Carolina. The LLC's operations in South Carolina were substantially controlled by the Missouri and Kansas corporations, but the operational and policy decisions made by those corporations were carried out by LLC employees in South Carolina.

Accordingly, the Fourth Circuit reasoned that the place of operations test would most accurately reflect the principal place of business of the LLC. The court noted that the LLC's business was to make payday loans from numerous store locations in South Carolina, where all of its employees, except four officers, also worked. The court concluded that South Carolina was the LLC's principal place of business, which destroyed diversity jurisdiction under CAFA.

The Fourth Circuit also refused to attribute the citizenship of the parent companies to the LLC even if they exercised complete control over it and the LLC could be considered merely its alter ego. The Fourth Circuit pointed out that the corporate parents decided to maintain the LLC as a legally separate entity and have undoubtedly benefitted from this arrangement. Therefore, the LLC could not complain that it would improperly elevate form over substance for the court to respect the very corporate structure its parents selected.

Commentary. *Ferrell* was decided before the Supreme Court decided *Hertz Corp. v. Friend*, 130 S. Ct. 1181, 175 L. Ed. 2d 1029 (2010). Although the Fourth Circuit was correct in holding that an LLC is an unincorporated association for CAFA purposes, its ruling on the LLC's principal place of business may now be suspect given the Supreme Court's ruling in *Hertz*.

In *Hertz*, the Court resolved a split in the circuits regarding the proper test for determining a corporation's principal place of business under 28 U.S.C. § 1332(c). The unanimous Court, recognizing the difficulties in adopting any test, placed "primary weight upon the need for judicial administration of a jurisdictional statute to remain as simple as possible." The Court rejected a corporate activities test in favor of the "nerve center" test. After detailing the growing complexity of the various approaches to determining the principal place of business, the *Hertz* Court looked to three sets of considerations supporting the nerve center test. First, the Court stated that the statute's language supported the approach. Second, the Court opined that simplicity is a major virtue in a jurisdictional statute. A complex jurisdictional test not only complicates a case, "eating up time and money" but produces appeals and reversals, encourages gamesmanship, and, again, diminishes the likelihood that results and settlements will reflect a claim's legal and factual merits. Additionally, simple jurisdictional rules promote greater predictability which is valuable to corporations making business and investment decisions, as well as to plaintiffs deciding whether to file suit in a state or federal court.

The Court then stated that it recognized that even under the "nerve center" test there would be hard cases. In an era of telecommuting, some corporations divide their command and coordinating functions among officers who work at several different locations. More importantly for the purpose of divining how the Court will rule on the CAFA issue, the Court noted that the use of a "nerve center" test may in some cases produce results that seem to cut against the basic rationale for diversity jurisdiction because there the test may be less likely to destroy complete diversity even though the corporation and its opposing party have a substantial connection to the same state. "However, in view of the necessity of having a clearer rule, we must accept them. Accepting occasionally counterintuitive results is the price the legal system must pay to avoid overly complex jurisdictional administration while producing the benefits that accompany a more uniform legal system."

The Court concluded by restating that the burden of persuasion for establishing diversity jurisdiction remains on the party asserting it. And, it warned against a rule that would permit jurisdictional manipulation, "thereby subverting a major reason for the insertion of the principal place of business' language in the diversity statute." Accordingly, if the "record reveals attempts at manipulation -- for example, that the alleged nerve center' is nothing more than a mail drop box, a bare office with a computer, or the location of an annual executive retreat -- the courts should instead take as the nerve center' the place of actual direction, control, and coordination, in the absence of such manipulation."

Given the Court's focus on the text of § 1332(c) as well as its intent to prevent jurisdictional manipulation to create diversity jurisdiction, it would seem that the Court would adopt the Fourth Circuit's view that a corporation may not "create" minimal diversity by choosing as the only operative citizenship the one that is diverse from the plaintiffs. If the plaintiff class is composed of citizens of the same state as any of the corporate defendant's citizenships under § 1332(c), it is irrelevant that its other citizenship is diverse from those plaintiffs. Although it is true that Congress intended to expand diversity jurisdiction in the class action context, it did not amend § 1332(c). Accordingly, the better approach is that a removing corporate defendant may not create federal jurisdiction by counting only one of its citizenships in an attempt to establish that CAFA's minimal diversity requirement is met.

Nonetheless, although the Fourth Circuit was correct to treat the LLC as a corporation, under *Hertz*, it should have decided that the LLC's principal place of business was Kansas, where its high level officers worked, because that appeared to be the LLC's "nerve center." Now that the Court has adopted the nerve center test for determining a principal place of business, courts ought to look to the headquarters of the partnership or unincorporated entity as its principal place of business.

RELATED LINKS: For further information, see Moore's Federal Practice:

- 15 Moore's Federal Practice (3d Ed.) 102.26[1][b][i];

- 15 Moore's Federal Practice (3d Ed.) 102.54[6];
- 15 Moore's Federal Practice (3d Ed.) 102.57[8]

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Local Controversy and Home State Exceptions For CAFA Federal Jurisdiction

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Local Controversy and Home State Exceptions For CAFA Federal Jurisdiction

By Georgene Vairo

October 19, 2010

SUMMARY: In *re Sprint Nextel Corp.* is a significant Class Action Fairness Act of 2005 ("CAFA") opinion. In *In re Sprint Nextel Corp.*, the Seventh Circuit held that the district court erred by relying on guesswork, rather than evidence and statistical principles, to determine whether two-thirds or more of the plaintiff class were citizens of the forum state for purposes of the home-state exception to CAFA jurisdiction.

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ARTICLE: Georgene Vairo on *In re Sprint Nextel Corp.*

Summary. *In re Sprint Nextel Corp.*, 593 F.3d 669, 2010 U.S. App. LEXIS 1928 (7th Cir. Jan. 28, 2010), is a significant Class Action Fairness Act of 2005 ("CAFA") opinion. CAFA significantly expands federal jurisdiction over state-claim-based class actions, but contains a number of complex exceptions to such jurisdiction. The so-called "local controversy" and "home state" exceptions turn on the percentage of class members who are citizens of the forum state. Thus, determining the citizenship of the class poses problems of proof. In *In re Sprint Nextel Corp.*, the Seventh Circuit held that the district court erred by relying on guesswork, rather than evidence and statistical principles, to determine whether two-thirds or more of the plaintiff class were citizens of the forum state for purposes of the home-state exception to CAFA jurisdiction.

Facts and Procedural Background. The complaint, filed in Kansas state court, alleged that the defendant conspired with other cell phone providers to impose artificially high prices for text-messaging service in violation of the Kansas Unfair Trade and Consumer Protection Act. The suit was brought as a class action on behalf of "all Kansas residents" who purchased text messaging service from the defendant or other cell phone providers. The complaint further specified that the class was limited to those who (1) had a Kansas cell phone number, (2) received their cell phone bill at a Kansas mailing address, and (3) paid a Kansas "USF fee," which is applied to all long[distance] calls within Kansas.

The defendant removed the case to federal district court in Kansas under the Class Action Fairness Act (CAFA) [28 U.S.C. § 1332(d)(2), (d)(5)]. It alleged that the amount in controversy exceeded \$5 million, that the class consisted of more than 100 class members, and that minimal diversity existed. It further showed that at least there were at least five non-Kansas class members who were national corporations that subscribed to Kansas cell phone service and

received bills at their Kansas locations.

The Judicial Panel on Multi-District Litigation transferred the case to the Northern District of Illinois. The plaintiff moved to remand on the basis that CAFA's home state exception applied. The district court agreed and remanded the case to state court.

CAFA Home-State Exception. The home-state exception to CAFA jurisdiction applies when "two-thirds or more of the members of all proposed plaintiff classes in the aggregate, and the primary defendants, are citizens of the State in which the action was originally filed" [28 U.S.C. § 1332(d)(4)(B)]. In these circumstances, CAFA jurisdiction may not be exercised, and a removed case must be remanded. The home state exception to CAFA jurisdiction raises two problems: 1) how to determine whether the "two-thirds or more" requirement is met, and 2) what is a "primary defendant"? The *Sprint* case involved the first issue, and the defendant mounted a two-prong attack on the requirement. First, it argued that in determining whether two-thirds or more of the class members were citizens of the forum state, the court had to consider all related law suits involving the same conduct. Second, it articulated a high evidentiary burden for showing that the requirement was met. The defendant was totally unsuccessful on its first argument, but obtained a remand to the district court on the other.

Whether "Two-thirds or More of the Members of All Proposed Plaintiff Classes in the Aggregate" Means that Class Members in Related Litigation Must be Counted. In resisting remand, the defendant argued that when the statutory exception specifies that "two-thirds or more of the members of all proposed plaintiff classes in the aggregate" must be from the home state, it means that two-thirds of the members of the proposed classes in *all* lawsuits alleging similar conduct, not just the proposed class in the suit at hand (emphasis added). Under this interpretation, Kansas citizens would not constitute at least two-thirds of the members across the proposed plaintiff classes in all messaging antitrust cases.

The court of appeals correctly rejected this reading, following the First Circuit's opinion in *In re Hannaford Bros. Co. Customer Data Sec. Breach Litig.* [564 F.3d 75, 78-79 (1st Cir. 2009)]. The defendant argued that the reference to "classes in the aggregate" could only mean that Congress intended to require a district court to search out similar cases. However, there may be more than one class in a single class action, and the plural language is meant to address that situation. For example, in a toxic tort case there could be both a medical monitoring class and a property remediation class. Without the requirement that the district court evaluate the citizenship of "the proposed classes in the aggregate," the exception might be taken to apply when two-thirds of just one of the classes was from the home state: "Preventing that misconception seems purpose enough for CAFA's reference to 'classes in the aggregate'" [see *In re Sprint Nextel Corp.*, 593 F.3d 669, 672 (7th Cir. 2010)].

Moreover, identical language is used in the local-controversy exception [28 U.S.C. § 1332(d)(4)(A)(i)], and in that context the defendant's construction could not apply. The local-controversy exception applies only when no other class action asserting the same or similar factual allegations against the same defendants has been filed within a three-year period. Thus, Congress couldn't have intended to require the courts to consider the composition of other similar class actions in this context, since there can't be any. It would be surprising, the court of appeals said, if the same language meant different things in these two closely related CAFA exceptions.

The Seventh Circuit also found that because the home state exception, unlike the local-controversy exception, is framed entirely in terms of the parties' citizenship, "the fact that this suit may be but a slice of a bigger controversy is irrelevant" [*Sprint Nextel*, 593 F.3d at 673]. It again noted the First Circuit case, *In re Hannaford Bros. Co. Customer Data Sec. Breach Litig.*, [564 F.3d 75 (1st Cir. 2009)] as a good illustration. *Hannaford* involved one of 25 different suits that were filed in various district courts against a grocery chain based in Florida, another that operates in the Northeast, and their common Belgian parent company. Despite the national and international aspects of the controversy as a whole, the First Circuit looked only at the case before it. Because the primary defendant was a Florida corporation and at least two-thirds of the plaintiffs were citizens of Florida, the state in which the action was brought, the First Circuit affirmed a remand order.

The court of appeals finally noted the defendant's argument that the underlying purpose of CAFA is to bring national controversies into federal court. That may have been Congress's general goal, the court said, but it also provided for exceptions. Plaintiffs are free to circumscribe their class definitions so that they can fit within one of those exceptions and avoid federal jurisdiction. The court concluded that only the class members in the current suit needed to be considered when determining the two-thirds fraction.

Commentary. The Seventh Circuit's analysis is sound. It is unquestionable that Congress did not intend that district courts look to other cases when counting the citizenship and percentages of forum state citizens. As the court put it, the defendant's construction was contrary to the structure of CAFA's exceptions even if Congress was seeking to channel most class actions into federal court. The exceptions contemplate smaller units of litigation in more than one court, but would prevent a nationwide class action from staying put in federal court.

Standard of Proof and Evidence Required To Show That Two-Thirds or More of Class Members Are Citizens of State. The defendant also argued that the plaintiffs had presented no evidence that two-thirds of their proposed class members were in fact Kansas citizens, as opposed to, for example, local offices of national corporations or out-of-state students at Kansas colleges, who might have Kansas cell phones and Kansas mailing addresses although not Kansas citizens.

As has become clear under CAFA [*see* Moore's Federal Practice, Chap. 107, § 107.41[1][e][i][B] (although removing defendant has burden of showing that CAFA jurisdiction exists, courts have held that plaintiff seeking remand has the burden of showing that an exception applies)], the court agreed with the defendant that the burden of proving the exception fell on the plaintiffs, who were seeking remand, to show that the home-state exception applied.

To do that, they had to establish by a preponderance of the evidence that two-thirds of their proposed class members were Kansas citizens, that is, either individuals domiciled in Kansas, corporations incorporated there, or unincorporated entities organized there or with their principle places of business there. However, the plaintiffs did not submit any evidence about citizenship. Rather, they alleged Kansas residence as opposed to Kansas citizenship. Nonetheless, the district court had found that the class definition itself, keyed to Kansas cell phone numbers and mailing addresses, made it more likely than not that two-thirds of the putative class members were Kansas citizens.

Although the district court's approach concededly amounted to common sense, the Seventh Circuit said that the district court's approach was mere guesswork. It was reasonable to suppose that people with Kansas cell phones and addresses lived and worked in Kansas, and it was also reasonable to suppose that the majority of these residents were citizens in that they viewed Kansas as their permanent home. Some residents might be college students from other states or soldiers, who lived or were stationed in Kansas but did not intend to stay there indefinitely, but these people probably were only a small proportion of the total population. The same view was also reasonable applied to cell phones belonging to businesses; only a fraction of businesses that used Kansas cell phone service would not be Kansas citizens.

Nevertheless, the Seventh Circuit concluded that there were a number of ways in which these reasonable assumptions about citizenship might turn out to be wrong. Therefore, it concluded that a district court may not draw conclusions about the citizenship of class members based on things like their phone numbers and mailing addresses. Rather, to carry their burden, the Seventh Circuit listed a number of ways in which plaintiffs can establish the two-thirds-or-more percentage.

First, plaintiffs might submit evidence that two-thirds of the class members were indeed Kansas domiciliaries or businesses. The Seventh Circuit understood that it would not be feasible to document each class member's citizenship individually, but the district court could rely on evidence as to a representative sample. This evidence could include affidavits or survey responses in which putative class members stated whether they intended to remain in Kansas indefinitely and were therefore citizens. For businesses, the plaintiffs could ask for information as to their citizenship under the relevant test. Given those results and the size of the sample and the estimated size of the proposed class, the district court could then use statistical principles to reach a conclusion as to the likelihood that two-thirds or more of the

proposed class members were citizens of Kansas. A likelihood of more than 50 percent would be sufficient to meet the preponderance-of-the-evidence burden of proof.

Alternatively, the plaintiffs simply could define their class as limited to Kansas citizens. By using that definition, the plaintiffs all but could have guaranteed that the suit would remain in state court. There would have been no concern that out of state businesses, college students, or soldiers were more than one third of the class. No evidence would have been necessary. Of course, the tradeoff was that this definition would have limited the pool of potential class members, and as a result, the potential recovery.

Commentary. The Seventh Circuit had a more difficult time dealing with the district court's ruling on the evidentiary issue than it did with the defendant's first argument. It is helpful for the evolution of CAFA jurisprudence that the court followed the now general rule that once the defendant established that CAFA jurisdiction exists, the burden then falls on the plaintiffs to show that the home state exception applies [*see Hart v. FedEx Ground Package System, Inc.*, 457 F.3d 675, 680 (7th Cir. 2006)]. And, like other courts, the Seventh Circuit found that the plaintiffs had to establish by a preponderance of the evidence that two-thirds of their proposed class members were Kansas citizens. In other words, the plaintiffs needed to show that the class members were either individuals domiciled in Kansas or corporations organized there, or other business entities meeting the relevant tests [*see, e.g., Preston v. Tenet Healthsystems Mem. Med. Ctr., Inc.*, 485 F.3d 804, 813-814 (5th Cir. 2007)].

While it also may have been helpful for the Seventh Circuit to take the common sense approach that the district had, because the plaintiff on a motion to remand does have the burden of proof, it was appropriate for the Seventh Circuit to want more than guesswork. As it said, individuals with Kansas cell phones presumably have them because they live or work in the state. Although being a resident is not the same thing as being a citizen, and many people in Kansas with cell phones may be residents, as opposed to citizens - students; prisoners; military - the court said that "it's hard to believe that those nondomiciliaries are collectively more than a drop in the bucket when it comes to class composition" [*Sprint Nextel*, 593 F.3d at 674]. With respect to corporations and business entities, similar presumptions applied. In sum, the court was "inclined to think that at least two-thirds of those who have Kansas cell phone numbers and use Kansas mailing addresses for their cell phone bills are probably Kansas citizens" [*Sprint Nextel*, 593 F.3d at 674]. And, many courts had been using such assumptions [*Kitson v. Bank of Edwardsville*, 2006 U.S. Dist. LEXIS 85285, at *21-*23 (S.D. Ill. Nov. 22, 2006) (holding court "entitled to assume" that class members were Illinois citizens on basis of Illinois mailing addresses because, in its view, mailing addresses are evidence of residence, which is evidence of domicile); *Caruso v. Allstate Ins. Co.*, 469 F. Supp. 2d 364, 367-368 (E.D. La. 2007) ("Although there well may be proposed classes where detailed proof of the two-thirds citizenship requirement is required, the Court finds that common sense should prevail in this closed-end class involving people who, as noted, hold an asset that is a measure of domicile, their home."); *Bennett v. Bd. of Comm'rs*, 2007 U.S. Dist. LEXIS 65363, at *17 (E.D. La. Aug. 31, 2007) (holding it was "reasonable to infer" that two-thirds of all class members were Louisiana citizens, where class was open to all "residents, domiciliaries, business entities, property owners, and other persons and entities residing or present in a certain parish in August 2005); *see also Joseph v. Unitrin, Inc.*, 2008 U.S. Dist. LEXIS 61726, at *16 (E.D. Tex. Aug. 12, 2008)].

However, the Seventh Circuit ultimately wanted more: It criticized the approach as "[s]ensible guesswork, based on a sense of how the world works, but guesswork nonetheless" [*Sprint Nextel*, 593 F.3d at 674]. Accordingly, it surveyed and agreed with other district courts that have held that a court may not draw conclusions about the citizenship of class members based on things like their phone numbers and mailing addresses. Rather, plaintiffs should provide affidavits or survey responses in which putative class members reveal whether they intend to remain in Kansas indefinitely [*Sprint Nextel*, 593 F.3d at 675. *See, e.g., Preston v. Tenet Healthsystems Mem. Med. Ctr., Inc.*, 485 F.3d 804, 817 (5th Cir. 2007); *Martin v. Lafon Nursing Facility of the Holy Family, Inc.*, 548 F. Supp. 2d 268, 273-274 (E.D. La. 2008)]. And, being the Seventh Circuit, it is not surprising that it suggested that statistical measures be used: "Statisticians and scientists usually want at least 95 percent certainty, *see* Michael O. Finkelstein & Bruce Levin, *Statistics for Lawyers* 120, (2d ed. 2001), but any number greater than 50 percent would have allowed the district court to conclude that the plaintiffs had established the citizenship requirement by a preponderance of the evidence" [*Sprint*

Nextel, 593 F.3d at 676].

Disposition. Accordingly, the court of appeals granted the petition for leave to appeal and vacated the order remanding the case to state court. On remand, the court of appeals said, the district court should give the plaintiffs another opportunity to prove that the proposed class satisfied the requirements of the home[8209]state exception. The remand order may help clarify the plaintiff's burden on a motion to remand further.

RELATED LINKS: For further information, see Moore's Federal Practice:

- 5 Moore's Federal Practice (3d Ed.) 23.63[2][d][ii];
- 15 Moore's Federal Practice (3d Ed.) 102.26;
- 16 Moore's Federal Practice (3d Ed.) 107.15[13][b][ii][E]

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Can Separately Filed Actions Be Removed as a Single Mass Action under CAFA?

2010 Emerging Issues 5363

Can Separately Filed Actions Be Removed as a Single Mass Action under CAFA?

By Georgene Vairo

October 19, 2010

SUMMARY: In *Anderson v. Bayer Corp.*, the Seventh Cir. rejected a defendant's jurisdictional argument that the number of plaintiffs in separate, but similar, lawsuits could be counted toward the 100 plaintiff requirement of the "mass action" provision of the Class Action Fairness Act of 2005. The court held that plaintiffs could file their claims as several separate cases, each with fewer than 100 plaintiffs, to avoid removal as a "mass action" under CAFA.

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ARTICLE: Georgene Vairo on *Anderson v. Bayer Corp.*

Summary. In *Anderson v. Bayer Corp.*, 610 F.3d 390, 2010 U.S. App. LEXIS 12769 (7th Cir. June 22, 2010), the Seventh Circuit rejected a defendant's jurisdictional argument that the number of plaintiffs in separate, but similar, lawsuits could be counted toward the 100 plaintiff requirement of the "mass action" provision of the Class Action Fairness Act of 2005 ("CAFA"). The court held that plaintiffs could file their claims as several separate cases, each with fewer than 100 plaintiffs, in order to avoid removal as a "mass action" under the Class Action Fairness Act.

Facts and Procedural Background. *Anderson* involved five separate actions originally filed in state court. The complaints in each case were virtually identical and, using verbatim language, alleged claims for personal injury, on behalf of different groups of plaintiffs, resulting from the use of a prescription medication manufactured by the defendant. The defendants removed the five cases to federal court under the "mass action" provisions of CAFA. The district court remanded four of the five cases to state court because they each had fewer than 100 plaintiffs. The fifth action was not remanded because the complaint named 100 plaintiffs, although apparently the attorneys meant to include only 99 plaintiffs.

The defendants sought permission to appeal the remand orders in the four remanded cases under 28 U.S.C. § 1453(c), a CAFA provision that creates an exception to the general rule that remand orders are not reviewable. They argued that (1) plaintiffs could not avoid federal diversity jurisdiction under CAFA by carving their filings into five separate pleadings, and (2) there was diversity jurisdiction over most of plaintiff's claims because the claims of the small number of non-diverse plaintiffs were fraudulently misjoined and should be severed.

Separately Filed Actions Could Not Be Removed as a Single "Mass Action." The defendant first argued that

the cases met CAFA's definition of a "mass action" and thus the district court had jurisdiction and should not have remanded. A "mass action" is "any civil action . . . in which the monetary relief claims of 100 or more persons are proposed to be tried jointly on the ground that the plaintiffs' claims involve common questions of law or fact" [28 U.S.C. § 1332(d)(11)(B)(i)]. Under CAFA, mass actions are deemed to be class actions, and removable to federal court, if CAFA's other jurisdictional requirements are met. Here, there was no dispute that the other requirements—amount in controversy and minimal diversity—were met in each of the four cases.

The jurisdictional issue was the 100-plaintiff minimum—none of the four cases as constituted actually involved the claims of 100 or more plaintiffs. The defendant urged the court of appeals not to place "too much weight on form" in the CAFA context. They argued that the plaintiffs' five separate complaints were a transparent attempt to circumvent CAFA and, as such, should be treated as a single mass action.

In support, the defendant cited *Freeman v. Blue Ridge Paper Products, Inc.* [551 F.3d 405 (6th Cir. 2008)], in which the Sixth Circuit had considered a related situation. The plaintiffs had divided their class action claims for nuisance into five cases, each covering a different six-month period, in order to avoid meeting CAFA's \$5 million jurisdictional amount. The Sixth Circuit found that "there was no colorable reason for breaking up the lawsuit in this fashion, other than to avoid federal jurisdiction" and therefore held that the damages sought in each suit had to be aggregated for the purpose of determining whether the amount-in-controversy requirement had been met.

The Seventh Circuit noted that *Freeman* was distinguishable from the present case because it involved class actions and did not address CAFA's mass action provision. CAFA's mass action provision provides that the term "mass action" does not include "any civil action in which the claims are joined upon motion of a defendant" [28 U.S.C. § 1332(d)(11)(B)(ii)(II)]. By excluding cases in which the claims were consolidated on a defendant's motion, the Seventh Circuit said, Congress appears to have contemplated that some cases that could have been brought as a mass action would, because of the way in which the plaintiffs chose to structure their claims, remain outside of CAFA's grant of jurisdiction. This was consistent with the general rule in diversity cases that the plaintiff is "master of the complaint" and may include or omit claims or parties in order to determine the forum.

The Seventh Circuit cited and joined the only other appellate court to have addressed the defendant's argument, the Ninth Circuit in *Tanoh v. Dow Chemical Co.* [561 F.3d 945 (9th Cir. 2009)]. The Ninth Circuit had considered whether seven similar cases, each involving fewer than 100 plaintiffs, could be treated as a single mass action for CAFA purposes. The court rejected the defendant's argument, noting that a mass action cannot be one in which the claims are joined on motion of a defendant. While the defendant in *Tanoh*, like the defendant here, had not formally moved for consolidation, it was essentially asking the court to consolidate separate actions for purposes of applying the mass action provision.

The Seventh Circuit agreed with this reasoning. "The mass action provision gives plaintiffs the choice to file separate actions that do not qualify for CAFA jurisdiction. The instant cases contain fewer than 100 plaintiffs and thus are not removable under the plain language of the statute. Bayer's argument that these separate lawsuits be treated as one action is tantamount to a request to consolidate them—a request that Congress has explicitly stated cannot become a basis for removal as a mass action."

Comment. The Seventh Circuit's limiting interpretation of the mass action provision is correct. The mass action provision was a political compromise in a number of respects and it is clear that Congress was less concerned with mass actions than class actions. To the extent that plaintiffs sought to abuse their freedom to craft their cases as they wish to avoid federal court, the Seventh Circuit noted that subsequent action in state court might render the cases removable. For example, the plaintiffs may seek to have the claims tried jointly. The claims would also become removable in a situation in which only a few representative plaintiffs would actually go to trial, with claim or issue preclusion to be used to dispose of the remaining claims without trial. However, until the plaintiffs did in fact propose that the claims be tried jointly, they did not constitute a mass action and were not removable to federal court.

Additionally, the Seventh Circuit (like the Ninth Circuit in *Tanoh*) expressed no opinion as to whether a state court's *sua sponte* joinder of claims might allow a defendant to remove separately filed state court claims to federal court as a single mass action. It would seem, however, that a state court's joinder would be no less offensive to the idea that the plaintiff is the master of the complaint than a defendant's attempt.

The most litigation-provoking mass action exclusion is the one concerning mass actions that have been joined for trial purposes on motion of the defendant. The definition of "mass action" requires that the cases "are proposed to be tried jointly on the ground that the plaintiffs' claims involve common questions of law or fact" [28 U.S.C. § 1332(d)(11)(B)(ii)(II)]. This provision does seem to invite plaintiffs' counsel to structure the claims of various plaintiffs into several smaller units to avoid CAFA jurisdiction. In turn, this invites defendants, as those in *Anderson* did, to argue that groups of cases with plaintiffs numbering fewer than 100 plaintiffs, but that otherwise meet the mass action provision, should be removable as "class actions in disguise."

Another district court correctly agrees with the approach of the Seventh and Ninth Circuits. In *Mobley v. Cerro Flow Prods.*, [2010 U.S. Dist. LEXIS 524, at *10-*12 (S.D. Ill. Jan. 5, 2010)], the defendant argued that if the thirty-two plaintiffs in the *Mobley* case were aggregated with the twenty-one plaintiffs in the separate *Custer* case, the nineteen plaintiffs in *Clayton* [*Clayton v. Cerro Flow Prods.*, 2010 U.S. Dist. LEXIS 226 (S.D. Ill. Jan. 4, 2010)], the five plaintiffs in *Williams*, and the thirty plaintiffs in *Brown* [*Brown v. Cerro Flow Prods.*, 2010 U.S. Dist. LEXIS 227 (S.D. Ill. Jan. 4, 2010)], the case would be deemed to contain 107 plaintiffs. The court, as the *Brown* court had, found this argument to be frivolous, as it was clearly precluded by the statutory language of CAFA.

Court Lacked Appellate Jurisdiction To Review Remand Order When Action Was Not "Mass Action."

Except in class actions, federal courts of appeal are barred from reviewing district court orders remanding removed cases to state court. However, a party may appeal from an order granting or denying a motion to remand a class action [28 U.S.C. § 1453(c)]. The Seventh Circuit has held that in such an appeal the court may consider any potential error in the district court's decision, not just a mistake in application of CAFA [*Brill v. Countrywide Home Loans, Inc.*, 427 F.3d 446, 451 (7th Cir. 2005)].

Here, however, the Seventh Circuit had concluded that the remanded cases were not a "mass action" and therefore not a class action. The plain language of § 1453(c) extends appellate jurisdiction only to remand orders in class actions. Accordingly, the court lacked appellate jurisdiction to proceed to the defendant's other issues. Because the cases were not a mass action, the district court had properly remanded them, and the appellate court had no jurisdiction to hear an appeal from the remand order.

RELATED LINKS: For further information, see Moore's Federal Practice:

- 5 Moore's Federal Practice (3d Ed.) 23.63[2][e];
- 16 Moore's Federal Practice (3d Ed.) 107.15[13][b][iv];
- 16 Moore's Federal Practice (3d Ed.) 107.43A.

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Use of Cy Pres in Class Action Settlements: Howe v. Townsend

2010 Emerging Issues 5310

Use of Cy Pres in Class Action Settlements: Howe v. Townsend

By Georgene Vairo

September 21, 2010

SUMMARY: *Howe v. Townsend* (In re Pharm. Indus. Average Wholesale Price Litig.) is a case of first impression on an increasingly important topic: the use of "cy pres" in class action settlements. In *Howe*, the First Circuit ruled that the district court did not abuse its discretion in approving a class action settlement that included a cy pres provision under which unclaimed money from the settlement fund would be distributed to charities.

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ARTICLE: Georgene Vairo on *Howe v. Townsend* (In re Pharm. Indus. Average Wholesale Price Litig.)

Summary. *Howe v. Townsend* (In re Pharm. Indus. Average Wholesale Price Litig.), 588 F.3d 24, 2009 U.S. App. LEXIS 25536 (1st Cir. Nov. 19, 2009), is a case of first impression on an increasingly important topic: the use of "cy pres" in class action settlements. In *Howe*, the First Circuit ruled that the district court did not abuse its discretion in approving a class action settlement that included a cy pres provision under which unclaimed money from the settlement fund would be distributed to charities. The First Circuit also discussed the requirement under Rule 23(c)(1)(B) that the district court "define the class and the class claims, issues, or defenses".

Facts and Procedural Background. The plaintiff class, users of a drug prescribed for prostate cancer, claimed they overpaid Medicare co-payments because the defendant, a drug manufacturer, fraudulently inflated the price of the drug. The parties reached a \$24 million settlement, which the district court approved. One of the named plaintiffs appealed and challenged the settlement on various grounds, as she had done continuously through the process of negotiating the final settlement agreement. The appellant's principal argument was that the settlement was unreasonable because it included a "cy pres" distribution.

The First Circuit affirmed. It began by detailing the long and contentious process that led to final approval of the settlement deal, including the district court's role in obtaining amendments to the agreement for the benefit of the class members. With respect to appeal, the First Circuit noted that the district court's approval of a class action settlement is reviewed for abuse of discretion. The court further noted that a district court may approve a settlement only if the settlement is fair, adequate, and reasonable. However, given the generality of the standard and the need to balance a settlement's benefits and costs, the district court enjoys considerable range in approving or disapproving a class settlement.

Inclusion of "Cy Pres" Distribution Did Not Make Settlement Unreasonable. Before its decision in *Howe*, the First Circuit had not considered whether settlement agreements in class actions may include a cy pres provision. Other circuits, however, have approved agreements that provide for cy pres funds [*see* 5 Moore's Federal Practice (3d Ed.) § 23.171].

First, it is important to understand what "cy pres" is. The First Circuit noted that some courts and commentators have used the terms "cy pres" and "fluid recovery" interchangeably, although they have different meanings and origins. The term cy pres is borrowed from trusts and estates law: the doctrine saves testamentary gifts that otherwise would fail because their intended use is no longer possible. Courts permit the gift to be used for another purpose as close as possible to the gift's intended purpose. In the class action context, some courts have approved cy pres funds, to be used for a charitable purpose related to the class plaintiffs' injury, when it is difficult for all class members to receive individual shares of the recovery and, as a result, some or all of the recovery remains. The use of a cy pres fund may prevent the defendant from walking away from the litigation without paying a full recovery when there are practical obstacles to individual distribution.

Under the settlement in the present case, reached after months of intense litigation and negotiation and with input from the district court, the defendant agreed to pay \$24 million in total compensation to the class members. In addition, the defendant agreed to pay all costs of distributing this money as well as a separate amount for attorney's fees and costs. The parties expected that a large portion of the \$24 million would go unclaimed because the class members were elderly, had died, or could die soon, and not all of them could be found. Accordingly, they agreed to create a cy pres fund that would pay any amount remaining after payout to the claimants to "mutually acceptable charitable organizations funding cancer research or patient care" that the court would approve in the future. The parties capped the cy pres amount at \$10 million. Expert evidence predicted that class members would claim only about \$17.2 million, leaving approximately \$6.8 million for the cy pres fund.

This cy pres fund, contrary to the appellant's argument, did not take any money away from the class members-in fact, all those who submitted claims were entitled to treble damages before any money was paid to charity through the cy pres fund. This process, the First Circuit said, was like other, routinely approved cy pres distributions. "It would elevate form over substance to require the parties to wait until after all claims are paid before reaching an agreement as to how to distribute any remaining money to charity."

The appellant nevertheless maintained that the class members were entitled to receive the entire settlement amount, arguing that a cy pres distribution was appropriate only when it was economically infeasible to distribute the remaining proceeds to the claimants. The appellant relied on the American Law Institute's recent draft of the Principles of the Law of Aggregate Litigation discussing the appropriateness of cy pres distributions in settlements [*see* American Law Institute, Principles of the Law of Aggregate Litigation § 3.07 (Apr. 1, 2009) (proposed final draft)]. The proposed draft, in the First Circuit's view, expresses a policy preference for redistributing remaining settlement money to class members to ensure they recover their losses. The ALI was concerned that cy pres funds are often inappropriate because few settlements award 100 percent of class members' losses. The ALI also believed that in most circumstances, distribution to class members better approximates the goals of the substantive law than does distribution to third parties who were not directly injured by the defendant's conduct.

In responding to the appellant's argument based on the ALI's concerns about the use of cy pres, the First Circuit mentioned that the district court had shared these concerns. The First Circuit noted that the district court had insisted that the settlement pay class members treble damages before any money would be distributed through cy pres. This, according to the First Circuit, was well above the ALI's hope that class members might receive 100-percent recovery, and demonstrated that the appellant had misunderstood the ALI's position. The district court also recognized that the cy pres fund serves the goals of civil damages by ensuring that the defendant would fairly pay for the losses of the entire class, even though some class members would never claim their recovery.

The First Circuit also found that the district court's approval reflected another important concern: facilitating a

settlement in a hard-fought, complex class action. A district judge must realistically evaluate a settlement based on the circumstances of the case, and the ultimate decision by the judge involves balancing the advantages and disadvantages of the proposed settlement as against the consequences of going to trial or other possible but perhaps unattainable variations on the proffered settlement. Taking all this into account, the district court's approval was not an abuse of discretion.

Commentary. The First Circuit has quite positively joined the camp of those who argue that cy pres settlement provisions serve important goals. It is notable that the court did not address a *court-imposed* cy pres provision, which might be used if there are remaining funds and the parties had not thought to negotiate a cy pres provision. Other courts and commentators are skeptical of the use of cy pres. This is especially interesting now because the Class Action Fairness Act of 2005 ("CAFA") specifically endorses the use of cy pres. [28 U.S.C. § 1712(e) provides: "In a proposed settlement under which class members would be awarded coupons, the court may approve the proposed settlement only after a hearing to determine whether, and making a written finding that, the settlement is fair, reasonable, and adequate for class members. The court, in its discretion, may also require that a proposed settlement agreement provide for the distribution of a portion of the value of unclaimed coupons to one or more charitable or governmental organizations, as agreed to by the parties. The distribution and redemption of any proceeds under this subsection shall not be used to calculate attorney's fees under this section"].

Even before CAFA, some courts had approved such settlements, or had required that unclaimed coupons or other awards be given to charity, as a condition for approval under Rule 23 [see *Simon II Litig. v. Philip Morris USA Inc. (In re Simon II Litig.)*, 407 F.3d 125, 131 (2d Cir. 2005) (noting the district court's order to allocate undistributed sums on a cy pres basis to treatment and research organizations); see also *Mirfasihi v. Fleet Mortg. Corp.*, 356 F.3d 781, 784 (7th Cir. 2004); *In re Mex. Money Transfer Litig.*, 267 F.3d 743, 746 (7th Cir. 2001); *Powell v. Georgia-Pacific Corp.*, 119 F.3d 703, 705-707 (8th Cir. 1997); *Democratic Cent. Comm. v. Washington Metro. Area Transit Comm'n*, 84 F.3d 451, 455 (D.C. Cir. 1996); *Six (6) Mex. Workers v. Ariz. Citrus Growers*, 904 F.2d 1301, 1307 (9th Cir. 1990); *In re Agent Orange Prod. Liab. Litig.*, 818 F.2d 179, 184-185 (2d Cir. 1987); *State of California v. Levi Strauss & Co.*, 41 Cal. 3d 460, 472-473, 224 Cal. Rptr. 605, 715 P.2d 564 (1986)].

Yet, cy pres distributions have been strongly criticized by some commentators who believe that any remaining funds should escheat to the state or be returned to the defendant. Indeed, one observation is that "[c]y pres performs unconstitutional alchemy by effectively transforming the underlying substantive law from a compensatory remedial model into a civil fine by means of nothing more powerful than a procedural joinder device" [see Martin H. Redish, Peter Julian & Samantha Zyontz, *Cy Pres Relief and the Pathologies of the Modern Class Action: A Normative and Empirical Analysis*, 62 Fla. L. Rev. 617, 665-666 (2010)]. These commentators fear that the use of cy pres leads courts to approve class actions that otherwise would not be certified either because the payout per claimant is so small or because of difficulties in ensuring that settlement funds are actually distributed to class members. Moreover some courts continue to be wary of cy pres, especially when the parties have not themselves negotiated the provision as part of an arms-length settlement subject then to judicial approval. For example, in one Second Circuit case, the class members claimed only a small part of the settlement. The district court then ordered a cy pres distribution to charity to prevent the few class members from obtaining a windfall. The case bounced back and forth between the district court and the Second Circuit and is a telling example of the difficult problems raised when deciding the role of cy pres in the context of a class action settlement [see, e.g., *Fears v. Wilhelmina Model Agency, Inc.*, 2009 U.S. App. LEXIS 5430 (2d Cir. Mar. 16, 2009)].

District Court Satisfied Requirements of Rule 23(c)(1)(B). The second issue of first impression for the First Circuit in *Howe* concerned Rule 23(c)(1)(B). This rule, added in 2003, requires an order certifying a class to "define the class and the class claims, issues, or defenses." The appellant argued that the district court had failed to apply this rule properly.

The appellant's brief presented three arguments why the court's final certification order erred under Rule 23(c)(1)(B): (1) by incorporating its prior orders and not giving a full restatement of those orders, the district court did

not define the class or its claims in sufficient detail; (2) even if the district court could incorporate prior orders, the prior orders did not define the class claims, issues, or defenses with sufficient clarity; and (3) neither the final order nor the prior orders explained why the court approved what she argued was an expanded settlement class.

The federal rules, the First Circuit said, contemplate a district court issuing an order certifying a class and detailing the class composition and the case's issues and claims, an order the court can amend before final judgment. Rule 23(c)(1) does not explicitly state that Rule 23(c)(1)(B)'s substantive requirements apply to amended orders, but the text appears to apply to any order certifying a class, including an order certifying an amended class.

The First Circuit found that the depth of explanation district courts should provide in amended certification orders depends on the circumstances. A district court can amend a certification order to reflect major changes or minor adjustments to the class. The court should ensure that, after the new order, the class's composition and claims remain well defined.

This interpretation, the First Circuit said, makes sense in light of Rule 23(c)(1)(B)'s history and purpose. Rule 23 was substantially revised in 2003 to provide the district courts with the tools, authority, and discretion to closely supervise class action litigation. As part of this project, the Advisory Committee on Civil Rules made several amendments to Rule 23(c) that put greater emphasis on understanding and articulating the "contours" of the class action throughout the litigation. Overall, better comprehension and explanation of classes and class claims helps district courts, appellate courts, attorneys, and parties all proceed with more information and mutual understanding.

In the present case, however, the district court easily satisfied Rule 23(c)(1)(B)'s text and purpose. The court could incorporate its prior orders by reference when certifying the expanded class. These prior orders plainly defined the class and the class claims, issues, and defenses in sufficient detail. The district court devoted many pages to the class's factual allegations against the defendant, and then carefully analyzed the proposed class's suitability for certification, again explaining the issues common to the class. The First Circuit found no merit in the appellant's argument that the certification order was deficient.

Commentary. The First Circuit's approach makes sense. The purpose of the rule was to provide clarification (and ultimately a better sense of who will be subject to preclusion) to assist the parties and the court as a class action makes its way through the litigation process. The Advisory Committee certainly did not intend to create formalistic barriers for dissatisfied class members to use to upset otherwise reasonable settlements.

RELATED LINKS: For further information, see Moore's Federal Practice

- 5-23 Moore's Federal Practice (3d Ed.) § 23.46[2][e][iii];
- 5-23 Moore's Federal Practice (3d Ed.) § 23.171

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Does An Arbitration Agreement Preclude or Allow Class Arbitration?

2010 Emerging Issues 5312

Does An Arbitration Agreement Preclude or Allow Class Arbitration?

By Georgene Vairo

September 21, 2010

SUMMARY: *Stolt-Nielsen S.A. v. AnimalFeeds Int'l Corp.* resolves an important class action arbitration issue. After the U.S. Supreme Court formally opened the door to class action arbitration in *Green Tree Financial Corp. v. Bazzle*, there was confusion in the lower federal courts on the issue of the extent to which an arbitration agreement precluded or allowed class arbitration. In *Stolt-Nielsen*, the Supreme Court provides some guidance on this issue.

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ARTICLE: Georgene Vairo on *Stolt-Nielsen S.A. v. AnimalFeeds Int'l Corp.*

Summary. *Stolt-Nielsen S.A. v. AnimalFeeds Int'l Corp.*, - U.S. -, 130 S. Ct. 1758, 176 L. Ed. 2d 605, 2010 U.S. LEXIS 3672, 2010-1 Trade Cas. (CCH) P76,982 (Apr. 27, 2010), resolves an important class action arbitration issue. After the United States Supreme Court formally opened the door to class action arbitration in *Green Tree Financial Corp. v. Bazzle*, [539 U.S. 444, 123 S. Ct. 2402, 156 L. Ed. 2d 414 (2003)], there was confusion in the lower federal courts on the issue of the extent to which an arbitration agreement precluded or allowed class arbitration. In *Stolt-Nielsen*, a 5-3 decision (Justice Sotomayor did not participate), the Supreme Court provides some guidance on this issue, holding that a party may not be compelled to submit to class arbitration under the Federal Arbitration Act without a contractual basis for concluding that the party agreed that class-wide arbitration would be available. However, a strong dissent suggests that the opinion leaves the door open to some arguments regarding its applicability to all arbitration agreements.

Facts and Procedural Background. The underlying dispute was between several shipping companies and their customers, who claimed that the shipping companies engaged in an illegal price fixing conspiracy. The shipping companies serve a large share of the world market for parcel tankers-seagoing vessels with compartments that are separately chartered to customers wishing to ship liquids in small quantities. One of their customers is AnimalFeeds, which supplies raw ingredients, such as fish oil, to animal-feed producers around the world. AnimalFeeds ships its goods pursuant to a standard shipping contract known in the maritime trade as a charter party. This shipping contract, however, contained a clause whereby the parties agreed to submit any disputes to arbitration in conformance with the Federal Arbitration Act (FAA). The arbitration provision read:

Arbitration. Any dispute arising from the making, performance or termination of this Charter Party shall be settled

in New York, Owner and Charterer each appointing an arbitrator, who shall be a merchant, broker or individual experienced in the shipping business; the two thus chosen, if they cannot agree, shall nominate a third arbitrator who shall be an Admiralty lawyer. Such arbitration shall be conducted in conformity with the provisions and procedure of the United States Arbitration Act [i.e., the FAA], and a judgment of the Court shall be entered upon any award made by said arbitrator.

Clearly, therefore, the dispute required arbitration. However, one of the customers served the shipping companies with a demand for class arbitration, seeking to represent a class who had been harmed by the alleged conspiracy. The parties agreed to submit the class arbitration issue to a panel of three arbitrators who were to follow the American Arbitration Association's Supplemental Rules for Class Arbitration. These rules, in accordance with *Green Tree Financial Corp. v. Bazzle*, require an arbitrator, as a threshold matter, to determine whether the applicable arbitration clause permits the arbitration to proceed on behalf of or against a class. The parties stipulated that the arbitration clause was silent with respect to class arbitration—that is, that no agreement had been reached on whether disputes were subject to class arbitration.

The panel of arbitrators concluded that the arbitration clause did allow for class arbitration, and then stayed the proceedings to allow the parties to seek judicial review. The district court vacated the award, concluding that the arbitrators' decision was made in "manifest disregard" of the law insofar as the arbitrators failed to conduct a choice-of-law analysis. The Second Circuit then reversed, concluding that, regardless of what law applied, the arbitrators' decision was not in manifest disregard of the law because neither federal maritime law nor New York law established a rule against class arbitration. The shippers then sought review in the Supreme Court, asking the Court to vacate the decision of the arbitration panel.

Justice Alito delivered the opinion of the Court, joined by Chief Justice Roberts, Justice Scalia, Justice Kennedy, and Justice Thomas.

Arbitrator's Decision Vacated. The decision of an arbitration panel may be vacated under the Federal Arbitration Act only if the arbitrators exceed their powers by straying from interpretation and application of the agreement and effectively dispensing their own idea of justice. Here, the arbitrators had apparently reasoned that the clause should be construed to permit class arbitration as a matter of public policy, rather than inquiring whether the FAA (or maritime law, or New York law) contained a "default rule" under which an arbitration clause is construed as allowing class arbitration in the absence of express consent. Thus, the panel decision simply imposed the panel's own conception of sound policy.

Because the arbitration panel exceeded its authority, it was necessary to either direct a rehearing by the arbitrators, or decide the issue. The Court concluded that there could be only one possible outcome on the facts of this case, and therefore proceeded to decide whether the clause permitted class-wide arbitration.

Effect of *Green Tree Financial Corp. v. Bazzle*. The arbitration panel, and the parties, had been confused about the Court's decision in *Bazzle*, which they considered controlling precedent. *Bazzle* concerned contracts between a commercial lender and its customers. The contracts contained an arbitration clause but did not expressly mention class arbitration. Nevertheless, an arbitrator conducted class arbitration proceedings and entered awards for the customers. The South Carolina Supreme Court affirmed the awards, holding that class arbitration may be ordered when the arbitration agreement is silent if it would serve efficiency and equity and would not result in prejudice.

When *Bazzle* reached the U.S. Supreme Court, however, no single rationale commanded a majority. A plurality opinion decided that the arbitrator and not a court should determine whether the contracts were indeed silent on the issue of class arbitration. The plurality therefore concluded that the decision of the South Carolina Supreme Court should be vacated and the case remanded for a decision by the arbitrator on this question. Justice Stevens concurred in the judgment, but did not endorse the plurality's rationale.

Accordingly, the majority in *Stolt-Nielsen* ruled that the judgment in *Bazze* does not require that an arbitrator, rather than a court, decide whether a contract permits class arbitration. Nor was it necessary to answer this question in the present case, because the parties' supplemental agreement expressly assigned this issue to the arbitration panel, and no party argued that this assignment was impermissible.

For the same reasons, *Bazze* did not determine what standard the appropriate decision-maker should apply in deciding whether a particular contract allows class arbitration. This was the question to be decided in the present case.

Commentary. The fact that the majority decided the issue, rather than remand it to the arbitrators, is somewhat interesting, in light of other recent Supreme Court decisions, including another 2010 decision that conferred most of the decision-making on the arbitrators rather than the courts [*see Rent-A-Center, West, Inc. v. Jackson*, - U.S. -, 130 S. Ct. 2772, 177 L. Ed. 403, 2010 U.S. LEXIS 4981 (2010) (arbitrator, rather than a federal district court, had authority to hear an unconscionability-based challenge to an arbitration agreement governed by the Federal Arbitration Act (FAA), where the arbitration agreement expressly delegated to an arbitrator exclusive authority to resolve any dispute regarding the enforceability or formation of the arbitration agreement, and the unconscionability-based challenge was to the arbitration agreement as a whole, rather than to the delegation provision itself); *Buckeye Check Cashing, Inc. v. Cardegna*, 546 U.S. 440, 126 S. Ct. 1204, 163 L. Ed. 2d 1038 (2006) (where parties to an agreement with an arbitration clause challenged the validity of the agreement as a whole, without challenging the validity of the arbitration provision itself, under the Federal Arbitration Act it was up to the arbitrator to determine in the first instance whether a contract containing an arbitration clause was valid regardless of whether the action challenging the contract was brought in state or federal court); *Greentree Financial Corp. v. Bazze*, 539 U.S. 444, 123 S. Ct. 2402, 156 L. Ed. 2d 414 (2003) (under the terms of the parties' contracts, the question whether the agreement forbids class arbitration was for the arbitrator to decide; the parties had agreed to submit to the arbitrator all disputes, claims, or controversies arising from or relating to the contract or the relationships which result from the contract, and a dispute about what the arbitration contract in each case means (i.e., whether it forbids the use of class arbitration procedures) was a dispute "relating to this contract" and the resulting "relationships"); *Howsam v. Dean Witter Reynolds, Inc.*, 537 U.S. 79, 123 S. Ct. 588, 154 L. Ed. 2d 491 (2002) (whether a petition for arbitration was timely under a rule of the National Association of Securities Dealers (NASD) providing that no dispute "shall be eligible for submission to arbitration where six (6) years have elapsed from the occurrence or event giving rise to the dispute" was not a question of "arbitrability" for a court but was a procedural gateway type of question for the arbitrator)].

Moreover, substitution of its own ruling rather than remanding seems to violate the spirit, if not the letter, of the Court's recent opinion in *Hall Street Assocs., L.L.C. v. Mattel, Inc.*, [552 U.S. 576, 587, 128 S. Ct. 1396, 170 L. Ed. 2d 254 (2008)], in which the court refused to allow enforcement of an arbitration agreement that provided for an elevated level of judicial review. The *Stolt-Nielsen* Dissent's position is based largely on its sense that the opinion here, both in terms of the Court substituting its own opinion and in terms of its reach beyond what it saw as the FAA's bases for overturning an arbitral opinion, undermines the authority of arbitrators. This is an important point. Surely, the majority intended to preserve a more traditional sense of arbitration that precluded class arbitration absent agreement - and that position is hard to dispute given the evolution of the Court's arbitration enforcement decisions as well as the FAA's general purpose of privileging arbitration. But, once arbitration becomes the forum, it is just as important to respect the decisions of the arbitrators.

Parties Must Expressly Agree to Class Arbitration. The Court reviewed the basis for the arbitration panel's decision and the Second Circuit's decision. It found that the arbitration panel appeared to rest its decision on AnimalFeeds' public policy argument. Because the parties agreed their agreement was "silent" in the sense that they had not reached any agreement on the issue of class arbitration, the arbitrators should have identified the rule of law that governed in that situation. Had they engaged in such an undertaking, they presumably would have looked either to the FAA itself or to one of the two bodies of law that the parties claimed were governing, i.e., either federal maritime law or New York law. But the panel did not consider whether the FAA provides the rule of decision in such a situation; nor did the panel attempt to determine what rule would govern under either maritime or New York law. Rather, the panel based its decision on post-*Bazze* arbitral decisions that "construed a wide variety of clauses in a wide variety of settings as

allowing for class arbitration." The arbitrators did not discuss whether any of these decisions were based on a rule derived from the FAA or on maritime or New York law, and their approach confirmed that they did not seek to determine the intent of the parties in the context of the governing arbitration clause.

Indeed, the Court noted that rather than inquiring whether the FAA, maritime law, or New York law contains a "default rule" under which an arbitration clause is construed as allowing class arbitration in the absence of express consent, the panel proceeded as if it had the authority of a common-law court to develop what it viewed as the best rule to be applied in such a situation. The arbitration panel seemed to find a post-*Bazze* consensus among arbitrators that class arbitration is beneficial in "a wide variety of settings," and therefore considered only whether there was any good reason not to follow that consensus in this case. Moreover, it rejected the shipping companies' citations to court cases denying consolidation of arbitrations, or by undisputed evidence that the type of clause used by the parties had "never been the basis of a class action," or by expert opinion that "sophisticated, multinational commercial parties of the type that are sought to be included in the class would never intend that the arbitration clauses would permit a class arbitration."

The Court then noted that interpretation of an arbitration agreement is generally a matter of state law, but that the FAA imposes certain rules of fundamental importance, including the basic precept that arbitration is a matter of consent, not coercion. The central purpose of the FAA is to ensure that private agreements to arbitrate are enforced according to their terms. Courts and arbitrators must give effect to the contractual rights and expectations of the parties, and the parties are generally free to structure their arbitration agreements as they see fit. Parties may also specify with whom they choose to arbitrate their disputes.

According to the Court, it follows from these established principles that a party may not be compelled under the FAA to submit to class arbitration unless there is a contractual basis for concluding that the party agreed to do so. In the present case, however, the arbitration panel imposed class arbitration even though the parties concurred that they had reached no agreement on that issue. The panel had determined that the parties did not intend to *preclude* class arbitration, and regarded this silence as dispositive. This conclusion, the Court said, was fundamentally at war with the foundational FAA principle that arbitration is a matter of consent:

An implicit agreement to authorize class-action arbitration, however, is not a term that the arbitrator may infer solely from the fact of the parties' agreement to arbitrate. This is so because class-action arbitration changes the nature of arbitration to such a degree that it cannot be presumed the parties consented to it by simply agreeing to submit their disputes to an arbitrator. In bilateral arbitration, parties forgo the procedural rigor and appellate review of the courts in order to realize the benefits of private dispute resolution: lower costs, greater efficiency and speed, and the ability to choose expert adjudicators to resolve specialized disputes. . . . But the relative benefits of class-action arbitration are much less assured, giving reason to doubt the parties' mutual consent to resolve disputes through class-wide arbitration.

The Court concluded that the question was whether the parties *agreed to authorize* class arbitration. Because the parties had stipulated that there was no agreement on this question, they could not be compelled to submit their dispute to class-wide arbitration, and the judgment of the court of appeals was reversed. The Court noted that it had no occasion to decide precisely what contractual basis might support a finding that the parties agreed to authorize class arbitration, as here the parties had stipulated that there was no agreement.

Dissent. A dissenting opinion by Justice Ginsburg (joined by Justice Stevens and Justice Breyer) argued that the questions presented were not ripe for judicial review, so that the petition for certiorari should be dismissed as improvidently granted.

Moreover, if the merits were considered, the dissent would have affirmed the judgment of the court of appeals. The parties had entered into a supplemental agreement that the arbitration would be conducted according to the rules of the American Arbitration Association for class arbitrations. One of these rules directs the arbitration panel to determine whether the applicable arbitration clause permits the arbitration to proceed on behalf of a class. The panel had decided

that the clause did. "The parties' supplemental agreement, referring the class-arbitration issue to an arbitration panel, undoubtedly empowered the arbitrators to render their clause-construction decision. That scarcely debatable point should resolve this case." A reviewing court may vacate an arbitration decision, even if convinced of serious error, only if the arbitrators exceeded their powers, which was not the case here.

Commentary. It is no surprise that the majority would reject an approach in which an arbitration panel could impose "its own conception of sound policy" instead of the parties' intent. However, the dissent quite strongly criticized the majority for picking and choosing those aspects of the arbitrators' opinion that fit their argument that the result was policy based as opposed to law or contract based.

It is also true that, as the majority suggests, shifting from a bilateral arbitration to a class action arbitration can have radical consequences in terms of the stakes involved, or the number of parties, or complexity.

Even though the decision in *Stolt-Nielsen* bends the presumptions against class arbitration, the opinion leaves several important issues open. For example, the parties arguably made it easier for the Court to rule that there was no consent on the issue of class arbitration because the parties had stipulated that there was no agreement. Absent such a stipulation, what language would support a finding that the parties intended class arbitration? The Court left that question open. For example, the American Arbitration Association's rules include procedures for class arbitrations. Suppose an arbitration agreement incorporates the AAA's rules or specifies that that the arbitration shall be conducted by the AAA. Is the existence of such rules together with an agreement pointing to the AAA (or other arbitration entity with similar rules) enough to demonstrate consent?

The majority and the dissent both noted that *Bazzle* was a consumer case. Will there be a different presumption with respect to the need for consent if the Court confronts a consumer contract as in *Bazzle*? On the other hand, it is one thing to say that a party to a commercial agreement, where there is equal bargaining power, cannot be "coerced" into class arbitration. It is another to say that a consumer who is essentially coerced into an arbitration agreement should be deprived of a class procedure. The majority's reasoning would seem to support the same result, but as a practical matter, corporations will likely amend their arbitration agreements to preclude class arbitration to make sure. The question then becomes, is a class action waiver clause in the consumer context enforceable? Some lower federal courts have ruled that they are not on the ground that they are unconscionable [*see In re American Express Merchants' Litigation*, 554 F.3d 300 (2d Cir. 2009), cert. granted, vacated and remanded sub nom. Am. Express Co. v. Italian Colors Rest., - U.S. -, 130 S. Ct. 2401, 176 L. Ed. 2d 920 (2010)]. The question is whether opinions such as this will stand the test of time.

RELATED LINKS: For further information, see Moore's Federal Practice:

- 5-23 Moore's Federal Practice (3d Ed.) 23.04[1];
- 19-203 Moore's Federal Practice (3d Ed.) § 203.12[1].

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From November 1988 until its closing in April 2000, Professor Vairo served on the Board of Trustees of the Dalkon Shield Claimants Trust, and since 1989 as the Chairperson. She serves on the editorial boards of several litigation and dispute resolution journals, including *Moore's Federal Practice*. She also is a member of the Rand Corporation's Institute for Civil Justice Board of Overseers. She is a member of the American Law Institute, has participated in numerous academic conferences, and has lectured widely to the bench and bar at programs various national and local associations and institutes.

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Does CAFA Require the Diversity Jurisdiction Amount in Controversy Requirement?

2010 Emerging Issues 5305

Does CAFA Require the Diversity Jurisdiction Amount in Controversy Requirement?

By Georgene Vairo

September 16, 2010

SUMMARY: In an opinion that has the potential to subvert the Class Action Fairness Act "CAFA", the Eleventh Circuit has interpreted the jurisdictional provisions of CAFA as incorporating the traditional diversity jurisdiction \$75,000 amount-in-controversy requirement. The court concluded that, in a CAFA action originally filed in federal court, at least one of the plaintiffs must allege an amount in controversy that satisfies the \$75,000 requirement.

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ARTICLE: Georgene Vairo on *Cappuccitti v. DirecTV, Inc.*

Summary. In an opinion that has the potential to subvert the Class Action Fairness Act ("CAFA"), 28 U.S.C. § 1332(d), a panel of the Eleventh Circuit has interpreted the jurisdictional provisions of CAFA as incorporating the traditional diversity jurisdiction \$75,000 amount-in-controversy requirement of § 1332(a). The court concluded that, in a CAFA action originally filed in federal court, at least one of the plaintiffs must allege an amount in controversy that satisfies the \$75,000 requirement [*see Cappuccitti v. DirecTV, Inc.*, 611 F.3d 1252, 2010 U.S. App. LEXIS 14724 (11th Cir. July 19, 2010)].

Facts and Procedural Background. This class action was brought in federal court asserting jurisdiction under the Class Action Fairness Act (CAFA). The plaintiffs were citizens of Georgia, and the defendant was a California corporation that provided television services. The plaintiffs alleged that the defendant violated Georgia law by charging them a fee for cancelling their subscriptions before the subscriptions expired.

The subscriber agreements between the plaintiffs and the defendant contained arbitration clauses and class action waiver provisions. The defendant therefore moved the court to compel the plaintiffs to submit to arbitration and also sought dismissal under Rule 12(b)(6) for failure to state a claim. The district court denied the motion to compel arbitration (reasoning that the arbitration and class action waiver clauses were unconscionable and therefore unenforceable), but granted the motion to dismiss. The defendant then appealed the denial of the motion to compel arbitration.

The Eleventh Circuit began by considering whether the district court possessed subject matter jurisdiction over the action, and concluded that jurisdiction under CAFA was absent from the inception of the case.

CAFA's Jurisdictional Requirements. Congress enacted CAFA in 2005 with an eye toward curbing "abuses of the class action device that have (A) harmed class members with legitimate claims and defendants that have acted responsibly; (B) adversely affected interstate commerce; and (C) undermined public respect for our judicial system" [Pub. L. No. 109[#8209]2, § 2(a)(2), *119 Stat. 4, 4-5 (2005)*]. In particular, Congress found that state courts were overly friendly toward class certification, provided insufficient notice to class members, and favored some plaintiffs over others in making class awards. In response, Congress amended the jurisdictional statutes to make it easier to both bring class actions in federal court and to remove class actions from state to federal court.

CAFA effectuated these goals largely by adding a new subsection to the diversity jurisdiction statute [*28 U.S.C. § 1332(d)*]. This subsection provides federal courts with original jurisdiction over class actions in which (1) the amount in controversy, aggregating the claims of all the class members, exceeds \$5,000,000 and (2) there is minimal diversity (at least one plaintiff and one defendant are from different states). Additionally, there must be 100 or more plaintiffs [*28 U.S.C. § 1332(d)(5)*]. CAFA defines a "class action" as "any civil action filed under rule 23 of the Federal Rules of Civil Procedure or similar State statute or rule of judicial procedure authorizing an action to be brought by 1 or more representative persons as a class action."

The burden of proof rests with the plaintiffs, as the ones relying on federal jurisdiction, to establish by a preponderance of the evidence that these jurisdictional requirements have been met.

The Eleventh Circuit noted that it had extensively interpreted CAFA's jurisdictional requirements in the removal context. The present case differed from these previous cases, and from the ordinary CAFA case, in that it had been filed originally in federal court, rather than removed from state court.

At Least One Class Member Must Meet the \$75,000 Amount-in-Controversy Requirement. The Eleventh Circuit, as it should, first sua sponte looked to see whether the district court had subject matter jurisdiction. Specifically, it considered whether CAFA's amount in controversy was met. Although it noted that CAFA was enacted to expand federal jurisdiction over class actions, it found that CAFA did not alter the general rule applicable in traditional diversity cases that at least one plaintiff satisfy the amount in controversy of \$75,000 [*28 U.S.C. § 1332(a)*].

Thus, the Eleventh Circuit asked a question that no other court had considered in the CAFA context: whether a court is required to apply the \$75,000 amount-in-controversy requirement of *28 U.S.C. § 1332(a)*, as well as the \$5,000,000 amount-in-controversy requirement of *§ 1332(d)*. The court had expressly reserved the question in a previous case written by the same court of appeals judge who wrote *Cappuccitti [Lowery v. Ala. Power Co., 483 F.3d 1184, 1206 (11th Cir. 2007)]*.

The court concluded that, in a CAFA action originally filed in federal court, at least one of the plaintiffs must allege an amount in controversy that satisfies the requirement for diversity jurisdiction provided in *28 U.S.C. § 1332(a)*. "Such a conclusion is compelled by the language of *§ 1332* as well as the general principle that federal courts are tribunals of limited jurisdiction whose power to hear cases must be authorized by the Constitution and by Congress. . . . If we held that *§ 1332(a)*'s \$ 75,000 requirement for an individual defendant did not apply to *§ 1332(d)(2)* cases, we would be expanding federal court jurisdiction beyond Congress's authorization. We would essentially transform federal courts hearing originally[#8209]filed CAFA cases into small claims courts, where plaintiffs could bring five[#8209]dollar claims by alleging gargantuan class sizes to meet the \$5,000,000 aggregate amount requirement. While Congress intended to expand federal jurisdiction over class actions when it enacted CAFA, surely this could not have been the result it intended."

The court noted that, while *§ 1332(d)* clearly altered *§ 1332(a)* to require only minimal diversity in CAFA actions, there was no evidence of congressional intent in *§ 1332(d)* to obviate *§ 1332(a)*'s \$75,000 requirement as to at least one

plaintiff. In further support of its conclusion, the court pointed out that the \$75,000 requirement is expressly retained with respect to removal of mass actions [*see* 28 U.S.C. § 1332(d)(11)(B)(i)], and stated that "we can think of no reason why Congress would have intended the requirement in the context of CAFA removal jurisdiction but not CAFA original jurisdiction. Holding otherwise would cause a nonsensical result: a case in which a plaintiff claimed less than \$75,000 in controversy in state court could not enter federal court by removal (defeating Congress's purposes in enacting CAFA), but could, if the plaintiff chose, be brought in federal court under CAFA original jurisdiction (assuming the case met all of CAFA's other requirements). Again, we highly doubt that Congress intended this result."

The District Court Lacked Subject Matter Jurisdiction. The plaintiffs had adequately alleged most of the requirements of CAFA jurisdiction—there was no dispute over diversity, or the \$5,000,000 requirement, or the 100-plaintiff minimum. However, the complaint failed to allege that at least one plaintiff had a claim of over \$75,000. To the contrary, the plaintiffs had alleged that the maximum penalty suffered by any individual plaintiff was \$480. If even one plaintiff had met the \$75,000 limit, the court could have exercised supplemental jurisdiction over the claims of the other class members [*see Exxon Mobil Corp. v. Allapattah Servs.*, 545 U.S. 546, 125 S. Ct. 2611, 162 L. Ed. 2d 502 (2005)]. But at least one plaintiff must meet the \$75,000 jurisdictional minimum, and the plaintiffs had not, and could not, allege this.

Because this basic requirement of jurisdiction was not met, the district court lacked subject matter jurisdiction over the case. It lacked the power to consider the motion to compel arbitration, and was required to dismiss the case.

Comment. Quite clearly, *Cappuccitti* is wrongly decided and at least one court already has rejected its reasoning [*Gutierrez v. Wells Fargo Bank, N.A.*, 2010 U.S. Dist. LEXIS 85123 (N.D. Cal. Aug. 10, 2010)]. The opinion has caused quite a stir in legal blog-land and within the Eleventh Circuit. In fact, both sides have petitioned for en banc review of the panel opinion. Non-parties have filed as well. For example, the Washington Legal Foundation filed a motion to uphold *Cappuccitti* on August 18, 2010. The prediction here is that one way or the other, through en banc review or by the Supreme Court itself, the panel opinion will be soundly rejected, for several reasons.

First of all, there is no basis in CAFA for treating cases removed to federal court differently than those brought in federal court in its original jurisdiction. CAFA provides that federal district courts have original jurisdiction over any class action in which the matter in controversy exceeds the sum or value of \$5,000,000, exclusive of interest and costs, [28 U.S.C. § 1332(d)(2)], provided, of course, that CAFA's minimal diversity requirements are met. Congress has expressly required that class members' claims be aggregated to determine the requisite amount in controversy: "In any class action, the claims of the individual class members shall be aggregated to determine whether the matter in controversy exceeds the sum or value of \$ 5,000,000, exclusive of interest and costs" [28 U.S.C. § 1332(d)(6)].

CAFA's aggregation requirement is intended to be a major departure from the traditional diversity requirements under which either every class member must have a claim worth more than \$75,000, or at least one named class member must have an individual claim worth more than \$75,000, and the claims of every other class member must satisfy the requirements for supplemental jurisdiction [*see Zahn v. International Paper Co.*, 414 U.S. 291, 301, 94 S. Ct. 505, 38 L. Ed. 2d 511 (1973)]. Although the amount-in-controversy minimum of \$5,000,000 seems high compared to the normal diversity jurisdiction minimum of only \$75,000, the aggregation rule is intended to make CAFA's \$5,000,000 minimum easier to meet in most class action cases.

The aggregation approach Congress takes in CAFA eliminates the need to focus on each class members' damages. Instead, the statute not only allows the class members' claims to be aggregated for jurisdictional amount purposes, it requires such aggregation. If the sum of the individual class members' damages exceeds \$5 million, the case meets CAFA's jurisdictional amount requirement. To put it another way, if the amount at risk from the defendant's viewpoint exceeds \$5 million, the jurisdictional amount requirement is satisfied.

The Eleventh Circuit's opinion is a stunning departure from this idea. The class members alleged damages in excess of \$5,000,000, but because the individual claims of the class members ranged from \$175 to \$480 there was no

jurisdiction.

The court's analysis is exceptionally thin. For example, the court stated that its result was "compelled by the language of § 1332" but it does not there cite to any of the numerous provisions of the traditional diversity jurisdiction provisions or CAFA. The court also said that its result was compelled by the "general principle that federal courts are courts of limited jurisdiction" but failed to explain how that general principle specifically informs the interpretation of CAFA's amount-in-controversy requirement, given especially, as the court conceded, that Congress intended to expand federal jurisdiction. The only real justification for the court's result is its argument that there is nothing in CAFA that suggests that there was "congressional intent in § 1332(d) [the entire CAFA jurisdictional provision] to obviate § 1332(a)'s \$75,000 requirement as to at least one plaintiff." But there is no need for "congressional intent" on this issue because the language of CAFA itself in § 1332(d)(6) requiring aggregation with respect to the \$ 5 million amount in controversy, and § 1332(d)(11)(B)(i) separately setting out a \$75,000 amount in controversy for mass action plaintiffs, compel the opposite conclusion.

The court made a number of mistakes in its analysis. First, it virtually ignored CAFA's aggregation rule, § 1332(d)(6). It cited it only when setting out CAFA's amount-in-controversy requirement, and failed to analyze the role the aggregation rule is designed to play in facilitating CAFA jurisdiction, as discussed above and in the next subsection.

Second, the Eleventh Circuit cited mass action cases, and not class action cases, as support for the idea that at least one plaintiff must meet the jurisdictional amount: its own decision in *Lowery v. Alabama Power Co.*, [483 F.3d 1184 (11th Cir. 2007)], and the Ninth Circuit's decision in *Abrego Abrego* [*Abrego Abrego v. Dow Chem. Co.*, 443 F.3d 676 (9th Cir. 2006)]. The mass action provision of CAFA, 28 U.S.C. § 1332(d)(11), provides that "mass actions" - that is, actions in which the claims of 100 or more persons are joined in the complaint, and where the amount in controversy is in excess of \$ 5 million - be treated as class actions. The problem with using mass action cases as support, however, is that the mass action provision has an additional amount-in-controversy provision. Under that provision, a mass action may be within CAFA jurisdiction, "except that jurisdiction shall exist only over those plaintiffs whose claims in a mass action satisfy the jurisdictional amount in controversy" of in excess of \$75,000 under the traditional diversity statute, 28 U.S.C. § 1332(a) [28 U.S.C. § 1332(d)(11)(B)(i)]. *Cappuccitti* was brought as a class action, not a mass action. Had it been brought as a mass action, the court's conclusion would be justified because none of the plaintiffs' claims were even close to meeting the \$75,000 amount in controversy. But, there is nothing in the rest of CAFA to suggest that such a limitation should apply in the class action context.

Finally, its attempt to distinguish the *Cappuccitti* case from the usual CAFA case also failed for several reasons. While the court is correct that as the proponent of federal jurisdiction, the plaintiffs had the burden of proving jurisdiction, the issue here turned on a question of law. Either CAFA requires at least one plaintiff to meet the jurisdictional amount or it doesn't. More importantly, Congress did not distinguish between original jurisdiction requirements and removal jurisdiction requirements.

There is no basis in CAFA for a holding that is limited to original jurisdiction cases, as the Eleventh Circuit could be read to be doing. The court said: "We hold that in a CAFA action *originally* filed in federal court, at least one of the plaintiffs must allege an amount in controversy that satisfies the current congressional requirement for diversity jurisdiction provided in 28 U.S.C. § 1332(a)." It further stated that refusing to impose the \$75,000 requirement for one plaintiff "would essentially transform federal courts hearing *originally-filed* CAFA cases into small claims courts, where plaintiffs could bring five-dollar claims by alleging gargantuan class sizes to meet the \$ 5,000,000 aggregate amount requirement. While Congress intended to expand federal jurisdiction over class actions when it enacted CAFA, surely this could not have been the result it intended." Indeed, this is precisely the scenario that Congress dealt with in CAFA - situations where aggregated small claims led to a high overall damages prayer for relief that could be ruinous to a corporate defendant. While it is true that the purpose of CAFA was to facilitate the removal of class action cases from state court to federal court, the statute is not so limited. It provides for original and removal jurisdiction. Indeed, the Federal Judicial Center has found that CAFA has led to an increased number of federal class actions, but the unintended consequence of CAFA is that a majority of the cases were filed originally in federal court. [Emery G. Lee III & Thomas

E. Willging, *The Impact of the Class Action Fairness Act of 2005 on the Federal Courts: Fourth Interim Report to the Judicial Conference Advisory Committee on Civil Rules*, Federal Judicial Center, April 2008, at 1, 12-13].

The bottom line is that *Cappuccitti* was wrongly decided and would eviscerate CAFA. That may be a happy thought to some, but certainly is not what Congress intended or provided for in the language of CAFA. There simply is no basis for grafting onto the CAFA's class action provisions the \$75,000 jurisdictional amount applicable to traditional diversity cases or CAFA class actions. In fact, under the Supreme Court's post-CAFA enactment decision in *Exxon Mobil Corp. v. Allapattah Servs.*, [545 U.S. 546, 125 S. Ct. 2611, 162 L. Ed. 2d 502 (2005)], it is possible to maintain a class action in federal court under traditional diversity jurisdiction so long as one plaintiff meets the \$75,000 amount in controversy. All that CAFA would add to that if the Eleventh Circuit is correct is CAFA's minimal diversity requirement.

RELATED LINKS: For further information, see Moore's Federal Practice:

- 5 Moore's Federal Practice (3d Ed.) § 23.63[2];
- 15 Moore's Federal Practice (3d Ed.) § 102.26[1][c]

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Class Certification under Dukes al. Wal-Mart Stores, Inc

2010 Emerging Issues 5306

Class Certification under Dukes al. Wal-Mart Stores, Inc

By Georgene Vairo

September 16, 2010

SUMMARY: *Dukes v. Wal-Mart Stores, Inc.*, is a landmark class action opinion. The Ninth Circuit, en banc, affirmed a panel decision that approved the certification of a sweeping nationwide employment discrimination class, and described and clarified the standards under which class actions may be certified. The defendant has petitioned for certiorari, and the opinion raises several critical issues that have divided the courts of appeals.

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ARTICLE: Georgene Vairo on *Dukes v. Wal-Mart Stores, Inc.*

Dukes v. Wal-Mart Stores, Inc., 603 F.3d 571, 2010 U.S. App. LEXIS 8576 (9th Cir. Apr. 26, 2010) (en banc), is a landmark class action opinion. The Ninth Circuit, en banc, affirmed a panel decision that approved the certification of a sweeping nationwide employment discrimination class, and described and clarified the standards under which class actions may be certified. The defendant has petitioned for certiorari, and the opinion raises several critical issues that have divided the courts of appeals.

Background. The plaintiffs alleged that the defendant, Wal-Mart Inc., discriminated against women employees in violation of Title VII of the Civil Rights Act of 1964, in that women (1) were paid less than men in comparable positions, despite having higher performance ratings and greater seniority, and (2) received fewer and waited longer for promotions. The plaintiffs contend that the defendant's strong, centralized structure fostered gender stereotyping and discrimination, that the policies and practices underlying this discriminatory treatment were consistent throughout the defendant's stores, and that this discrimination was common to all women employees.

The district court issued a lengthy order granting in part and denying in part Plaintiffs' motion for class certification. With respect to Plaintiffs' claims for equal pay, the district court granted Plaintiffs' certification motion as to issues of alleged discrimination and all forms of requested relief. With respect to Plaintiffs' promotion claim, the court certified the proposed class with respect to issues of alleged discrimination (including liability for punitive damages, as well as injunctive and declaratory relief); however, the court rejected the proposed class with respect to the request for back pay, determining that data relating to the challenged promotions were not available for all class members. The court also exercised its discretion to provide for notice and an opportunity for employees to opt-out of the punitive damages portion of the class.

The district court certification order covered a nationwide class encompassing all women employed by the defendant at any time after December 26, 1998, and encompassing claims for injunctive relief, declaratory relief, and back pay (but not compensatory damages). The defendant appealed, and a panel of the Ninth Circuit affirmed the decision [*see* *Dukes v. Wal[#8209]Mart, Inc.*, 509 F.3d 1168, 1177-1180 (9th Cir. 2007)]. The Ninth Circuit then granted a motion for rehearing en banc, resulting in the current opinion.

Size of Class. This class action, involving the nation's largest employer and perhaps as many as 1.5 million women employees, is notable for its size. However, the court observed that, at oral argument, defense counsel had conceded that if past employees were excluded, the class to be certified would be less than 1.5 million, perhaps closer to 500,000. Moreover, given the size of the defendant, it was unsurprising that the plaintiffs sought to represent such a large class. In any event, the size of the class, the court said, should not change the analysis the Supreme Court required in *General Telephone Co. of the Southwest v. Falcon* [457 U.S. 147, 157-159, 102 S. Ct. 2364, 72 L. Ed. 2d 740 (1982)], nor should it necessitate an even harder look at the merits, as the dissent had proposed.

Standard of Review. A district court's decision regarding class certification is not only reviewed for abuse of discretion, but is subject to "very limited" review, to be reversed only on a strong showing that the district court's decision was a clear abuse of discretion. However, the Ninth Circuit stated, a court abuses its discretion if its decision is premised on legal error. The district court's factual findings as to the applicability of the Rule 23 criteria are entitled to deference, and appellate review is limited to whether the district court correctly selected and applied the Rule 23 criteria. The party seeking certification bears the burden of showing that the Rule 23 requirements have been met. If plaintiffs meet this burden, they should be allowed to pursue their action as a class.

Standards for Class Certification Under Rule 23: Relevance of the Merits of the Case. The en banc court first reviewed Supreme Court authority, authority from other circuits, and authority within the Ninth Circuit to clarify what standards a district court must apply when deciding whether to certify a class. The Supreme Court, the court said, has provided clear if sometimes misunderstood guidance. The leading case is *Falcon*, in which the Court ruled that a class action may be certified only if "the trial court is satisfied, after a rigorous analysis, that the prerequisites of Rule 23(a) have been satisfied." The Court further explained that this "rigorous analysis" will generally involve considerations that are enmeshed in the factual and legal issues of the cause of action. The analysis will often, though not always, require looking behind the pleadings, even to issues overlapping with the merits of the underlying claims. Every circuit to consider this matter had reached essentially the same conclusion: that *Falcon's* central command requires district courts to ensure that Rule 23 requirements are actually met, not simply presumed from the pleadings.

The court also noted the confusion resulting from a misunderstanding of the Supreme Court's decision in *Eisen v. Carlisle & Jacquelin* [417 U.S. 156, 177-178, 94 S. Ct. 2140, 40 L. Ed. 2d 732 (1974)], in which the Supreme Court ruled that Rule 23 does not give a court "any authority to conduct a preliminary inquiry into the merits of a suit in order to determine whether it may be maintained as a class action." This means that a court may not make any premature determinations of the merits, but does not prevent the court from probing the same facts when necessary to determine whether, for example, the plaintiffs have demonstrated common questions of law or fact.

The court's review of cases from other circuits showed agreement as to these standards. "The core holding across circuits that have considered the issue is essentially unanimous: district courts must satisfy themselves that the Rule 23 requirements have been met before certifying a class, which will sometimes, though not always, require an inquiry into and preliminary resolution of disputed factual issues, even if those same factual issues are also, independently, relevant to the ultimate merits of the case." Prior cases from the Ninth Circuit had also adhered to these standards.

The court summed up the standards to be applied by district courts in the Ninth Circuit as follows:

In short, these observations, which include the Supreme Court's direction, long[#8209]standing precedent in this court, and treatment from other circuits, lead us to the following explanation of the proper standards governing a district court's adjudication of a Rule 23 motion for class certification. First, when considering class certification under Rule 23,

district courts are not only at liberty to, but must, perform a rigorous analysis to ensure that the prerequisites of Rule 23 have been satisfied, and this analysis will often, though not always, require looking behind the pleadings to issues overlapping with the merits of the underlying claims. It is important to note that the district court is not bound by these determinations as the litigation progresses. Second, district courts may not analyze any portion of the merits of a claim that do not overlap with the Rule 23 requirements. Relatedly, a district court performs this analysis for the purpose of determining that each of the Rule 23 requirements has been satisfied. Third, courts must keep in mind that different parts of Rule 23 require different inquiries. For example, what must be satisfied for the commonality inquiry under Rule 23(a)(2) is that plaintiffs establish common questions of law and fact, and answering those questions is the purpose of the merits inquiry, which can be addressed at trial and at summary judgment. Fourth, district courts retain wide discretion in class certification decisions, including the ability to cut off discovery to avoid a mini-trial on the merits at the certification stage. Fifth, different types of cases will result in diverging frequencies with which the district court will properly invoke its discretion to abrogate discovery. As just one example, we would expect a district court to circumscribe discovery more often in a Title VII case than in a securities class action resting on a fraud-on-the-market theory, because the statistical disputes typical to Title VII cases often encompass the basic merits inquiry and need not be proved to raise common questions and demonstrate the appropriateness of class resolution. Plaintiffs pleading fraud on the market, on the other hand, may have to establish an efficient market to even raise common questions or show predominance.

Rule 23(a) Requirements Were Shown. The class in this case was broad and diverse, encompassing both salaried and hourly employees in a range of positions, who are or were employed at one or more of the defendant's 3,400 stores across the country. Nevertheless, the district court had found that the large class was united by a complex array of company-wide practices.

Numerosity Unchallenged. The en banc court concluded that the district court's review of the four Rule 23(a) requirements complied with the standards it had described, and the district court had not abused its discretion in finding that these requirements were met. As to the first requirement, numerosity, there was no dispute.

Commonality and Expert Evidence. As to the commonality requirement, the plaintiffs had offered factual evidence, expert opinions, statistical evidence, and anecdotal evidence that provided sufficient support to raise the common question whether the defendant's female employees nationwide were subjected to a single set of corporate policies (not merely a number of independent discriminatory acts) that may have worked to unlawfully discriminate against them. Evidence of the defendant's subjective decision-making policies suggested a common legal or factual question regarding whether the defendant's policies or practices were discriminatory.

The defendant had objected to the expert opinion evidence as vague and imprecise—specifically, the defendant contended that the evidence did not meet the standards for expert testimony set forth in Federal Rule of Evidence 702 and *Daubert v. Merrell Dow Pharms., Inc.*, 509 U.S. 579, 597, 113 S. Ct. 2786, 125 L. Ed. 2d 469 (1993), which held that a trial court must act as a "gatekeeper" in determining whether to admit or exclude expert evidence. The Seventh Circuit, by comparison, has ruled that a court must perform a full *Daubert* analysis at the certification stage if an expert's scientific evidence is critical to the certification decision [see *American Honda Motor Co. v. Allen*, discussed below].

Here, according to the Ninth Circuit, the district court had properly rejected the objection. The defendant did not challenge the expert's methodology or contend that his findings lacked relevance; it challenged only whether certain inferences could be persuasively drawn from his data. *Daubert* does not require a court to admit or exclude evidence based on its persuasiveness, but rather requires a court to admit or exclude evidence based on its scientific reliability and relevance. Hence, a *Daubert* analysis would not have addressed the defendant's objections. The court noted that "[w]e are not convinced by the dissent's argument that *Daubert* has exactly the same application at the class certification stage as it does to expert testimony relevant at trial. . . . However, even assuming it did, the district court here was not in error. Thus we need not resolve this issue here."

Typicality Satisfied Without Representatives for Each Level of Management. Typicality was also shown. Even though individual employees in different stores with different managers may have received different levels of pay or may have been denied promotion or promoted at different rates, because the discrimination they claim to have suffered occurred through alleged common practices (e.g., excessively subjective decision making in a corporate culture of uniformity and gender stereotyping) the district court did not abuse its discretion by finding that the class representatives' claims were sufficiently typical of the absent class members claims. Additionally, the lack of a representative for each level of management did not undermine typicality.

Adequacy Met Despite Argument of Conflicts. Finally, the adequacy of representation requirement was met. Although the defendant argued that the plaintiffs could not satisfy this factor because of a conflict of interest between female managers who were both class members and decision-making agents of the defendant, the district court properly recognized that courts need not deny certification of an employment class simply because the class includes both supervisory and non[8209]supervisory employees.

Class Could Be Certified Under Rule 23(b)(2) Despite Conflicting Standards for Claims for Monetary Relief. Rule 23(b)(2) requires showing that the party opposing the class has acted or refused to act on grounds that apply generally to the class, so that final injunctive relief is appropriate respecting the class as a whole. This prong of Rule 23(b) does not extend to cases in which the appropriate final relief relates exclusively or predominantly to money damages.

The court noted that the Ninth Circuit, in defining whether money damages "predominate," has previously adopted a test that focuses on the plaintiffs' subjective intent in bringing a lawsuit [*see Molski v. Gleich*, 318 F.3d 937, 950 (9th Cir. 2003)]. Other circuits use an approach under which monetary relief predominates over other forms of relief unless it is "incidental" to requested injunctive or declaratory relief [*see Allison v. Citgo Petroleum Corp.*, 151 F.3d 402, 415-416 (5th Cir. 1998)]. Here, however, the court saw no need to use either approach.

The court overruled the *Molski* approach as fatally flawed because it avoids consideration of the practical impact of a request for monetary relief on the litigation itself. Moreover, it requires courts to engage in a nebulous and imprecise inquiry into the plaintiffs' intent. The court also rejected the *Allison* standard as contradictory to the Advisory Committee Note to Rule 23(b)(2), which forbids certification under Rule 23(b)(2) if monetary relief is the "predominant" form of relief. "Predominant" is not synonymous with "more than incidental."

Adoption of a "Predominance" Test. Instead, the Ninth Circuit adopted an approach that focuses on the term "predominant" as used in the Committee Note, meaning "superior in strength, influence, or authority." To determine whether monetary relief predominates, a district court should consider, on a case[8209]by[8209]case basis, the objective effect of the relief sought on the litigation. Factors such as whether the monetary relief sought determines the key procedures that will be used, whether it introduces new and significant legal and factual issues, whether it requires individualized hearings, and whether its size and nature—as measured by recovery per class member—raise particular due process and manageability concerns, would all be relevant, though no single factor would be determinative.

Under this standard, the district court's decision to include claims for back pay in a class certified under Rule 23(b)(2) was not an abuse of its discretion. Like other courts, the Ninth Circuit concluded that a request for back pay is fully consistent with the certification of a Rule 23(b)(2) class. Nor did the large size of the claims of itself mean that monetary claims necessarily predominated, because the predominance test turns on the primary goal and nature of the litigation, not the possible size of the total damages award.

Special Consideration for Punitive Damages. On the other hand, the district court did abuse its discretion by failing to analyze whether certifying punitive damages claims under Rule 23(b)(2) caused monetary damages to predominate. Notwithstanding its decision to require notice and an opportunity for opt[8209]out for the Rule 23(b)(2) punitive damages class, the district court abused its discretion by certifying the punitive damages claims under Rule 23(b)(2) without first undertaking an analysis of whether certification of the claims for punitive damages (in addition to

injunctive and declaratory relief as well as back pay) rendered the final relief "predominantly" related to monetary damages. The court therefore remanded so that the district court could consider this question. Moreover, the court noted that the district court, if Rule 23(b)(2) certification was not proper for the punitive damages claims, could consider a "hybrid" certification of Rule 23(b)(2) and 23(b)(3) classes in one action.

Special Consideration for Ex-employees. Finally, the court noted that persons who were no longer employees of the defendant at the time the complaint was filed did not have standing to pursue injunctive or declaratory relief. Monetary relief therefore appeared to predominate with respect to these class members. The district court could, however, on remand, certify a separate Rule 23(b)(3) class of former employees for back pay and punitive damages.

Conclusion. The en banc Ninth Circuit court concluded that the district court acted within its broad discretion in determining that it would be better to certify a class action instead of clogging the federal courts with innumerable individual suits litigating the same issues repeatedly. The court affirmed the district court's certification of a Rule 23(b)(2) class insofar as the class consisted of current employees (as of the date the complaint was filed), with respect to claims for injunctive relief, declaratory relief, and back pay. On remand, the district court was instructed to analyze whether certification under Rule 23(b)(2) or Rule 23(b)(3) would be appropriate for the punitive damages claims and whether an additional class or classes might be appropriate under Rule 23(b)(3) with respect to the claims of former employees. The court declined, given the tentative nature of the district court's trial plan, to address the defendant's due process and manageability challenges to that plan. The court also noted that the district court had discretion to modify or decertify the class should it become unmanageable, although mere size does not render a case unmanageable.

Concurrence. A very brief concurring opinion by Judge Graber pointed out that the majority's opinion said only that current female employees could maintain a Rule 23(b)(2) class action against their employer, when they challenged as discriminatory the effects of company-wide policies. "If the employer had 500 female employees, I doubt that any of my colleagues would question the certification of such a class. Certification does not become an abuse of discretion merely because the class has 500,000 members."

Dissent. A dissenting opinion by Judge Ikuta, joined by four other members of the en banc court, would have held that the district court abused its discretion in certifying the class. The dissent emphasized the size of the class, and argued that the plaintiffs failed to present "significant proof" of a discriminatory policy or practice. The anecdotes, statistical evidence, and expert testimony relied on by the majority did not come close to meeting the requirements for demonstrating commonality and typicality, showing that the district court had failed in its responsibility to conduct a rigorous analysis of the evidence. When the plaintiffs' evidence was subjected to a rigorous inquiry, the dissent said, it was inadequate to bridge the gap between the six plaintiffs' claims of individual discrimination and a class-wide claim of company-wide discrimination.

Additionally, the dissent argued that the action should not have been certified because the defendant had the right to raise affirmative defenses as to each class member's claim, therefore requiring up to 1.5 million individual determinations of liability. Moreover, the district court (and the majority) failed to undertake a proper analysis of whether the proposed class should be certified under Rule 23(b)(2) or 23(b)(3). Rule 23(b)(2) was designed for classes seeking class-wide injunctive relief, not for classes seeking individual damages, back pay, or other individual relief. Because the proposed class raised "an enormous number" of individual questions, it was not an appropriate class for 23(b)(2) certification.

The dissent concluded that "[d]espite these flaws, the majority affirms those legal errors with even less analysis and inquiry than the district court. Never before has such a low bar been set for certifying such a gargantuan class. The majority's ruling provides scant limits to the types of classes that can be certified. Put simply, the door is now open to Title VII lawsuits targeting national and international companies, regardless of size and diversity, based on nothing more than general and conclusory allegations, a handful of anecdotes, and statistical disparities that bear little relation to the alleged discriminatory decisions."

Finally, an additional, very brief dissenting opinion by Chief Judge Kozinski observed that the members of the class "held a multitude of jobs, at different levels of Wal-Mart's hierarchy, for variable lengths of time, in 3,400 stores, sprinkled across 50 states, with a kaleidoscope of supervisors (male and female), subject to a variety of regional policies that all differed depending on each class member's job, location and period of employment. Some thrived while others did poorly. They have little in common but their sex and this lawsuit."

Commentary. Just as the panel decision had, the en banc *Dukes* opinion has generated a vigorous debate about the appropriate scope of class actions in general and employment discrimination class actions in particular. There are a number of significant issues discussed by the en banc court that are fertile grounds for Supreme Court review because there are significant differences among the courts of appeals that ought to be bridged.

Dukes raises at least four significant issues that the Supreme Court may want to examine:

(1) What is the Standard for Meeting Rule 23 Requirements? The Second, Third, and Fifth Circuits have definitively held that a plaintiff must satisfy a "preponderance of the evidence" standard with respect to Rule 23's requirements at the class certification stage. On the other hand, the *Wal-Mart* court failed to grapple with those burden of proof issue decisions by suggesting that those courts were dealing with securities law cases. One issue here is whether the Supreme Court would adopt an across-the-board standard regardless of the type of class action.

(2) How Much Money is Too Much Money in a Rule 23(b)(2) Class? Again, there is a clear division among the circuits regarding the availability of monetary relief in Rule 23(b)(2) class actions. The Fifth, Sixth, Seventh and Eleventh Circuits permit only "incidental" monetary damages, while the Second and the Ninth Circuits use a more permissive balancing test. Does this mean that a Rule 23(b)(2) class may seek monetary damages for either back pay or punitive damages? The *Wal-Mart* majority opinion sought to defuse this issue by remanding plaintiffs' claims for punitive damages to the district court to determine if they should be certified instead under Rule 23(b)(3). This leaves only the issue of back pay under Rule 23(b)(2), which most courts do consider a form of equitable relief. Even if such a remedy is equitable, how much is too much?

(3) How Representative Must the Named Plaintiffs Be? The dissent argued that plaintiffs must present "significant proof" of a discriminatory policy or practice that affected all class members, citing *Gen. Tel. Co. of Sw. v. Falcon*, 457 U.S. 147, 159, 102 S. Ct. 2364, 72 L. Ed. 2d 740 (1982). How is it possible for the plaintiffs to do that when the commonality" and "typicality" requirements under Rule 23(a) for such a uniquely large class are based largely on the experiences of only six plaintiffs and some debatable statistical evidence and expert testimony? Given the sprawling, decentralized nature of Wal-Mart's operations and the discretionary power of its store managers, this issue may present plaintiffs with a serious problem. Just as it did in *Amchem* in a completely different context, the Supreme Court seems to frown on sprawling class actions.

(4) To What Extent May A Class Action Effectively Cut Off A Defendant's Opportunity to Present Individualized Defenses? The class certification under Rule 23(b)(2) seems to cut off Wal-Mart's ability to mount its statutory affirmative defenses under Title VII, which arguably entitle it to individualized hearings. Does the class certification here violate the provision in the Rules Enabling Act mandating that federal rules of procedure may not abridge or modify any substantive right [see 28 U.S.C. § 2072(b)]?

Which Issues Will Interest the Supreme Court? Prior to the Ninth Circuit's en banc decision, the monetary relief issue seemed inevitably headed for the Supreme Court, because of the clear division among the Circuits. After the *Dukes* decision, the standard and proof issues with respect to meeting the Rule 23(a) requirements loom large even though the Ninth Circuit majority did not go whole hog by both denying certification with respect to employees who had already left Wal-Mart at the time of the action's filing and by attempting to characterize its position as midway among the courts of appeals who have ruled on the issues. But the Ninth Circuit did not note that both the Second and

Third Circuits had gone on to place the burden on the plaintiff to demonstrate by a preponderance of the evidence that Rule 23's requirements have been satisfied, a burden much higher than it appeared to have used. Had the Ninth Circuit used the standard of the other courts, it is difficult to believe that the six representative plaintiffs could have shown that their claims were typical of those of between 500,000 and 1,500,000 other employees spread across 3,400 stores, each under the control of a local store manager.

Additionally, it is also likely that the Supreme Court will want to look at the Ninth Circuit's distinction between the standards for certifying (b)(2) as opposed to (b)(3) classes, or for different types of causes of action. The Federal Rules of Civil Procedure are supposed to be transubstantive. Indeed, one might think that the Supreme Court was seeking uniformity in its *Shady Grove* opinion this Term [*Shady Grove Orthopedic Assocs. P.A. v. Allstate Ins. Co.*, 130 S. Ct. 1431, 176 L. Ed. 2d 311, 2010 U.S. LEXIS 2929 (Mar. 31, 2010)]. Having said that, however, it is still unclear what standard the Court might ultimately adopt. There is no language for a standard in Rule 23. Thus, the Court may simply re-affirm its language in *Falcon*, that the plaintiff must present "significant proof" that the treatment of the representative plaintiffs was indicative of similar treatment accorded the rest of the class. Arguably, the trend among the courts of appeals toward the "preponderance" standard might go beyond interpretation of the Rule.

In sum, it is likely that we have not seen the end of this battle. Absent a settlement, *Dukes* appears to be destined to reach the Supreme Court. The question now is whether Supreme Court will grant certiorari now, or await the results of the district court remand. Certainly the pressure is on the defendants.

RELATED LINKS: For further information, see Moore's Federal Practice:

- 5 Moore's Federal Practice (3d Ed.) § 23.43[3][c];
- 5 Moore's Federal Practice (3d Ed.) § 23.80;
- 5 Moore's Federal Practice (3d Ed.) § 23.84

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Rule 23 Prevails Over New York Law Limiting Class Actions

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Rule 23 Prevails Over New York Law Limiting Class Actions: U.S. Supreme Court Construes the Rules Enabling Act

By Allan Ides

May 25, 2010

SUMMARY: In *Shady Grove Orthopedic Assocs. v. Allstate Ins. Co.*, a 5-person majority of the Supreme Court held that in a federal diversity suit, Federal Rule of Civil Procedure 23, which lists the criteria for proceeding as a class action in federal court, prevails over a New York law that would have prohibited a class action under the circumstances presented. The majority held that Rule 23 controlled the issue presented.

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ARTICLE: Rule 23 Prevails Over New York Law Limiting Class Actions: U.S. Supreme Court Construes the Rules Enabling Act

Introduction. In *Shady Grove Orthopedic Assocs. v. Allstate Ins. Co.*, 130 S. Ct. 1431, 176 L. Ed. 2d 311, 2010 U.S. LEXIS 2929 (Mar. 31, 2010), a 5-person majority of the Supreme Court held that in a federal diversity suit, Federal Rule of Civil Procedure 23, which lists the criteria for proceeding as a class action in federal court, prevails over a New York law that would have prohibited a class action under the circumstances presented. In assessing the conflict between Rule 23 and the New York law, the majority held that Rule 23 controlled the issue presented - the criteria for certification of a class - and was valid under the standards of the Rules Enabling Act ("REA") [28 U.S.C. § 2072]. As a consequence, Rule 23 supplanted the state law to the contrary.

Suit to Recover Statutory Interest on Insurance Benefits. A medical provider brought a class action against an insurer in a federal district court in New York alleging that the insurer routinely refused to pay interest on overdue benefits. The plaintiff sought interest on the overdue benefits under a New York statute requiring insurers to pay or deny claims within 30 days [see N.Y. Ins. Law § 5106(a)]. The district court dismissed the suit for lack of jurisdiction, holding that the class action claims were precluded by another New York statute that prohibited class actions to recover statutory penalties [see N.Y. Civ. Prac. Law § 901(b)]. The Second Circuit affirmed. The Supreme Court reversed the Second Circuit's judgment and remanded the case for further proceedings.

Rule 23 and the New York Law. Federal Rule of Civil Procedure 23(a) sets forth "prerequisites" for class actions, generally referred to as the numerosity, commonality, typicality, and adequacy-of-representation requirements. Rule 23(b) states that "[a] class action may be maintained if Rule 23(a) is satisfied and if" the suit falls into one of three described categories.

New York Civil Practice Law § 901(a) sets forth class action requirements similar to the prerequisites in Rule 23(a), with an additional requirement that the class action be superior to other available methods for the fair and efficient adjudication of the controversy. Subsection (b) of the statute provides that "[u]nless a statute creating or imposing a penalty, or a minimum measure of recovery specifically authorizes the recovery thereof in a class action, an action to recover a penalty, or minimum measure of recovery created or imposed by statute may not be maintained as a class action."

Framework for Decision. Writing for the Court, Justice Scalia explained the framework for deciding whether Rule 23 or the New York law governs: First, the Court had to decide whether Rule 23 answers the question in dispute, namely, whether the suit can proceed as a class action. If Rule 23 answers the question, it governs unless it exceeds statutory authorization provided in the REA. "We do not wade into *Erie's* murky waters unless the federal rule is inapplicable or invalid," the Court stated.

Rule 23 Answers Question and Conflicts with New York Law The five justices in the majority agreed that Rule 23 controlled the issue presented. The Rule states that "[a] class action *may be maintained*" (emphasis added) if the suit satisfies the four criteria of subdivision (a) and fits into one of the three categories described in subdivision (b). This "creates a categorical rule entitling a plaintiff whose suit meets the specified criteria to pursue his claim as a class action." Because the New York law attempts to answer the same question, but in a different way, i.e., stating that the suit may *not* be maintained as a class action because of the relief it seeks, the New York law must give way to the Federal Rule unless the Federal Rule is invalid.

The Court rejected the Second Circuit's argument that Rule 23 and the New York law address different issues and, therefore, do not conflict. The Second Circuit had found no conflict, reasoning that Rule 23 concerns only the criteria for determining whether a given class can and should be certified, while the New York law addresses the antecedent question of whether the particular type of claim was eligible for class treatment in the first place. The Court rejected this distinction between eligibility and certifiability as "entirely artificial," noting that both are preconditions for maintaining a class action. The Court read Rule 23 as empowering a federal court to certify a class in each and every case in which the Rule's criteria are met, so that any purported limitation on that power, such as the New York law's prohibition on class actions seeking statutory penalties, necessarily conflicts with it.

Justice Ginsburg's dissent argued that there was no conflict between the New York law and Rule 23 because the New York law did not concern whether the plaintiff can maintain its suit as a class action, which is the subject of Rule 23, but rather only the *remedy* the plaintiff could obtain if it won its suit. The majority disagreed, reasoning that the New York law says nothing about what remedies a court can award, but rather prevents class actions seeking statutory penalties from coming into existence at all. Under the New York law, a court could not even certify a class action seeking both statutory penalties and other remedies. The majority specifically expressed no view as to whether a state law that merely set a ceiling on damages recoverable in a class action would conflict with Rule 23.

Justice Ginsburg also argued that there is no conflict between Rule 23 and the New York law because the *purpose* of the New York law is merely to restrict remedies. Again, the majority disagreed, stating that even if that were the intent of the New York legislature, the intent could not override the statute's clear text, which limits a plaintiff's power to maintain a class action. Moreover, determining whether state and federal rules conflict based on the subjective intent of state legislatures would lead to confusion, inconsistent results, and excessive work for federal judges. And more importantly, the Court emphasized, regardless of purpose, Rule 23 and the New York law flatly contradict each other.

Rule 23 Is Valid: Two Approaches. The REA authorized the Supreme Court to promulgate rules of procedure, subject to the limitation that the rules "shall not abridge, enlarge or modify any substantive right" [28 U.S.C. § 2072(a), (b)]. The five Justices who agreed that the New York law conflicts with Rule 23 also agreed that Rule 23 was valid under the REA. However, they parted ways with respect to the proper approach to determining validity.

Really Regulates Procedure. Justice Scalia, joined by Chief Justice Roberts and Justices Thomas and Sotomayor

argued that the only criterion for validity under the REA is whether the rule really regulates procedure, i.e., the judicial process for enforcing rights and duties recognized by substantive law and for justly administering remedy and redress for disregard or infraction of them. If it governs only the manner and the means by which a litigant's rights are enforced, it is valid; if it alters the rules of decision by which the court will adjudicate those rights, it is not. Whether the rule will incidentally affect a litigant's substantive rights, which most procedural rules do, is beside the point.

Applying the "does it regulate procedure" criterion, these four Justices concluded that insofar as Rule 23 allows willing plaintiffs to join their separate claims against the same defendants in a class action, it clearly regulates procedure. It is, simply stated, a procedural joinder device not unlike Rules 18 (joinder of claims) and 20 (joinder of parties). Moreover, Rule 23 neither changes plaintiffs' separate entitlements to relief nor abridges defendants' rights, but merely alters how the claims are processed. Like traditional joinder, the class action format leaves the parties' legal rights and duties intact and the rules of decision unchanged.

These four Justices refused to consider whether the New York law creates a substantive right or was enacted for substantive reasons. The substantive nature of the New York law simply makes no difference, according to these justices. They reasoned that a federal rule is not valid in some jurisdictions and invalid in others, depending on the state law with which it conflicts. It is the substantive or procedural nature of the *federal* rule that controls, not the substantive or procedural nature of the conflicting state law.

Abridge, Enlarge, or Modify a Substantive Right. Justice Stevens took a different approach, rejecting the idea that the only criterion for determining validity is whether the federal law really regulates procedure. He argued that federal laws must be interpreted with some degree of sensitivity to important state interests and regulatory policies, and that there are some state procedural rules that federal courts must apply in diversity cases because they function as a part of the State's definition of substantive rights and remedies. For example, citing *Moore's*, Justice Stevens noted that federal courts sitting in diversity have applied state "procedural" rules that make it more difficult to bring or prove a claim or that define the amount of recovery. He concluded that an approach that focuses only on whether the federal rule regulates procedure ignores the REA's ban on rules that "abridge, enlarge or modify any substantive right," the balance Congress struck between uniform rules of federal procedure and respect for a State's construction of its own rights and remedies. Justice Stevens acknowledged that his approach may result in a more complex inquiry than Justice Scalia's, but that cannot be avoided, he argued, because it is what the REA requires.

Nevertheless, even under this approach, Justice Stevens concluded that Rule 23 satisfies the REA. The bar for finding an Enabling Act problem is high in his view; the mere possibility that a federal rule would alter a state-created right is not enough. Moreover, the mere fact that a state law is designed as a procedural rule suggests it reflects a judgment about how state courts ought to operate, not a judgment about the scope of state-created rights and remedies.

Justice Stevens noted that the New York law precluding class actions seeking statutory penalties applies to claims based on New York law, federal law, or the law of any state. Therefore, it does not appear to be a rule that, though procedural in form, actually defines New York's rights and remedies. He acknowledged some legislative history that could be read to suggest that New York officials wished to create a limitation on New York's statutory damages, but, he pointed out, that is not the law they adopted.

Dissent: Respect for State Policies Requires Application of State Law. Justice Ginsburg, joined by Justices Kennedy, Breyer, and Alito, argued that in the interest of respecting state regulatory policies, the New York law and Rule 23 can be, and should be, read so as not to conflict. She pointed out that the Court has long interpreted the federal rules with sensitivity to important state interests and a will to avoid conflict with important state regulatory policies, a point with which Justice Stevens agreed. In finding a conflict between Rule 23 and the New York law, "[t]he Court veers away from that approach . . . in favor of a mechanical reading of Federal Rules, insensitive to state interests and productive of discord," she wrote.

Based on legislative history, Justice Ginsburg determined that the prohibition on class actions seeking statutory

penalties in the New York law was enacted not for the procedural purpose of furthering the fair conduct or efficiency of litigation, but rather for the substantive purpose of limiting a defendant's liability in a single lawsuit in order to prevent the exorbitant inflation of penalties. Thus, the New York law limits the remedy. Rule 23, on the other hand, prescribes the considerations relevant to class certification and post-certification proceedings. "Sensibly read," she concluded, "Rule 23 governs procedural aspects of class litigation, but allows state law to control the size of a monetary award a class plaintiff may pursue." Read in this way, the statutes do not conflict.

Having found no unavoidable conflict between Rule 23 and the New York law, Justice Ginsburg would decide the case under the Rules of Decision Act as interpreted in *Erie* [*see* 28 U.S.C. § 1652; *Erie R.R. v. Tompkins*, 304 U.S. 64, 58 S. Ct. 817, 82 L. Ed. 1188 (1938)]. Under the Act, federal courts sitting in diversity are to apply state law when failure to do so would invite forum-shopping and yield markedly disparate litigation outcomes. Failing to apply the New York law to this case would enable the plaintiff to seek class relief ten thousand times greater than the individual remedy available to it in state court. Even the four Justices in the plurality recognized that this will lead to forum shopping, but they viewed that as "the inevitable (indeed, one might say the intended) result of a uniform system of federal procedure." Justice Ginsburg, on the other hand, viewed this result as an unacceptable infringement on New York's right to place limitations on state-created remedies.

Comment. In a diversity case, when there is a potential conflict between a Federal Rule of Civil Procedure and a state law the basic inquiry proceeds in two steps. First, a court must ask whether the federal rule is sufficiently broad to control the issue presented. Second, if the rule is sufficiently broad to control, the court must determine whether the rule is valid under the standards established by the Rules Enabling Act [28 U.S.C. § 2072(a) & (b)]. (Of course, the rule also must be consistent with any applicable constitutional standards.) If the rule is both broad enough to control and valid, it must be applied regardless of state law to the contrary. Despite the length and seeming complexity of its various opinions, *Shady Grove* reflects this relatively simple model. There are, however, two points of controversy worth noting.

The debate between the majority and the dissent in *Shady Grove* involves the first step of the above analysis - the sufficiently-broad-to-control inquiry. The question boils down to this: How broadly or narrowly should one interpret a federal rule that potentially conflicts with state law? Justice Scalia's opinion for the majority focuses on the text of Rule 23, which he argues, rather straightforwardly, creates right to proceed as a class action once certain criteria have been satisfied. Justice Scalia also concludes that the plain text of Rule 23 offers no interpretive leeway through which to avoid a conflict with the NY law. Under such circumstances, policy plays no role in the interpretive process. Justice Ginsburg in dissent takes a different tack. She puts the text aside and argues instead that principles of federalism ought to inform the breadth of a federal rule and especially so when important state regulatory policies are at stake. One might say, somewhat oversimplifying, that she places the policy of non-interference with state prerogative first and the text of the rule second. Justice Stevens, in his concurring opinion, agrees with Justice Scalia's textual analysis and also with the policy concerns raised by Justice Ginsburg; however, as to the latter, Justice Stevens doubts the admissibility of such policy concerns given the clarity of Rule 23. Taking all this together, the sufficiently-broad-to-control question requires an interpretation of the text of the rule in question, and, to the extent that the text might support alternative interpretations that do not conflict with state law, any relevant policy concerns triggered by that potential conflict. The key question then is the extent to which the text of the rule lends itself to alternative "non-conflicting" interpretations.

Second, the debate between Justice Scalia and Justice Stevens centers on the correct method through which to assess the validity of a federal rule under the REA, i.e., step two of the analysis. Justice Scalia would ask whether the rule "really regulates procedure," borrowing language from *Sibbach v. Wilson & Co.*, 312 U.S. 1, 14, 61 S. Ct. 422, 85 L. Ed. 479 (1941), which Justice Scalia argues is binding precedent. Justice Stevens, on the other hand, focuses on the text of REA and particularly 28 U.S.C. § 2072(b), which provides that the federal rules "shall not abridge, enlarge, or modify any substantive right." Justice Stevens argues that *Sibbach* should not be read as having placed an interpretive gloss on this statutory text.

What is the significance of this debate? Justice Scalia's approach focuses completely on the rule itself and not on

the application of that rule in a particular case. If the rule really regulates procedure within the federal judicial system, i.e., the manner and the means through which rights are enforced, it is valid. Justice Stevens, on the other hand, would allow a court to determine whether a federal rule functioned in a particular case to "abridge, enlarge, or modify" a substantive right. The benefit of Justice Scalia's approach is that it is simple in application and would be unlikely to lead to the invalidation of any federal rule given the detailed process through which the rules are promulgated. The benefit of Justice Stevens's approach is that it would allow for an occasional (very occasional) invalidation of a federal rule as applied. It may well be that the dissenters in *Shady Grove* would side with Justice Stevens since they seem to envision a federal pleading system that is more responsive to state substantive law and policy. Until the Court takes a definitive position on this issue, one might want to construct arguments based on both approaches.

RELATED LINKS: For further information, see Moore's Federal Practice:

- 17A-124 Moore's Federal Practice -- Civil § 124.02;
- 17A-124 Moore's Federal Practice -- Civil § 124.03;
- 17A-124 Moore's Federal Practice -- Civil § 124.04.

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Whether Voluntary Settlement Moots Appeal of Denial of Class Certification

2010 Emerging Issues 4978

Whether a Class Representative's Voluntary Settlement of Her Individual Claims Moots Her Ability to Appeal a Denial of Class Certification

By Allan Ides

April 20, 2010

SUMMARY: In *Narouz v. Charter Communications, LLC*, 591 F.3d 1261, 2010 U.S. App. LEXIS 917 (9th Cir. 2010), the Ninth Circuit joined three other circuits in holding that a voluntary settlement of a class representative's individual claims does not necessarily moot the class representative's standing to appeal a denial of class certification.

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ARTICLE: *Allan Ides on Narouz v. Charter Communications, LLC and Whether a Class Representative's Voluntary Settlement of Her Individual Claims Moots Her Ability to Appeal a Denial of Class Certification*

In *Narouz v. Charter Communications, LLC*, 591 F.3d 1261, 2010 U.S. App. LEXIS 917 (9th Cir. 2010), the Ninth Circuit joined three other circuits in holding that a voluntary settlement of a class representative's individual claims does not necessarily moot the class representative's standing to appeal a denial of class certification.

Legal Background. In *United States Parole Comm'n v. Geraghty*, 445 U.S. 388, 100 S. Ct. 1202, 63 L. Ed. 2d 479 (1980), the Supreme Court held that a class representative whose claim had been *involuntarily* mooted pending appeal retained standing to challenge the trial court's denial of class certification. In the Court's view, the named representative retained a personal stake in the certification question based on his concrete interest of spreading litigation costs among the class. *Id.* at 403. The *Geraghty* Court left open the question "as to whether a named plaintiff who settles an individual claim after denial of class certification may . . . appeal from the adverse ruling on class certification." *Id.* at 404 n.10.

As to that question, the emerging rule among the circuits is that a named representative who voluntarily settles her individual claims may challenge a denial of certification if she retains a personal stake in the certification controversy, such as by retaining an interest in spreading litigation costs, as in *Geraghty*, or by retaining some or all of her class-based claims. See *Richards v. Delta Air Lines, Inc.*, 453 F.3d 525, 529 (D.C. Cir. 2006) (class certification claim not moot when plaintiff settled her individual claims, but retained her substantive and procedural "class claim"); *Potter v. Norwest Mortgage, Inc.*, 329 F.3d 608, 614 (8th Cir. 2003) (class certification claim moot when plaintiff settled all substantive claims and provided no evidence of having retained any interest in the spreading of litigation costs); *Toms v. Allied Bond & Collection Agency, Inc.*, 179 F.3d 103, 106 (4th Cir. 1999) (class certification claim moot when

settlement "expressly relinquished" "any and all" claims as a member or representative of the class); *but see*

Love v. Turlington, 733 F.2d 1562, 1565 (11th Cir. 1984) (treating voluntary settlements as indistinguishable from the involuntary mootings at issue in *Geraghty*).

Procedural Background. Narouz filed a class action against Charter Communications, LLC (Charter) in state court. He alleged wrongful termination and various violations of the state labor code. All of these claims were asserted on behalf of a putative class of Charter employees, except the wrongful termination claim, which was asserted on behalf of Narouz alone. Charter removed the case to the United States District Court for the Central District of California. Narouz and Charter eventually entered two separate settlement agreements, one for the class claims and one in settlement of Narouz's individual claims. The appellate court described the two agreements as follows:

The actual settlement agreement, which was negotiated over several additional months, included a "Class Action Joint Stipulation of Settlement," providing for the gross payment by Charter of \$267,500 (including attorney's fees). A separate agreement was entered into between Charter and Narouz, which called for \$60,000 to be paid by Charter to Narouz for the release of Narouz's wrongful termination claim, claims for any unpaid wages "aside from those related to Narouz's class allegation," claims for any emotional distress, pain and suffering, and penalties "aside from those related to Narouz's class allegation." Narouz was also eligible to receive an additional amount (\$20,000) conditioned on the district court's final approval of the class settlement. The agreement specified, however, that if the Court did not approve the settlement, the \$60,000 payment already made would be considered to be consideration for any and all remaining "individual claims."

After signing the agreements, Narouz filed a motion, supported by Charter, to certify the class for settlement purposes and for preliminary approval of the settlement. The district court refused to certify the class or to approve the settlement. Narouz, pursuant to his separate agreement with Charter, then filed a stipulation and request to dismiss all of his individual claims. The district court entered an order dismissing those claims and terminating the case, after which Narouz filed an appeal of the district court's denial of certification.

On the Question of Mootness. As to mootness, the Ninth Circuit panel majority concluded, "We hold that when a class representative voluntarily settles his or her individual claims, but specifically retains a personal stake [in the class claim], he or she retains jurisdiction to appeal the denial of class certification." The court further explained that a class representative who releases "any and all interests he or she may have had in class representation" retains no personal stake in the class claim and may not appeal a denial of class certification. However, "a settlement agreement that specifically provides that the class representative is solely releasing individual claims may permit the class representative to retain a 'personal stake' in the class claim." The key, therefore, is whether the representative retains any class-based claims. In short, in the context of a voluntary settlement by the class representative, the determination of mootness turns on the terms of the settlement and specifically on whether the representative has retained a personal stake in the certification question by retaining some or all of her class-based claims.

In applying the above principles, the panel majority found three remaining categories of class-based claims retained by Narouz sufficient to give him a personal stake in the certification question. First, the separate agreement between Narouz and Charter expressly applied only to Narouz's individual, non-class-based claims, *i.e.*, to those claims "aside from those related to Narouz's class allegation." Second, Narouz retained an interest in the \$20,000 enhancement award, to which he would be entitled if he achieved a reversal on appeal and, on remand, the district court approved the settlement. Finally, if no appeal were available, the claim for attorneys' fees would not be released.

The dissent's analysis began "with the principle that a class representative with voluntarily dismissed individual claims has mooted his appeal of a prior denial of class certification, *unless* the language of *both* the settlement agreement and the dismissal demonstrate a live controversy and a personal stake in the case." (italics in original) Applying this principle, the dissent concluded that both the settlement agreement and the proposed order of dismissal filed by Narouz established that Narouz had waived all of his claims, both individual and class-based. In addition, in the

dissent's view, Narouz had reserved neither a right to appeal a denial of certification nor a right to shift litigation costs among the class. Essentially, the dissent read the agreements strictly with a presumption in favor of mootness.

On the Question of Class Certification. The district court's written order denying certification for settlement purposes provided, "The motion is denied since the court is unable to ascertain a class which can be certified." Given the absence of analysis, the Ninth Circuit majority concluded that it could not provide meaningful appellate review. Hence, it vacated and remanded for reconsideration of the motions to certify and settle. In addition, and without further elaboration, other than a reference to "the circumstances of this case," the appellate court ordered reassignment of the case to a different judge.

Comment. The majority and dissent in *Narouz* agreed on the basic legal standards pertaining to the question of mootness: the voluntary dismissal of a class representative's individual claims does not automatically moot the class representative's standing to challenge a denial of certification on appeal. The key question for both the majority and the dissent is whether the class representative retains a personal stake in the certification question. Moreover, one can safely conclude that the rule adopted by the Ninth Circuit - both the majority and the dissent - represents the majority rule among the circuits. The disagreement between the panel majority and dissent is, however, more than a fact-specific quibble over the text of a particular settlement agreement. The majority reads the settlement agreement in a light most favorable to finding justiciability - as does the concurrence - while the dissent reads that agreement (and the proposed dismissal order) from a presumption against such a finding. The majority and concurrence never fully confront the dissent's presumption-of-mootness approach and never fully engage the dissent's contrary interpretation of the agreements. Perhaps, like the reassignment to a different judge, the more generous reading adopted by the majority was a product of "the circumstances of this case." One is left to wonder, therefore, whether in the future the stricter approach (and presumption) endorsed by the dissent might well set the standard applied to voluntary settlements. Certainly, a cautious lawyer will want to take the stricter interpretive approach into account when drafting a settlement agreement that runs the risk of mooting a potential appeal.

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Vairo on College of Dental Surgeons of PR v. Connecticut Gen. Life Ins. Co.

2009 Emerging Issues 4766

Georgene Vairo on College of Dental Surgeons of Puerto Rico v. Connecticut Gen. Life Ins. Co.

By Georgene Vairo

December 28, 2009

SUMMARY: If a complaint against multiple defendants does not specifically define a proposed class, can the action be subject to removal under the Class Action Fairness Act? In *College of Dental Surgeons of Puerto Rico v. Connecticut Gen. Life Ins. Co.*, the First Circuit Court of Appeals addresses this question, as well as other CAFA issues. In this Expert Issues Analysis, Professor Georgene Vairo evaluates the First Circuit's approach to the CAFA issues.

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ARTICLE: Summary. *College of Dental Surgeons of Puerto Rico v. Connecticut Gen. Life Ins. Co.*, 585 F.3d 33, 2009 U.S. App. LEXIS 23299 (1st Cir. Oct. 22, 2009), deals with two issues: First, the First Circuit articulated the standards that apply when the court of appeals is considering whether to allow or disallow applications for leave to pursue discretionary appeals under CAFA. Second, the First Circuit ruled that a complaint need not specifically define a proposed class in order to be subject to removal under the Class Action Fairness Act, provided the complaint indicates it is filed as a class action.

Facts and Procedural Background. The plaintiff ("College"), an entity created by the Puerto Rico legislature and representing dentists licensed in Puerto Rico, brought suit against 25 defendants, including insurance companies, health maintenance organizations, and the like. The complaint alleged various types of claims, such as fraudulent practices with respect to contracting and claims processing, all arising under Puerto Rico law. The complaint further alleged that the case qualified for treatment as a class action under Puerto Rico law. However, the complaint did not define the plaintiff class.

Two of the defendants filed a timely notice of removal to federal court under the Class Action Fairness Act (CAFA) [*see 28 U.S.C. §§ 1332(d), 1453(b)*]. They claimed that CAFA jurisdiction existed because the complaint contained class-type allegations sufficient to come within CAFA's scope. Several parties, including other defendants, moved to remand, arguing that CAFA did not give the district court subject matter jurisdiction.

The district court granted the motions to remand, reasoning that the complaint did not "sufficiently define[]" the contours and membership of the plaintiff class and, thus, the College "has not defined a class [within] Federal pleading requirements." [*College of Dental Surgeons of P.R. v. Triple S Management, 2009 U.S. Dist. LEXIS 34327* (D.P.R. Apr. 21, 2009)]. On that basis, the court found CAFA jurisdiction wanting, without reaching questions raised by the plaintiff

and objecting defendants about whether any of CAFA's specific jurisdictional exceptions applied.

The removing defendants sought permission to appeal under CAFA's appellate provision [*see* 28 U.S.C. § 1453(c)(1)]. The First Circuit accepted the appeal. After sketching the background of the case, the court first tackled discussed when the factors it will use when determining whether to accept an appeal, and then addressed the merits of the district court's order. It concluded that the district court acted prematurely in remanding the action. Consequently, it vacated the remand order and remitted the case for further proceedings in the district court.

Grounds for Leave To Appeal. The court began by noting that post-removal procedures are dictated by the provisions of 28 U.S.C. § 1447. These procedures generally apply to CAFA cases, but with some modifications. Specifically, pursuant to § 1447(d), most remand orders are not immediately appealable, [*see, e.g., Things Remembered, Inc. v. Petrarca*, 516 U.S. 124, 127, 116 S. Ct. 494, 133 L. Ed. 2d 461 (1995)]. However, CAFA allows a court of appeals to "accept an appeal from an order of a district court granting or denying a motion to remand a class action to the State court from which it was removed" [28 U.S.C. § 1453(c)(1)]. Because this grant of discretionary authority is relatively new and out of the ordinary, the court took the opportunity to announce the criteria that bear on its willingness to grant an application of this type.

The court noted that other courts of appeals have touched upon this topic, and it borrowed from and synthesized the factors identified by other courts of appeals. For example, the First Circuit noted that a common theme is that the presence of an important CAFA-related question is a factor weighing in favor of allowing an application for leave to appeal. On the other hand, if the pivotal issue is not a CAFA issue, even when it is an important issue, such issues are generally not thought to be entitled to the same weight as a CAFA issue. The First Circuit explained this dichotomy by pointing to a Senate Report that was published after CAFA's enactment. The Senate Report stated that the discretion granted under section 1453(c) was designed, in large part, to "develop a body of appellate law interpreting the legislation." S. Rep. No. 109-14, at 49 (2005), *reprinted in* 2005 U.S.C.C.A.N. 3, 46.

Uncertainty is another factor in favor of an affirmative exercise of discretion. Similarly, to warrant immediate appeal, the question presented usually will be unsettled. The court of appeals will also assess whether the question might have been incorrectly decided. If the district court decided the question correctly, the need for immediate review is lessened.

The court of appeals will also consider whether the question is consequential to the resolution of the particular case. Another particularly important factor is whether the question is likely to evade effective review if left for consideration only after final judgment. Because CAFA is chiefly a jurisdictional statute, cases raising serious jurisdictional issues will often fit this model. On the other hand, if the question is one that is unlikely to recur, there is a weaker argument for allowing an interlocutory appeal.

Another consideration is whether the application arises from a decision or order that is sufficiently final to position the case for intelligent review. Piecemeal appeals are discouraged. Finally, the court of appeals will construct a balance of relevant harms. This entails weighing the probable harm to the applicant should an immediate appeal be refused against the probable harm to the other parties should an immediate appeal be entertained.

Balancing these factors, the court accepted the appeal.

Comment. The First Circuit provides a useful and sensible list of factors to guide courts in determining whether to exercise discretionary appellate jurisdiction. However, its (and other courts of appeals') emphasis on CAFA issues may be misplaced. Indeed, it is somewhat curious that the court notes the Senate Report but at the same time casts doubt on its reliability as a guide because it was published after CAFA was enacted. There is nothing in § 1453(c) that suggests that remand orders predicated on a CAFA issue rather than some other issue are more important. To the extent that Congress intended to end the forum selection battle as soon as possible, and to ensure that cases that should be in federal court remain there, it is equally plausible that Congress intended that the courts of appeals accept cases

involving CAFA as well as non-CAFA issues. Of course, CAFA itself presents a wealth of issues that are likely to be a part of any removal/remand battle. But, overemphasizing such issues on the theory that Congress wanted CAFA law to develop may be a reach.

Accordingly, it was also wise that the First Circuit noted that its list is merely a guide because many decisions are likely to be case-specific. It is also true that this case was, as the First Circuit put it, "a good prototype. Here, the CAFA question—the relationship between CAFA jurisdiction and the precision of the class allegations contained in the complaint—is important, unsettled, and recurrent. Absent an interlocutory appeal, the question will in all probability escape meaningful appellate review. The district court's resolution of the question appears to rest on shaky ground."

Finally, in terms of its analysis, it is important to recall that the removing defendants also argued that federal question jurisdiction, 28 U.S.C. § 1331, was an alternate ground for removal. The First Circuit, however, was correct to consider whether there was a federal question ground for removal because removal under § 1441(a) and (b) requires that all defendants agree to remove. In this case, several defendants objected to removal. Thus, even if the plaintiffs' complaint could be said to allege a federal question, the lack of unanimity would doom removal under § 1441 [see *Chicago, Rock Island & Pac. Ry. Co. v. Martin*, 178 U.S. 245, 247-248, 20 S. Ct. 854, 44 L. Ed. 1055 (1900)].

CAFA Basics. The First Circuit's analysis of the remand order began with a review of CAFA basics. CAFA grants federal courts subject matter jurisdiction over many large, multistate class actions by creating a specialized form of diversity jurisdiction. Subject to certain exceptions, that jurisdictional grant applies to class actions in which the amount in controversy exceeds \$5,000,000 and minimal diversity exists between the parties. CAFA defines a "class action" as "any civil action filed under rule 23 of the Federal Rules of Civil Procedure or similar State statute or rule of judicial procedure authorizing an action to be brought by 1 or more representative persons as a class action" [28 U.S.C. § 1332(d)(1)(B)]. Puerto Rico is treated as a state, so class actions brought there are removable under CAFA. If removal is improvidently granted because the action does not meet the statutory requirements, the district court must remand to the original state court. The party seeking removal bears the burden of showing federal jurisdiction.

Remand Was Improperly Granted. The district court had concluded that CAFA jurisdiction did not attach because the complaint failed to sufficiently define the class. However, CAFA requires only that the action be "filed under" Federal Rule 23 or some state-law analog of that rule. The district court ignored the second-state-law analog-part of the definition. The College's complaint plainly invoked Puerto Rico's class action rules and contained allegations of harm to the "members of the class." The complaint appeared to allege claims for class-wide relief; it consistently alleged harm to dentists as a professional group; it described the College as representing the "dentistry class" in Puerto Rico; it stated that its allegations were similar to those made in a class action pending in the United States District Court for the Southern District of Florida; and it sought class-wide relief. Indeed, the College never argued that its suit was other than a class action.

The First Circuit cut the district court some slack: "In fairness, this may be a mere matter of form; although the district court did not say so, it may have realized that the complaint was filed under a state-law analogue to Rule 23—but nonetheless thought it insufficient." However, the "more acute problem" was with the substance of the district court's analysis. In deciding that the complaint did not confer CAFA jurisdiction, the district court failed to mention these allegations and relied instead on the absence of any sufficient class definition in the complaint.

In sum, the only issue was whether a class action was filed. The absence from the complaint of a sufficient class definition was not relevant to this determination. A complaint that contains class-type allegations historically has been assumed to assert a class action before formal class certification, and CAFA's definition of a class action embraces this principle in that it expressly applies "to any class action before or after the entry of a class certification order" [28 U.S.C. § 1332(d)(8)]. In this case whether or not the plaintiff would succeed in satisfying the requirements of Rule 23 was not before the court of appeals, but was a question for the district court at the class certification stage. Accordingly, the district court's ruling on the inadequacy of the class definition was premature and not a proper basis for remand.

Comment. The First Circuit was correct to rule that in itself the absence of a class definition should not doom CAFA jurisdiction. Indeed, it emphasized the importance of a class definition for other purposes: "Let us be perfectly clear. We do not minimize the importance of being able to define the class-but class composition (including compliance with the requirements of Rule 23) is not the issue at the inception of a class action. In all but the clearest of cases, the existence vel non of a sufficiently defined class is appropriately addressed after some development of the facts and under Rule 23's established protocol for weighing the propriety of class certification. Reviewing the complaint alone is not normally a suitable method for determining whether a class eventually can be certified. . . . It follows, we think, that reviewing the complaint alone is not normally a suitable occasion for determining whether the plaintiff has sufficiently defined a cognizable class."

The First Circuit left open the possibility that there might be rare situations in which it is obvious from the complaint alone that there cannot be a class that would warrant certification. Under these circumstances removal jurisdiction might not attach and remand might be proper. However, this was not such a case. The removing defendants tried to justify the district court's order by arguing that the court may have concluded that a class *never* could be certified in this case because the College, as an association of dentists rather than an individual dentist, could not itself be a member of a certifiable class. But, the First Circuit correctly noted that an association can sue on behalf of its members [*see Hunt v. Wash. State Apple Comm'n*, 432 U.S. 333, 343, 97 S. Ct. 2434, 53 L. Ed. 2d 383 (1977)].

What Happens on Remand? The First Circuit added two postscripts. First, it thoughtfully noted that there is an open question whether a later denial of class certification would divest a district court of CAFA jurisdiction, but expressed no opinion on this question. This is an emerging issue on which the courts of appeals need to provide guidance [*Compare Falcon v. Philips Elecs. N. Am. Corp.*, 489 F. Supp. 2d 367, 368 (S.D.N.Y. 2007) (stating that CAFA jurisdiction is terminated if class certification is denied on a "basis that precludes even the reasonably foreseeable possibility of subsequent class certification"), and *In re TJX Cos. Retail Sec. Breach Litig.*, 564 F.3d 489, 492 (1st Cir. 2009) (suggesting in dictum that "denial [of class certification] would . . . defeat [CAFA] jurisdiction"), with *Genenbacher v. CenturyTel Fiber Co. II*, 500 F. Supp. 2d 1014, 1017 (C.D. Ill. 2007) (contra). *See generally Avritt v. Reliastar Life Ins. Co.*, Civ. No. 07-1817, 2009 U.S. Dist. LEXIS 51524 (D. Minn. June 18, 2009) (collecting conflicting case law)].

Second, the court noted that two exceptions to CAFA jurisdiction might be applicable in a case such as this: the "local controversy" exception [*see 28 U.S.C. § 1332(d)(4)(A)*], and the "home state" exception [*see 28 U.S.C. § 1332(d)(4)(B)*]. These questions had not been addressed by the district court and the record was largely undeveloped. Consequently, these issues were also left to the district court on remand.

Comment. It would seem that this case is a perfect candidate for the local controversy or home state exceptions to CAFA jurisdiction even with the burden of proving the exception is on the plaintiffs. Nonetheless, given the two-part nature of CAFA - first, determine whether there is CAFA jurisdiction; second, determine whether a CAFA exception applies - it was appropriate for the First Circuit to resolve the basic jurisdictional issue of whether CAFA requires the pleading of a class definition. To the extent that the court was concerned with the evolution of CAFA jurisprudence, it achieved its goal in that respect. We now await the court's guidance in terms of CAFA's exceptions, and more importantly in a case such as this one, whether refusal to certify a class ousts the federal court of jurisdiction.

RELATED LINKS: For further information, see Moore's Federal Practice:

- 5 Moore's Federal Practice (3d Ed.) " 23.63A[1], [5]

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Georgene Vairo on Coffey v. Freeport McMoran Copper & Gold

2009 Emerging Issues 4767

Georgene Vairo on Coffey v. Freeport McMoran Copper & Gold

By Georgene Vairo

December 28, 2009

SUMMARY: In *Coffey v. Freeport McMoran Copper & Gold*, the Tenth Circuit tackled several important issues concerning the CAFA. In this Expert Issues Analysis, Professor Georgene Vairo analyzes the court's ruling that on appeal of a remand order under CAFA, an appellate court has discretion to consider any potential errors in the order. Professor Vairo also evaluates the court's analysis of the scope of CAFA's "local controversy" exception.

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ARTICLE: Summary. Although a per curiam opinion, *Coffey v. Freeport McMoran Copper & Gold*, 581 F.3d 1240, 2009 U.S. App. LEXIS 19996 (10th Cir. Sept. 4, 2009), is important for two reasons: First, it interprets the reach of the Class Action Fairness Act's appeal provision, ruling that on an appeal of a remand order under CAFA, an appellate court has discretion to consider any potential errors in the order, and is not limited to mistakes in applying CAFA. Second, the opinion provides an analysis of the scope of CAFA's "local controversy" exception.

Facts and Background. The plaintiffs filed a class action in Oklahoma state court asserting state law claims based on the defendants' alleged contamination of their property through operation of a zinc smelter in Blackwell, Oklahoma. Plaintiffs included in their class definition all Oklahoma citizens currently domiciled in the State of Oklahoma who own real property in Blackwell, or within a five-mile radius of the smelter site, and all Oklahoma citizens who reside or at any time resided on real property located in Blackwell or within a five-mile radius of the smelter site.

The defendants removed the case to federal court, asserting jurisdiction under the Class Action Fairness Act (CAFA) and the Comprehensive Environmental Response, Compensation and Liability Act (CERCLA). The plaintiffs made a timely motion to remand arguing that their claims did not raise a federal question under CERCLA and that CAFA's local controversy exception applied.

The district court agreed with the plaintiffs and remanded to state court. The defendants were then granted permission to appeal from the remand order under the CAFA provision [28 U.S.C. § 1453(c)(1)] that provides an exception to the general rule that a remand order is not reviewable.

Purpose of CAFA. The Tenth Circuit began by noting that CAFA was enacted to curb the perceived abusive practice by plaintiffs of litigating class actions with interstate features in state courts. It was quick, however, to also note

that Congress created a "local controversy" exception to CAFA for cases "consisting of primarily local, *intrastate* matters." [*Coffey* at 1243]. The basic CAFA federal jurisdiction requirements of a class action involving at least 100 members and over \$5 million in controversy and minimal diversity were clearly met in this case. However, according to the Tenth Circuit, this case presented a "classic example" of what Congress intended to except from CAFA jurisdiction under the local controversy exception. This case is a truly local controversy because it involved only Oklahoma citizens who were affected by a purely local incident.

Analysis of "Local Controversy" Exception to CAFA. The "local controversy" exception [28 U.S.C. § 1332(d)(4)(A)] has three main requirements, two of which were not contested. First, the exception requires that more than two-thirds of the class members be citizens of the forum state. Second, the principle injuries must have been sustained in the forum state. In this case, all the members of the plaintiff class were citizens of a single state, Oklahoma, and the principal injuries unquestionably occurred in that state. The third requirement, whether, as the Senate Report on CAFA put it, there was "one real local defendant," was in dispute. To satisfy this third requirement, plaintiffs must show that there is at least one defendant (1) from whom "significant relief" is sought, (2) whose alleged conduct forms a "significant basis" for the claims, and (3) who is a citizen of the state in which the action was filed.

One of the defendants, which had owned and operated the allegedly polluting smelter from 1922 to 1974, was undisputedly a defendant whose alleged conduct formed a significant basis for the claims. Thus, the "significant relief" part of the test was satisfied. However, the defendants argued that the "significant relief" and citizenship elements were not met.

Significant Relief. The plaintiffs argued that the owner/defendant was a defendant against whom significant relief was sought as all the class members had claims against it, and it was likely that this defendant would be held responsible for some or all of the plaintiffs' damages. Relying on an unpublished magistrate judge's opinion, the defendants, however, argued that the language "from whom significant relief is sought" requires consideration of a defendant's ability to pay a judgment. The owner/defendant no longer had any assets and therefore would not be a "significant defendant" under this approach.

The court of appeals, like the district court, rejected the defendants' argument. The unambiguous statutory language refers to a defendant from whom significant relief is "sought," not one from whom the relief "may be obtained." Nothing in the statute, the court said, indicated that Congress intended district courts to "wade into the factual swamp of assessing the financial viability of a defendant" at this preliminary stage in the litigation. Accordingly, the owner/defendant satisfied the "significant relief" requirement.

Citizenship. Under the significant relief provision, the local defendant must also be a citizen of the state in which the action was originally filed (Oklahoma). The owner/defendant was a New York corporation, and therefore was a citizen of Oklahoma only if it had its principal place of business there [*see* 28 U.S.C. § 1332(c)(1)].

The defendant had owned and operated the smelter in Oklahoma from 1922 to 1974. Although the plant had closed, the defendant was still licensed to do business in Oklahoma. Its only important recent activities had been environmental remediation efforts carried out in Oklahoma. The district court determined that these clean-up activities were the only purpose for the continued existence of the defendant, and that the remediation efforts were a "substantial activity in which it is currently engaged" sufficient to establish Oklahoma as its principal place of business. The court of appeals applied a "clearly erroneous" standard of review and concluded that the defendants had failed to show that the district court's decision was clear error.

Comment. The Tenth Circuit got it right. The opinion correctly leaves in state court hands a case that has little to no national impact.

The court's straightforward, plain meaning approach to the "significant relief" issue clearly makes sense. Congress did not intend for CAFA to provide for protracted battles over whether the federal courts ought to retain jurisdiction. So,

the Tenth Circuit correctly rejected an approach to CAFA that put a defendant's ability to pay into the jurisdictional analysis. Similarly, although on the facts perhaps a closer question, and the district court's opinion a bit muddled, the Tenth Circuit was correct to defer to the district court's principle place of business analysis. While it is true that federal jurisdiction is based on the set of facts that exist at the time a case is filed, given the corporate history as well as the actual work still being performed by the defendant in question, it was not erroneous to find that the defendant's principle place of business was Oklahoma.

Even supporters of the idea that CAFA jurisdiction is necessary over state claim class actions with a national import should agree that CAFA should not be used to oust state courts of jurisdiction over purely local matters. To the extent that the Tenth Circuit invigorates the local controversy exception, it is protecting the principle of federalism while honoring the plaintiffs' choice of forum. Indeed, by rendering its decision in a per curiam opinion, the court may be signaling that it is prepared to protect these values in even harder cases. In other words, when construing the words of the exception, the Tenth Circuit will keep in mind the purpose of CAFA and will not seek to overreach in retaining federal jurisdiction. The court's plain meaning reading of CAFA here was correct and consistent with Congressional aims.

Scope of Appeal Not Limited to Issue of CAFA Jurisdiction. The defendants also asserted that CERCLA provided a federal question basis for jurisdiction [28 U.S.C. § 1331 & 1441(a), (b)]. The district court had disagreed, and the defendants sought to appeal this issue, asking the court of appeals to reverse the remand order on this ground if it found that the "local controversy" exception to CAFA jurisdiction applied.

The general rule is that a district court decision to remand for lack of subject matter jurisdiction is not appealable [28 U.S.C. § 1447(d)]. CAFA, however, contains a provision allowing such review when it is the basis for removal [28 U.S.C. § 1453(c)]. The defendants had appealed the remand order under that provision. The plaintiffs argued that the court of appeals had jurisdiction under § 1453(c) to review only the CAFA issues.

The court of appeals stated that had the district court order to remand had been based solely on the CERCLA issue, it would have lacked jurisdiction. But, because the order to remand was also based on CAFA, the Tenth Circuit found that § 1453(c) provided a basis to review the CERCLA issue as well. It agreed with the Seventh Circuit's opinion in *Brill v. Countrywide Home Loans, Inc.* [427 F.3d 446, 451-452 (7th Cir. 2005)], and concluded that when a statute authorizes interlocutory appellate review, the entire decision comes before the court for review. Nothing in the language of the CAFA provision limits the scope of review to CAFA issues. Rather, § 1453(c) allows the court of appeals to accept an appeal "from an *order* of a district court granting or denying a motion to remand" [emphasis added]. Thus, the court was free to consider any potential error in the district court's order, not just a mistake in application of CAFA.

Nevertheless, although agreeing with the defendants that it had jurisdiction to consider the CERCLA issue, the Tenth Circuit found that the decision to exercise that jurisdiction is discretionary. The court noted that the purpose of the CAFA provision allowing review is to develop a body of appellate law interpreting CAFA without unduly delaying the litigation of class actions. Accordingly, this was an appropriate case in which to decline to exercise its discretion.

Comment. The takeaway point in the court's discussion of appellate jurisdiction is to ensure that a district court order granting or denying a remand be based on all grounds for the decision. If no CAFA ground is a part of the order, then no appellate jurisdiction to review the order exists. Additionally, to the extent that a party seeks to preserve the non-CAFA ground for review, it should be prepared to argue why it would be inefficient not to undertake an immediate review of the issue, or will not result in delay.

Conclusion. The court of appeals concluded that all the requirements of the local controversy exception were met and that the exception applied. The court declined to consider whether CERCLA might provide an alternative basis for federal jurisdiction. The court therefore affirmed the district court's order remanding the case to state court.

RELATED LINKS:

■ 15 Moore's Federal Practice (3d Ed.) 102.26[1][d][iii]

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Georgene Vairo on Vinole v. Countrywide Home Loans, Inc.

2009 Emerging Issues 4479

Motion to Deny Class Certification: Georgene Vairo on Vinole v. Countrywide Home Loans, Inc.

By Georgene Vairo

October 15, 2009

SUMMARY: *Vinole v. Countrywide Home Loans, Inc.* provides defense counsel with an important tool when confronting class allegations: a preemptive motion to deny class certification. The Ninth Circuit ruled that a defendant may move to deny class certification, and the court may rule on the motion, even though plaintiffs have not yet filed a motion to certify a class. Georgene Vairo, professor and author, analyzes the *Vinole* case.

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ARTICLE: Summary. *Vinole v. Countrywide Home Loans, Inc.*, 571 F.3d 935, 2009 U.S. App. LEXIS 14771 (9th Cir. July 7, 2009), is a case of great practical importance. It provides defense counsel with an important tool when confronting class allegations: a preemptive motion to deny class certification. In *Vinole*, the Ninth Circuit ruled that a defendant may move to deny class certification, and the court may rule on the motion, even though plaintiffs have not yet filed a motion to certify a class. It firmly rejected the plaintiffs' argument that there is a per se rule against allowing a district court to entertain a defendant's motion to deny class certification. Rather, as long as the plaintiff has had sufficient time to take discovery on certification issues and is not otherwise prejudiced, the court may entertain such motions.

Background and Procedural History. Two plaintiffs sought to represent a proposed class of the defendant's employees. They alleged that they were improperly classified as "exempt" outside sales representatives and that, as a result, the defendant failed to pay them overtime and other wages. The defendant filed its motion to deny certification before the plaintiffs had filed a motion seeking certification and prior to the pretrial motion deadline and discovery cutoff. The district court granted the motion and denied certification. The Ninth Circuit granted the plaintiffs' petition for an interlocutory appeal under *Federal Rule of Civil Procedure 23(f)*.

Motion To Deny Certification Was Not Per Se Improper. The Ninth Circuit concluded, first, that Rule 23 does not preclude a defendant from bringing a "preemptive" motion to deny certification. There is no per se rule against allowing such motions, as the plaintiffs had argued. Indeed, rather than charting "troubling new territory," as the plaintiff warned, preemptive motions to deny class certification have become a well-established option.

Rule 23(c)(1)(A) addresses the timing of a district court's class certification determination. It provides: "*Time to Issue:* At an early practicable time after a person sues or is sued as a class representative, the court must determine by

order whether to certify the action as a class action." The Ninth Circuit noted that nothing in the plain language of the timing provision either vests plaintiffs with the exclusive right to put the class certification issue before the district court or prohibits a defendant from seeking early resolution of the class certification question.

The Ninth Circuit also noted that, while it had never before expressly addressed the issue, it had affirmed a district court's order granting a motion to deny certification, and district courts throughout the nation have considered motions to deny certification. The court also cited **Moore's Federal Practice** for the proposition that defendants may move to deny class certification before plaintiffs file a motion to certify a class.

In short, the Ninth Circuit ruled that the plaintiffs had read into Rule 23 a *per se* prohibition against motions to deny class certification that did not exist. The defendant had filed its motion to deny certification at a permissible time in the proceedings.

Comment. The Ninth Circuit correctly rejected the plaintiffs' *per se* rule. The cases cited by the plaintiffs in support of their argument for a *per se* prohibition were inapposite. Two of the cases had rejected the defendant's motion to strike the class allegations before any responsive pleading had been filed, and before any discovery had been taken. In other words, those motions were premature because the plaintiff did not have time to establish the facts needed to support certification. The courts did not purport to establish a *per se* ban on defense motions for class certification. The third case involved the separate issue of whether the district court could properly deny a defendant's motion under Rule 23(d)(4) to compel amendment of the pleadings to eliminate class allegations on the ground that such a motion was "procedurally inseparable" from the question of class certification. The district court there held only that it was procedurally improper to consider a motion to compel an amendment of the pleadings in a class action case where the question of certification was not yet before the court, and discovery was ongoing.

Court Did Not Abuse Its Discretion in Granting Defendant's Motion To Deny Certification. The plaintiffs argued that the district court abused its discretion in granting the motion before the pretrial motion cutoff and the discovery cutoff. However, the court of appeals found no authority for the proposition that a district court either abuses its discretion or errs as a matter of law by considering the issue of class certification before expiration of a pretrial motion deadline. This was just another version of the plaintiffs' argument that they were entitled to control the timing of the district court's consideration of the class certification issue, an argument that had already been rejected.

The district court also did not abuse its discretion in ruling before the discovery cutoff. The plaintiffs had adequate time (ten months) in which to conduct discovery related to class certification. They had conducted significant discovery and apparently did not intend to propound any additional discovery on this subject. Their real complaint here, again, was that they "didn't want to be on defendants' schedule."

Finally, the plaintiffs had not shown any procedural prejudice resulting from the timing of the consideration of certification issues. The plaintiffs had a sufficient opportunity to present their case for certification. Accordingly, the district court did not abuse its discretion in deciding the motion to deny certification when it did.

Comment. It is unquestionably true that the Ninth Circuit correctly rejected the plaintiffs' proposed *per se* rule. The devil is in the details, however: when should the court deny such motions? The Ninth Circuit focuses the inquiry on prejudice. Had the plaintiffs been able to show that the motion was premature because they needed more discovery to meet the defendants' certification arguments, the Ninth Circuit could have followed the cases denying motions on the ground of prematurity. Summary judgment practice, under *Fed. R. Civ. P. 56(f)*, provides plaintiffs with a similar option. When a plaintiff can demonstrate the existence of relevant evidence that it may obtain in discovery, the court will prevent the defendant from railroading the plaintiff and provide the plaintiff the opportunity to take the needed discovery.

A plaintiff seeking to defeat a defendant's motion to deny class certification must not make the same mistakes that the plaintiffs did in *Vinole*. Here are some lessons to be learned from *Vinole*:

1) Plaintiffs should be alert to the need to take discovery on class issues immediately, and, should the defendant make a motion that it thinks is premature, be able to demonstrate the need for additional time. Plaintiffs need to emphasize that they were deprived of adequate time in which to complete discovery, rather than simply stating that they "didn't want to be on defendants' schedule" as the *Vinole* plaintiffs had. Moreover, plaintiffs need to be specific about the discovery they seek and why it is necessary. In *Vinole*, in contrast, the plaintiffs squandered ten months of the discovery period, including admitting at the hearing before the district judge that they would not take additional discovery, but rather wanted to prepare more declarations in support of the motion for class certification that they wanted the court to entertain. Nothing in the record in *Vinole* suggested that plaintiffs could not have more diligently prepared their certification argument in the months between the date the defendant filed its motion and the date the plaintiffs' opposition brief was due.

2) Plaintiffs ought to carefully consider whether it is desirable to withhold information from adversaries at the class certification stage as a strategic matter. In *Vinole*, the Ninth Circuit said that it was evident that plaintiffs had made a strategic choice to limit the amount of evidence they presented to the district court in opposition to defendant's motion. They proffered their class certification arguments through their "preview" declarations, rather than presenting the actual declarations of their clients.

3) Plaintiffs ought not make the further strategic choice of relying on an "all or nothing" approach. In *Vinole*, the plaintiffs, "in a strategic gamble," according to the Ninth Circuit, relied on their position that the defendant's motion was *per se* improper to avoid having the district court decide the motion on the merits. At the very least, the plaintiffs did not request a continuance or an extension of time in which to respond to the defendant's motion. As the Ninth Circuit explained, "If Plaintiffs truly were not prepared to present their position on class certification, it seems reasonable that they would have requested an extension or continuance as soon as possible after Countrywide filed its motion to deny class certification."

District Court Properly Refused To Certify Class. The district court had held that analysis of whether a salesperson was "exempt" would require an individualized inquiry into the manner in which each salesperson actually carried out his or her work, and therefore precluded certification on predominance grounds. The plaintiffs argued that the court should adopt a rule that class certification was warranted under Rule 23(b)(3) whenever an employer uniformly classifies a group of employees as exempt, notwithstanding the necessity of individualized analysis. However, the Ninth Circuit ruled that a district court abuses its discretion in relying on a uniform exemption policy to the near exclusion of other factors relevant to the predominance inquiry. The district court must take into consideration all factors in favor of, or against, class certification. The overarching focus remains whether trial by class representation would further the goals of efficiency and judicial economy. Here, the district court weighed the relevant considerations. The Ninth Circuit concluded that the district court had conducted a proper inquiry into the Rule 23 factors and had not abused its discretion in deciding not to certify the proposed class.

RELATED LINKS: See Moore's Federal Practice for more information

- 5 Moore's Federal Practice (3d Ed.) " 23.82[1]

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Applicability of CAFA: Georgene Vairo on Admiral Ins. Co. v. Abshire

2009 Emerging Issues 4480

Applicability of CAFA: Georgene Vairo on Admiral Ins. Co. v. Abshire

By Georgene Vairo

October 15, 2009

SUMMARY: The Fifth Circuit in *Admiral Ins. Co. v. Abshire* held that the addition of class allegations to a suit originally filed in the early 1990s did not commence a new suit so as to bring the action within the scope of CAFAs jurisdictional provisions. The decision is significant because it rejects the relation back approach that has been adopted by many sister circuits. Georgene Vairo, professor and author, analyzes the importance of this opinion.

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ARTICLE: Summary. Proponents and opponents of the Class Action Fairness Act (CAFA) all knew that its terms would provide fodder for litigation. They did not expect, though, that the issue of the applicability of CAFA would be the first major question to confront the courts. And, they certainly did not expect that nearly five years after the enactment of CAFA, litigants would still be arguing about whether a case that was commenced in state court before CAFA was enacted in February 2005 would be subject to removal under CAFA's expanded jurisdictional standards. *Admiral Ins. Co. v. Abshire*, 574 F.3d 267, 2009 U.S. App. LEXIS 14335 (5th Cir. July 2, 2009), is another of these cases. The Fifth Circuit there held that the addition of class allegations to a suit originally filed in the early 1990's did not commence a new suit so as to bring the action within the scope of CAFA's jurisdictional provisions. More importantly, the decision is significant because it rejects the "relation back" approach that has been adopted by many sister circuits.

Facts and Procedural Background. During the early 1990s, 1,383 plaintiffs sued Louisiana in state court for alleged negligent, intentional, and criminal acts that allegedly led to the failure of three companies from which the plaintiffs had purchased life insurance, annuities, and corporate notes. The cases were consolidated and litigated in state court for years, but the difficulty of maintaining communication with the large number of plaintiffs raised ethical issues that hampered settlement efforts. Additionally, a number of plaintiffs had died and it was becoming increasingly difficult for plaintiffs' counsel to substitute survivors. Believing that only class certification could give the attorneys the authority needed to participate in mediation and to settle the case, the court permitted the plaintiffs to amend the complaint to seek class certification. Thus, in 2008, the plaintiffs filed the ninth amended complaint, which, for the first time, defined a proposed class. The amended complaint also sought "costs of suit, including reasonable attorneys' fees as provided by law."

As soon as the plaintiffs filed the ninth amended complaint, Louisiana removed the action to federal court,

claiming subject-matter jurisdiction under CAFA. Finding that CAFA did not apply because the case was commenced before the Act's effective date (February 18, 2005), the district court remanded the case to state court. The district court denied the plaintiffs' request for fees and costs associated with the removal and remand.

The Fifth Circuit agreed with the district court that remand was proper because, regardless of what analysis it applied, the action was commenced long before CAFA's effective date. On the other hand, the Fifth Circuit rejected the plaintiffs' argument on cross-appeal for fees for improvident removal. The Fifth Circuit ruled that because of the complexity of the commencement question, the district court did not abuse its discretion in denying the plaintiffs' request for attorney's fees and costs. Thus, the Fifth Circuit affirmed the remand and the denial of fees and costs.

Default Rule: Original Petition "Commences" Case Under State Law. CAFA applies only to "civil actions commenced" on or after its effective date, February 18, 2005 [Pub. L. 109-2, § 9; *Exxon Mobil Corp. v. Allapattah Servs., Inc.*, 545 U.S. 546, 571, 125 S. Ct. 2611, 162 L. Ed. 2d 502 (2005) (CAFA is not retroactive)]. The date on which a civil action is "commenced" for purposes of CAFA is determined by state law, in this case, the law of Louisiana. Absent special circumstances, a suit is commenced under Louisiana law when the original petition is filed in a court of competent jurisdiction [La. Code Civ. Proc. Ann. Art. 421 (2008)]. Under this default rule, the suit was commenced around December 11, 1991, when at least one of the petitions was filed, long before the effective date of CAFA.

Comment. The Fifth Circuit agrees with the other courts of appeals that have ruled on the question of how to determine the original date of commencement -- turn to the law of the state in which the district court sits [*see Pritchett v. Office Depot, Inc.*, 420 F.3d 1090, 1093-1098 (10th Cir. 2005) (action commenced on date action was first filed in court of proper jurisdiction, not date it was removed to federal court); *Smith v. Nationwide Prop. & Cas. Ins. Co.*, 505 F.3d 401, 405 (6th Cir. 2007) (state law determines when matter is commenced for purposes of CAFA); *McAtee v. Capital One, F.S.B.*, 479 F.3d 1143, 1146-1148 (9th Cir. 2007) (action commenced under applicable state law when original complaint was filed in state court); *Tmesys, Inc. v. Eufaula Drugs, Inc.*, 462 F.3d 1317, 1319 (11th Cir. 2006) (consensus among circuits is that state law determines when action is commenced for purposes of CAFA); *Knudsen v. Liberty Mutual Ins. Co.*, 411 F.3d 805, 806-807 (7th Cir. 2005) (initial removal under CAFA was unavailing, because the suit had been "commenced" in state court before February 18, 2005); *Patterson v. Dean Morris, L.L.P.*, 448 F.3d 736, 739-741 (5th Cir. 2006) (action commenced one day before effective date of CAFA under applicable state law and therefore could not be removed under Act); *Natale v. Pfizer, Inc.*, 424 F.3d 43, 44 (1st Cir. 2005) (action commences for purposes of removal jurisdiction under CAFA as of date of filing in state court)].

It makes sense for the federal courts to look to state law as a guide to when a state court action commences because it accords with the *Erie* Doctrine. [*see Erie R.R. v. Tompkins*, 304 U.S. 64, 58 S. Ct. 817, 82 L. Ed. 1188 (1938) (holding that state law applies to substantive issues in diversity cases); *Walker v. Armco Steel Corp.*, 446 U.S. 740, 100 S. Ct. 1978, 64 L. Ed. 2d 659 (1980) (affirming that state law controls the meaning of the time of commencement in diversity cases); *see generally* Lonny Sheinkopf Hoffman, *The "Commencement" Problem: Lessons from a Statute's First Year*, 40 U.C. Davis L. Rev. 469 (2006) (arguing that state rules on commencement should be applied; criticizing the "relation back" approach) ("Hoffman Commencement").]

Did the Action Recommence for CAFA Purposes? No Because A "Civil Action" Does Not Mean "Class Action." Notwithstanding the default rule that an action is commenced under state-law rules, the Fifth Circuit and other courts of appeals have recognized that under some circumstances an action may recommence for CAFA purposes. For example, in *Braud v. Transp. Service Co.*, the Fifth Circuit held that the addition of a new defendant to a case "commences" a new civil action as to that defendant for purposes of CAFA [*Braud v. Transp. Serv. Co.*, 445 F.3d 801, 804 (5th Cir. 2006)].

Louisiana tried a variation of that theme, arguing that the term "civil action" in Section 9 of CAFA means "class action." Under this theory, an action would be "commenced" after CAFA's effective date if class certification were sought after February 18, 2005, in an action that had been filed before that date as a non-class action. The Fifth Circuit

rejected this argument, correctly pointing out that "civil action" is not synonymous with "class action. A "civil action" may commence before it becomes a "class action," and Congress selected the commencement of the "civil action" as the relevant event for CAFA applicability. In fact, Congress deleted language that would have extended CAFA to cases in which a class certification order was entered on or after the enactment date [*see Pritchett v. Office Depot, Inc.*, 420 F.3d 1090, 1095 (10th Cir. 2005), discussed in June 2005 **MOORE'S FEDERAL PRACTICE UPDATE**, p. 96].

Comment. The Fifth Circuit was correct in dispatching Louisiana's argument so readily. In the first place, it is unquestionably true that a "class action" is a subset of the more extensive and exclusive term "civil action." Moreover, federal courts have uniformly rejected a similar argument that the removal of a case itself is a commencement for CAFA purposes [*see, e.g., Bush v. Cheaptickets, Inc.*, 425 F.3d 683, 686-688 (9th Cir. 2005) (rejecting defense argument that "removed" means "commenced"); *Pfizer, Inc. v. Lott*, 417 F.3d 725, 725-726 (7th Cir. 2005) (suit commences for purposes of CAFA when it is filed in state court, not when it is removed to federal court).].

Class Allegations Did Not "Drastically Modify" Case. The Fifth Circuit has recognized exceptions to the default rule that a lawsuit commences on the date prescribed by state law. Nonetheless, the addition of the class allegations here did not so drastically modify the suit that it justified departure from the default commencement rule. Louisiana had argued that the ninth amended complaint not only exposed it to class liability for the first time, but also exposed it to additional liability with respect to (1) a claim for attorney's fees and costs, (2) the "resurrection" of claims held by deceased plaintiffs for whom no one had been substituted, and (3) the "resurrection" of certain previously dismissed plaintiffs.

Indeed, when a defendant receives notice of claims and parties in the original complaint, and the subsequent amended complaints are not game-changing, it is hard to argue that there has been a drastic modification. The Fifth Circuit distinguished *Braud v. Transp. Service Co.*, in which it had held that the addition of a new defendant to a case "commences" a new civil action as to that defendant for purposes of CAFA [*Braud v. Transp. Serv. Co.*, 445 F.3d 801, 804 (5th Cir. 2006)]. In *Braud*, application of the default rule for commencement of civil actions raised notice and due process concerns with respect to the added defendant. In contrast, application of the default rule in this case would not raise any such concerns, because the proposed class as defined in the ninth amended complaint was limited to persons who were individual parties to the suits filed in the early 1990s. In other words, no plaintiffs of whose claims the defendant was unaware were added by the class allegations.

Comment. The Fifth Circuit is justified in its conclusion that merely melding previously joined plaintiffs or their survivors into a class for case management purposes is not sufficient to commence a new suit under CAFA. The point of the drastic modification rationale for holding that a case has been recommenced would not apply in this case on the basis of the "resurrection" of some dead plaintiffs' claims. Louisiana had always been on notice of them. Although "resurrection" of a deceased is always a surprise, resurrection of a deceased's claims should not be.

However, the fact that the Fifth Circuit referred to the class allegations having been made for case management purposes raises the question whether the result would be different if the class allegations were made for trial or other adjudication on the merits purposes. The court's reasoning appears to be sound in this case no matter why the class allegations were made. However, the Fifth Circuit cites lower court cases that suggest that the result would be different if the class allegations had expanded the number of class members, the bases for recovery, and the extent of the sought after remedy significantly. Accordingly, the "drastic modification" rationale for departing from the default rule needs to be carefully examined depending on the case and its procedural history.

Relation-Back Analysis Unhelpful. Several circuits use a "relation-back" analysis to determine whether an amendment to a complaint commences a new action for CAFA purposes [*see, e.g., Prime Care of Northeast Kansas, LLC v. Humana Ins. Co.*, 447 F.3d 1284, 1286 (10th Cir. 2006); *Knudsen v. Liberty Mut. Ins. Co.*, (*Knudsen II*), 435 F.3d 755, 757 (7th Cir. 2006); *Plubell v. Merck & Co.*, 434 F.3d 1070, 1071-1073 (8th Cir. 2006)]. The Fifth Circuit rejected this approach as "particularly unilluminating in this case," to the extent that it is ever analytically relevant.

The Fifth Circuit explained that the relation-back doctrine in Civil Rule 15 is driven by evidentiary and notice concerns related to statutes of limitation. CAFA's commencement provision, on the other hand, is motivated by retroactivity concerns, such as the unjust disturbance of settled legal expectations on which a party has relied. The addition of a new claim based on a statute enacted after the defendant's conduct might satisfy relation-back criteria but nevertheless disturb settled legal expectations. On the other hand, the addition of a claim that does not relate back will not disturb settled legal expectations if brought within the statutory limitation period. The Fifth Circuit concluded that relation-back and retroactivity might overlap, but they are logically independent, and the relation-back test should not necessarily control the analysis of CAFA's non-retroactivity provision.

Comment. Again, the Fifth Circuit's analysis should be applauded for its analytic approach. While the relation-back approach has a superficial appeal especially because it seems to capture the idea of "drastic modification" and implicates notice and a notion of fairness to defendants, the court was correct to point out that the rationales differ for the two issues. This fine-tuning of the analysis likely will become standard. In so many areas in which CAFA and its terms have created litigation, it has taken time for the courts of appeals to develop a more nuanced approach to the issue at hand. For a deeper analysis yet of the rationale for rejecting the relation-back approach, see *Hoffman Commencement, supra*.

No New Action Even Under Relation-Back Analysis. In any event, the Fifth Circuit held, the relation-back criteria of both Louisiana and federal law were satisfied in this case [*see Fed. R. Civ. P. 15(c)(1)(B)*; La. Code Civ. Proc. Ann. Art. 1153 (2008)]. Under Louisiana law, the addition of plaintiffs relates back to the filing of the original petition if (1) the amended claim arises out of the same conduct, transaction, or occurrence set forth in the original pleading; (2) the defendant either knew or should have known of the existence and involvement of the new plaintiff; (3) the new and the old plaintiffs are sufficiently related so that the added or substituted party is not wholly new or unrelated; and (4) the defendant will not be prejudiced in preparing and conducting a defense [*Giroir v. South Louisiana Med. Ctr., 475 So. 2d 1040, 1044 (La. 1985)*]. The only arguably new parties were the survivors of the earlier deceased plaintiffs who were not properly substituted before class certification was sought. If these persons were included in the class definition, they would satisfy the Louisiana requirements for relating back. Under federal law, class members are not new plaintiffs even when they were not previously joined to the action as individuals [*Schorsch v. Hewlett-Packard Co., 417 F.3d 748, 750, 752 (7th Cir. 2005)*]. The only arguably new claim is the request for attorney's fees, which arises out of the same transaction or occurrence that led to the filing of the original complaint.

Relationship Between CAFA Commencement Issue and 28 U.S.C. § 1446(b). Like the "recommencement" argument for allowing removal of a previously unremovable case under CAFA, Section 1446(b) provides a second shot at removal of a previously unremovable case. The Fifth Circuit noted that the parties had confused its holding in *Braud*. It noted that the *Braud* decision had two holdings: first, that the addition of a new defendant commences a new suit for CAFA purposes; and second, that Section 1446(b) then opens a new window for removal because the character of the litigation has changed. The court noted the confusion between the substantive need to determine whether a case has been recommenced, or whether there is a new case that is subject to CAFA, with the procedural requirement of § 1446(b). Further, it noted the different policies underlying § 1446(b) and § 9 of CAFA, CAFA's effective date provision:

Section 1446 protects a plaintiff's choice of forum from a defendant's untimely effort to remove unless the defendant could not have removed the case before or did not have the same incentives to remove it; Section 9 of CAFA protects a plaintiff's choice of forum from Congress's post hoc expansion of the federal courts' subject matter jurisdiction unless the plaintiff attempts to use an old suit insulated from removal to bring new claims.

Comment. It is helpful that the Fifth Circuit seeks to clarify the steps in determining whether a case is properly

removed under CAFA. And, the court is correct, as the Tenth Circuit was in *Prime Care of Northeast Kansas, LLC v. Humana Ins. Co.*, 447 F.3d 1284, 1286 (10th Cir. 2006), to note the problem. Section 1446(b) allows a defendant to remove a case (and if the removal is based on CAFA not all the defendants need to join) within 30 days of receiving notice, via an amended complaint or some other paper, that the case is subject to federal jurisdiction. The Fifth Circuit agreed with the Tenth Circuit that the effective date of CAFA did not by itself create a new 30-day removal window on the basis of CAFA jurisdiction. Such an argument subverts the notion of an effective date.

Appellate Jurisdiction over Order Awarding Attorney's Fees and Costs. The general ban on review of remand orders [*see* 28 U.S.C. § 1447(d)] does not apply to cases removed under CAFA [28 U.S.C. § 1453(c)(1)]. However, the statute excepting CAFA cases from the appellate review ban does not mention related orders concerning attorney's fees and costs. In any event, the Fifth Circuit pointed out, such orders are reviewable in any event because the general ban does not apply to such collateral orders.

Comment. The Fifth Circuit raises a tricky issue. In the case before it, the defendants petitioned to appeal the remand under § 1453(c)(1), and the plaintiffs petitioned for a cross-appeal of the denial of sanctions. The Fifth Circuit noted that the plaintiffs did not need to petition to cross-appeal; they could have simply cross-appealed once the court of appeals granted the defendants' petition to appeal. But, what if the defendants had not petitioned to appeal, could or should the plaintiffs have petitioned to appeal the denial of § 1447(c) fees? The plaintiff should not need to resort to § 1453(c)(1) because there is an alternative route to obtaining appellate jurisdiction. As the Fifth Circuit correctly suggested, the § 1447(d) ban on appellate review does not apply to a district court order on fees because it is a collateral order. The district court retains jurisdiction, even after remand, to award attorney's fees and its decision is appealable as a collateral matter. Accordingly, the plaintiff may simply appeal the denial of fees as a collateral order [*see Moore's Federal Practice* § 107.43 ("Once the remand is effected, the federal court lacks further jurisdiction over the case except that the court retains authority to adjudicate collateral matters, such as costs, fees, and sanctions")].

Or, what if defendant petitions to appeal a remand order, but the appellate court refuses to grant the defendant's petition? If the plaintiff has not cross-appealed, it is likely that the 7 days for filing an appeal under CAFA will have expired by the time the court of appeals denies the defendant's petition to appeal the district court's decision to remand. Again, the answer should be that the collateral nature of the order on § 1447(c) puts it beyond the § 1447(d) bar, and or the need to invoke § 1453(c). In other words, because § 1453(c) applies only to decisions to remand, not decisions to award fees under § 1447(c).

Although the Fifth Circuit did not need to deal with any timing issues under § 1453(c), it is important to note that when it is necessary to invoke it to seek review of a remand order, there had been confusion as to the timing for petitioning to appeal under CAFA. Congress has now fixed the date -- effective December 1, 2009, the petition must be filed no later than 10 days after the CAFA order is filed [*see* Pub L. No. 111-16, ' 6(2), 7, 123 Stat. 1607].

Application of the Supreme Court's Standard for Awarding § 1447(c) Fees. Under *Martin v. Franklin Capital Corp.*, attorney's fees should not ordinarily be awarded on remand if the removing party had an objectively reasonable basis for removal [*Martin v. Franklin Capital Corp.*, 546 U.S. 132, 136, 126 S. Ct. 704, 163 L. Ed. 2d 547 (2005)]. There was some evidence that Louisiana removed the case in order to prolong the litigation and impose costs on the plaintiffs. On the other hand, the Fifth Circuit found that the commencement question was sufficiently complex to create a relatively close question. *Braud* was the only Fifth Circuit decision that provided guidance, and it expressly withheld judgment on at least one dispositive issue. The Fifth Circuit concluded that while it might have been objectively unreasonable for Louisiana to conclude that the amended complaint commenced a new civil action, it could not say that the district court abused its discretion in reaching the opposite conclusion.

RELATED LINKS: For more information, see *Moore's Federal Practice*

- 5 *Moore's Federal Practice* (3d Ed.) 23.63[2][a];
- 10 *Moore's Federal Practice* (3d Ed.) 54.171[4][h];
- 15 *Moore's Federal Practice* (3d Ed.) 102.26[1][a][i];

- 16 Moore's Federal Practice (3d Ed.) 107.15[13][b][i][A];
- 16 Moore's Federal Practice (3d Ed.) 107.41[3][a];
- 19 Moore's Federal Practice (3d Ed.) 202.11[5]

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Local Controversy Exception CAFA: Vairo on Kaufman v. Allstate New Jersey

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Local Controversy Exception CAFA: Geogene Vairo on Kaufman v. Allstate New Jersey Ins. Co

By Geogene Vairo

July 28, 2009

SUMMARY: Kaufman v. Allstate New Jersey Ins. Co. is an important case involving the construction of the local controversy exception under CAFA. The Third Circuit joined its sister circuits in ruling that the party objecting to federal jurisdiction under CAFA has the burden of showing that the exception applies. In this Emerging Issues Analysis, Geogene Vairo, professor and author, analyzes the Kaufman decision.

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ARTICLE: Summary. *Kaufman v. Allstate New Jersey Ins. Co.*, 561 F.3d 144, 2009 U.S. App. LEXIS 6429 (3d Cir. Mar. 26, 2009), is an important case involving the construction of the "local controversy" exception under the Class Action Fairness Act (CAFA) [see 28 U.S.C. §§ 1332(d), 1453]. In answering a question of first impression in the Third Circuit, the court joined its sister circuits in ruling that the party objecting to federal jurisdiction under CAFA has the burden of showing that the exception applies. The Third Circuit also ruled on several thorny questions of first impression in all of the circuits, holding that (1) only current defendants should be considered in determining whether the local controversy exception to Class Action Fairness Act (CAFA) jurisdiction applies; (2) the "significant basis" provision of the exception is satisfied if the local defendant's alleged conduct is a significant part of the alleged conduct of all the defendants; and (3) the "principal injuries" requirement of the exception is satisfied when *either* (a) principal injuries resulting from the alleged conduct of each defendant were incurred in the state in which the action was originally filed, *or* (b) principal injuries resulting from any related conduct of each defendant were incurred in that state.

Facts and Procedural History. Plaintiffs filed a class action against six automobile insurers in New Jersey state court, alleging that the insurers refused to pay for the "diminished value" of cars damaged in accidents. "Diminished value" is the loss in value even after the car has been completely repaired. The plaintiffs claimed that the insurers' failure to pay for that loss violates New Jersey law and their insurance contracts. The complaint defined two classes: (1) the "Equitable Relief Class," consisting of all persons currently insured by defendants under policies issued in New Jersey; and (2) the "Damages Sub-Class," consisting of all persons currently or previously insured by defendants who, within the six years before the complaint was filed, submitted damage claims and did not receive compensation for diminished value. After three New Jersey insurers were voluntarily dismissed, three defendants were left, one of which was a New Jersey insurer.

One of the insurers removed the case to district court under the Class Action Fairness Act (CAFA) [see 28 U.S.C.

§§ 1332(d)(2), 1453]. The district court remanded the case to state court, holding that it fell within the local controversy exception to CAFA jurisdiction [*see* 28 U.S.C. § 1332(d)(4)(A)]. The Third Circuit vacated the district court's opinion in part and remanded the case to that court for further proceeding.

Removing Defendant Has Burden of Proving CAFA Jurisdiction. By the time *Kaufman* was decided, it had become clear that the proponent of federal jurisdiction had the burden of proving that CAFA jurisdiction existed. Indeed, the parties conceded the jurisdictional requirements of minimal diversity, a class consisting of at least 100 members, and an aggregate amount in controversy of \$5,000,000 [*see* 28 U.S.C. § 1332(d)(2)]. Nonetheless, the Third Circuit discharged its duty to ensure that jurisdiction existed. The minimal diversity requirement was satisfied because at least one plaintiff was a citizen of New Jersey and one of the defendants, Geico, was a citizen of Maryland. Of the two remaining defendants, one (Allstate New Jersey) was a citizen of New Jersey, and the other a citizen of Wisconsin and Massachusetts. The class numbered thousands of New Jersey policy holders. With respect to the amount in controversy, because the parties conceded the \$5,000,000 jurisdictional amount, the Third Circuit applied the "legal certainty" test [*see* *Frederico v. Home Depot*, 507 F.3d 188, 193 (3d Cir. 2007)]. Because plaintiffs' complaint implicated hundreds of thousands of policies, together with claims for punitive damages, the Third Circuit found CAFA jurisdiction because it did not appear that the plaintiff was not entitled to recover the jurisdictional amount.

Plaintiff Has Burden of Proving Exception to CAFA Jurisdiction. CAFA is a somewhat unusual jurisdictional statute because it contains provisions excepting the exercise of jurisdiction, one provision requiring the district court to remand the case under the "local controversy" or "home state" exceptions, and another provision affording the district court discretion to retain the case or remand. Although a matter of first impression in the Third Circuit, all the other courts of appeals to consider which party has the burden of proving one of the exceptions appropriately have decided that the party seeking the remand must prove the exception [*see, e.g.,* *Serrano v. 180 Connect, Inc.*, 478 F.3d 1018, 1024 (9th Cir. 2007); *Hart v. FedEx Ground Package Sys. Inc.*, 457 F.3d 675, 680 (7th Cir. 2006); *Frazier v. Pioneer Ams. LLC*, 455 F.3d 542, 546 (5th Cir. 2006); *Evans v. Walter Indus., Inc.*, 449 F.3d 1159, 1165 (11th Cir. 2006)]. Finding the reasoning of its sister circuits compelling, the Third Circuit held that the plaintiffs had the burden of showing that the local controversy exception applied. The court further explained that this burden-shifting approach is justified by analogy to practice under the removal statute [*see* 28 U.S.C. § 1441(a); *Breuer v. Jim's Concrete of Brevard, Inc.*, 538 U.S. 691, 698, 123 S. Ct. 1882, 155 L. Ed. 2d 923 (2003) ("Since 1948, therefore, there has been no question that whenever the subject matter of an action qualifies it for removal, the burden is on a plaintiff to find an express exception.")].

Local Controversy Exception. The "local controversy" exception to CAFA jurisdiction is among the most convoluted provisions in the linguistically-challenged Class Action Fairness Act. It mandates a remand when it or the "home state" exception applies. Under the local controversy exception to CAFA, a district court must decline to exercise jurisdiction [28 U.S.C. § 1332(d)(4)(A)]:

(i) over a class action in which

(I) greater than two-thirds of the members of all proposed plaintiff classes in the aggregate are citizens of the State in which the action was originally filed;

(II) at least 1 defendant is a defendant

(aa) from whom significant relief is sought by members of the plaintiff class;

(bb) whose alleged conduct forms a significant basis for the claims asserted by the proposed plaintiff class; and

(cc) who is a citizen of the State in which the action was originally filed; and

(III) principal injuries resulting from the alleged conduct or any related conduct of each defendant were incurred in the State in which the action was originally filed; and

(ii) during the 3-year period preceding the filing of that class action, no other class action has been filed asserting the same or similar factual allegations against any of the defendants on behalf of the same persons.

Only Current Defendants Considered. The first problem confronting the Third Circuit was whether the district court erred by including the three dismissed New Jersey defendants in its determination of whether the local controversy exception applied. The Third Circuit held that only the remaining defendants should be considered. The Third Circuit acknowledged that federal diversity jurisdiction is generally determined based on the circumstances prevailing when the suit was filed -- the "time of filing" rule. However, citing *Grupo Dataflux v. Atlas Global Group, L.P.*, 541 U.S. 567, 575, 124 S. Ct. 1920, 158 L. Ed. 2d 866 (2004), the court found that there are exceptions to the time of filing rule when the parties themselves, rather than the circumstances of the parties, change. Moreover, a key condition of the local controversy exception is the presence of at least one significant local defendant. If application of the exception were determined at the time the complaint was filed, the exception could be applied even when the local defendant has been dropped from the lawsuit.

To be consistent with CAFA's purpose of providing federal jurisdiction over cases of national, rather than local, significance, the focus must be on the actual defendants before the court. In other words, looking at the complaint at the time of filing could result in an inconsistency with the exception's focus on discerning local controversies based, in part, on the presence of a significant local defendant. Thus, the court concluded, application of the local controversy exception must be determined based on the three remaining defendants. Of those, only the New Jersey insurer was a possible "significant local defendant."

Comment. The Third Circuit's approach makes sense. First of all, it is a given that jurisdiction existed. The only question is whether an exception to CAFA jurisdiction applied. Thus, the plaintiff ought to play the hand it has at the time it makes the local exception argument. Although the plaintiff is the master of the complaint, in the procedural posture at the time of making a motion to remand, it does not make sense to revert to who was named in the complaint. Rather it makes sense to consider only those parties remaining in the case. The idea is to determine which cases ought to stay in federal court because they are of national significance. Only the current parties ought to be considered in determining whether the case should stay in federal court, or be remanded because the local exception applies.

Elements of the Mandatory Exception to CAFA Jurisdiction. CAFA provides for two types of mandatory exception to CAFA jurisdiction -- the "local controversy" exception and the so-called "home state" exception. Both exceptions require that "greater than two-thirds of the members of all proposed classes in the aggregate are citizens of the State in which the action was originally filed" [see 28 U.S.C. § 1332(d)(4)(A)(i)(I)]. In *Kaufman*, only the convoluted local controversy exception was implicated. To summarize the mandatory local controversy exception, CAFA requires: 1) a class in which two-thirds of the class members are local citizens [28 U.S.C. § 1332(d)(4)(i)(I)]; 2) who seek "significant relief" [28 U.S.C. § 1332(d)(4)(i)(II)(aa)]; 3) from at least one local defendant [§ 1332(d)(4)(i)(II), (II)(cc)]; 4) whose alleged conduct forms a "significant basis" for the class claims [28 U.S.C. § 1332(d)(4)(i)(II)(bb)]; and 5) where the "principal injuries" resulting from the alleged conduct or any related conduct of each defendant were incurred in the state [28 U.S.C. § 1332(d)(4)(i)(III)].

"Significant Basis" Requires Comparison of Defendants' Conduct. The Third Circuit began an archeological dig into the language of CAFA's local controversy exception by zeroing in on the "significant basis" element. The defendants argued that the "significant basis" provision was not satisfied because not every member of the proposed class had a claim against the local defendant. Each plaintiff had a claim only against its own insurer, so only the local defendant's insureds had a claim against it.

The defendants relied on the use of the term "class" rather than "members of the class," which is used in the "significant relief" provision of the local controversy exception [see 28 U.S.C. § 1332(d)(4)(A)(i)(II)(aa) (class action must include at least one local defendant "from whom significant relief is sought by members of the plaintiff class" (emphasis added))] and in the home-state exception [28 U.S.C. § 1332(d)(4)(B) (exception to CAFA jurisdiction when "two-thirds or more of the members of all proposed plaintiff classes in the aggregate, and the primary defendants, are

citizens of the State in which the action was originally filed" (emphasis added)]. CAFA defines "class" as "all of the class members in a class action" [*see* 28 U.S.C. § 1332(d)(1)(A) (emphasis added)]. Moreover, the significant basis provision says that the local defendant's conduct should form a significant basis of "the" claims asserted by "the" proposed plaintiff class, not "some" claims asserted by "members" of the proposed plaintiff class.

The Third Circuit agreed that the significant basis provision requires at least one local defendant whose alleged conduct forms a significant basis for all the claims asserted in the action. However, according to the Third Circuit, this does not imply that every member of the proposed plaintiff class must assert a claim against the local defendant. The plain text of the subsection (bb) relates the alleged conduct of the local defendant, on one hand, to all the claims asserted in the action, on the other. Assessing the quantity of claims based on the local defendant's alleged conduct may be useful, but a party's conduct may form a significant basis of an entire set of claims even if some claims within the set are not based on that conduct. Thus, what is required is a comparison of the local defendant's alleged conduct to the alleged conduct of all the defendants. The significant basis provision is satisfied if the local defendant's alleged conduct is a significant part of the alleged conduct of all the defendants.

Comment. The Third Circuit's reasoning is justified by the language of the local controversy provision. A reading of parts (aa), (bb), and (cc) together, because they are joined with an "and," not an "or," supports the court's conclusion. To the extent that (aa) requires that "members" of the class -- not the entire class -- must seek "significant relief" from the local defendant, it follows that not all members of the class must have a claim against that defendant. Rather, it is enough if the "conduct" by the local defendant giving rise to the claims for significant relief is in itself a significant basis for the class claims as a whole. Although this is a plaintiff-friendly construction of the local controversy exception, it does leave room for defendants to argue that the relief sought against the local defendant is not significant (stay tuned for more case law on the construction of that CAFA term), or that taken as a whole, the local defendant's conduct vis-à-vis the other remaining defendants, is not significant enough to warrant a remand.

In other words, so long as the plaintiff class meets the two-thirds rule, and the complaint names a local defendant alleging claims similar to those alleged against the non-citizen defendants, the plaintiff will be in a good position to show that the case is so localized that it ought to be litigated in state court. Such an approach comports with the intent of the local controversy exception. In cases in which more than two-thirds of the class members are citizens of the state, and where the claims solely involve conduct in that state, and the in-state -- local -- defendant is alleged to have engaged in the same conduct, principles of federalism point to resolution of the dispute in state court rather than federal court.

Nuggets for the Defendants on Remand. Nonetheless, the Third Circuit provided the defendants with some food for thought to escape remand to state court. It remanded the case to the district court to reconsider its significant basis analysis in light of its opinion. The district court had properly rejected the defendants' argument that every member of the class had to have a claim against the local defendant. However, the district court simply considered the number of automobile insurance policies the local defendant had sold in New Jersey, which represented 13 percent of all the auto policies sold in the state, and concluded that the significant basis provision was satisfied because the local defendant had issued substantially more policies than other defendants and it could not be considered "trivial or of no importance" [*Kaufman v. Allstate Ins. Co.*, 2008 U.S. Dist. LEXIS 71245, at *13 (D.N.J. Sept. 10, 2008)].

The district court took for granted that every insurance policy sold by each defendant violated New Jersey law and that no defendant ever paid an insurance claim for diminished value, and the court did not compare the local defendant's alleged conduct to the alleged conduct of all the defendants. This reliance on mere generic market share numbers was insufficient, according to the Third Circuit. Moreover, it is not enough that the local defendant's alleged conduct is "more than trivial or of no importance" or that the local defendant is a major player in a particular market. "The local defendant's alleged conduct must be an *important* ground for the asserted claims in view of the alleged conduct of all the defendants" (court's emphasis).

Principal Injuries Resulting From Alleged Conduct or Related Conduct. Finally, the Third Circuit considered

the "principal injuries" provision of the local controversy exception, which requires that the "principal injuries resulting from the alleged conduct *or* any related conduct of each defendant were incurred in the State in which the action was originally filed" (emphasis added) [28 U.S.C. § 1332(d)(4)(A)(i)(III)]. One defendant argued that this means that principal injuries resulting from the alleged conduct *and* any related conduct of each defendant had to have been incurred in New Jersey. Under this theory, the local controversy exception was inapplicable because the defendant issued insurance policies providing identical coverage in other states, and principal injuries resulting from this "related conduct" would be incurred outside New Jersey.

Neither the district court nor the Third Circuit agreed with this argument. The Third Circuit relied on the "plain language" of the exception, which invokes "the alleged conduct or any related conduct" in the disjunctive. The provision is satisfied when either (1) principal injuries resulting from the alleged conduct of each defendant were incurred in the state in which the action was originally filed, *or* (2) principal injuries resulting from any related conduct of each defendant were incurred in that state. In this case, the alleged conduct was the failure to insure or pay for diminished value claims in New Jersey, and the putative class would be made up of members with insurance policies issued in New Jersey. Thus, to the extent there were any injuries resulting from the alleged conduct, those injuries were incurred in New Jersey, and the principal injuries provision was satisfied.

Comment. The Third Circuit's ruling on the "principal injuries" issue is consistent with its "significant basis" ruling. It suggests that the alleged conduct of the local defendant is severable from any related conduct by non-instate defendants. In other words, the Third Circuit's construction of the entire local controversy exception allows a sensible focus on what that local defendant did in the context of the entire case. To the extent that it is significant, the case should be treated as a local matter.

Moreover, it would be ironic had the defendant escaped New Jersey state court on claims by a mostly New Jersey class raising purely questions of New Jersey law on the basis that it harmed citizens of other states based on their laws, even though the injuries were similar.

RELATED LINKS: See Moore's Federal Practice for more information.

- Moore's Federal Practice (3d Ed.) § 23.63[2][d][iii];
- 15 Moore's Federal Practice (3d Ed.) § 102.26[1][d][iii];
- 16 Moore's Federal Practice (3d Ed.) § 107.15[13][b][ii][E]

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Jahan Sagafi on Gentry v. Superior Court

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By Jahan Sagafi

December 6, 2007

SUMMARY: In *Gentry v. Superior Court*, the CA Supreme Court recently balanced the statutory policies in favor of arbitration agreements including class action waivers against the overtime pay statutes and found the latter to prevail. The United States Supreme Court denied Circuit City's petition for a writ of certiorari to the *CA Supreme Court (128 S. Ct. 1743 (March 31, 2008))*.

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ARTICLE: Introduction. In *Gentry v. Superior Court [42 Cal. 4th 443, 64 Cal. Rptr. 3d 773, 165 P.3d 556 (2007)]*, the California Supreme Court balanced the statutory policies in favor of arbitration agreements against the overtime pay statutes and found the latter to prevail, making two specific holdings.

First, the Court held that, when evaluating class arbitration waivers, the trial court must consider the following factors [*Gentry v. Superior Court, 42 Cal. 4th at 463, 64 Cal. Rptr. 3d 773, 165 P.3d 556 (2007)*]:

- . The damages at stake;
- . The potential for retaliation;
- . Class members' knowledge of their rights; and
- . Other "real world obstacles" to the vindication of rights through individual arbitration.

If class arbitration will be "significantly more effective" than individual litigation or arbitration, and individual resolution will likely diminish enforcement of overtime laws, the trial court must invalidate a class arbitration waiver [*Gentry v. Superior Court, 42 Cal. 4th at 463, 64 Cal. Rptr. 3d 773, 165 P.3d 556 (2007)*].

Second, the court held that a 30-day opt-out provision can warrant a finding of procedural unconscionability. It situated the opt-out provision in between the two extremes of a free negotiation among equally positioned parties (which precludes a finding of procedural unconscionability), and an adhesive take-it-or-leave-it contract (which almost guarantees such a finding) [*Gentry v. Superior Court, 42 Cal. 4th at 470, 64 Cal. Rptr. 3d 773, 165 P.3d 556 (2007)*].

Gentry in Context of Arbitration Agreement Decisions. *Gentry* essentially builds on the recognition by earlier cases, *Armendariz* and *Discover Bank*, that arbitration agreements used by sophisticated entities to undermine individuals' statutory and common law rights must be scrutinized carefully and invalidated in appropriate circumstances. In *Armendariz v. Found. Health Physicare Servs.* [24 Cal. 4th 83, 99 Cal. Rptr. 2d 745, 6 P.3d 669 (2000)], the California Supreme Court held that arbitrations of unwaivable employment rights must not depart unduly from the traditional judicial process in terms of damages, discovery, written opinions, judicial review, and cost allocations. In *Discover Bank v. Superior Court* [36 Cal. 4th 148, 30 Cal. Rptr. 3d 76, 113 P.3d 1100 (2005)], the Court held that at least some class action waivers in consumer contracts are unconscionable.

Factual Background in Gentry. In *Gentry*, the plaintiff, a salaried customer service manager for Circuit City, brought suit alleging that he was not exempt from California labor laws requiring premium pay for hours worked in excess of eight in a day and 40 in a week. When hired, he had signed an arbitration agreement waiving his procedural and substantive rights in various ways. The arbitration agreement (1) prohibited *Gentry* from suing Circuit City in court; (2) limited any arbitration to the resolution of his claims only (i.e., no collective or class arbitration); (3) limited punitive damages to a maximum of \$5,000; (4) assigned recoverability of attorney's fees to the arbitrator's discretion; and (5) abbreviated the statute of limitations period from four years to one year. The agreement allowed *Gentry* 30 days to opt out, which he did not do [*Gentry v. Superior Court*, 42 Cal. 4th at 451, 64 Cal. Rptr. 3d 773, 165 P.3d 556 (2007)].

Unconscionability Under Discover Bank. In *Discover Bank*, the California Supreme Court had criticized several aspects of a class arbitration waiver. The Court frowned on both the procedural unconscionability (the agreement was adhesive in requiring the credit cardholder to either agree or close her account) and the substantive unconscionability (the agreement's object was to exempt Discover Bank from responsibility for its wrongdoing, and was therefore against public policy) inherent in the waiver [*Discover Bank v. Superior Court*, 36 Cal. 4th at 160-161, 30 Cal. Rptr. 3d 76, 113 P.3d 1100 (2005)].

The Court focused on the low damages in consumer cases as a prime reason to preserve mechanisms for classwide resolution. The Court also noted that class actions serve to check the temptation for companies to engage in widespread but slight individual wrongdoing to reap handsome profit at customers' expense. Furthermore, the one-sidedness of the agreement was an issue, in that the bank was not likely giving up any rights by preventing access to class litigation. Importantly, the Court in *Discover Bank* left the determination of unconscionability to the courts on a case-by-case basis, pointing to adhesiveness, amount of damages in dispute, imbalance in bargaining power, and allegations of wrongdoing in the particular dispute at issue [*Discover Bank v. Superior Court*, 36 Cal. 4th at 161-162, 30 Cal. Rptr. 3d 76, 113 P.3d 1100 (2005)].

The Court in *Gentry* noted that *Discover Bank* does not preclude class arbitration, since it is a "well-accepted alternative to class litigation .. and individual arbitration" [*Gentry v. Superior Court*, 42 Cal. 4th at 454, 64 Cal. Rptr. 3d 773, 165 P.3d 556 (2007)].

Unwaivable Statutory Rights. The *Gentry* court emphasized that the Labor Code explicitly creates unwaivable rights. It espouses "a clear public policy .. that is specifically directed at the enforcement of California's minimum wage and overtime laws for the benefit of workers." Those rights are unwaivable in part because they concern the health and welfare of the public, not just the individual employee. Practitioners should bear in mind this focus when crafting arguments regarding whether a given agreement runs afoul of public policy. For example, in certain consumer contexts this argument may have less traction, whereas in the employment discrimination context, the argument may have even more force [*Gentry v. Superior Court*, 42 Cal. 4th at 455, 64 Cal. Rptr. 3d 773, 165 P.3d 556 (2007)].

Gentry reaffirms the formulation of boundaries for arbitrations addressing statutory employment rights set out in *Armendariz* and *Little* [*Gentry v. Superior Court*, 42 Cal. 4th at 456-457, 64 Cal. Rptr. 3d 773, 165 P.3d 556 (2007)];

see *Armendariz v. Found. Health Physcare Servs.*, 24 Cal. 4th 83, 99 Cal. Rptr. 2d 745, 6 P.3d 669 (2000); *Little v. Auto Stiegler, Inc.*, 29 Cal. 4th 1064, 130 Cal. Rptr. 2d 892, 63 P.3d 979 (2003)]:

- (1) Damages may not be curtailed below those available under the statute;
- (2) Adequate discovery must be afforded;
- (3) There must be a written arbitration decision and judicial review; and
- (4) The employer must pay all costs unique to arbitration.

Courts will continue to carefully scrutinize arbitration agreements to ensure that they are not "misused to accomplish a de facto waiver" of unwaivable statutory employment rights. Thus, plaintiffs and defendants should attempt to show that agreements similar to those at issue in their cases result in de facto waiver or balanced outcomes in arbitrated disputes, respectively [*Gentry v. Superior Court*, 42 Cal. 4th at 457, 64 Cal. Rptr. 3d 773, 165 P.3d 556 (2007)].

Preference for Class Actions. The atmospherics of *Gentry* should not be underestimated. In the opinion, the California Supreme Court repeatedly invoked employee- and class action-friendly opinions in *Bell*, *Sav-On Drug Stores*, *Ramirez*, and other cases to expound on the virtues of class actions [*Gentry v. Superior Court*, 42 Cal. 4th at 457, 64 Cal. Rptr. 3d 773, 165 P.3d 556 (2007); see *Bell v. Farmers Ins. Exchange*, 115 Cal. App. 4th 715, 9 Cal. Rptr. 3d 715 (2004); *Sav-On Drug Stores, Inc. v. Superior Court*, 34 Cal. 4th 319, 17 Cal. Rptr. 3d 906, 96 P.3d 194 (2004); *Ramirez v. Yosemite Water Co.*, 20 Cal. 4th 785, 85 Cal. Rptr. 2d 844, 978 P.2d 2 (1999)]:

- . The ability of absent class members to silently recover without jeopardizing job security or investing time and money in litigation;
- . The vindication of the rights of employees and consumers who are unaware of the violations they have suffered; and
- . The preservation of judicial resources.

Furthermore, the Court took a very practical approach, time and again detailing the problem of unequal bargaining power and the real-world obstacles employees face in litigation. Thus, practitioners litigating these issues should take care to acknowledge the benefits of class actions and invoke or distinguish the factors listed above in discussing the facts at issue [*Gentry v. Superior Court*, 42 Cal. 4th at 468-469, 64 Cal. Rptr. 3d 773, 165 P.3d 556 (2007)]. For example, Circuit City's argument that the DLSE has received only 446 to 808 retaliation claims annually was turned against it, as the Court found these facts to show "widespread" retaliation, further buttressing the value of class actions.

Key Factors in Unconscionability Analysis. In *Gentry*, the Court appropriately continued its focus on the parties' relative bargaining positions. The court noted that employees-especially those to whom minimum wage and overtime pay statutes are directed-generally have fewer resources than their employers, often fear retaliation, and may not be aware of their rights. In litigating these issues, attorneys should address the relative positions of the parties, and its resulting impact on the unconscionability analysis.

Gentry also noted that the modest size of minimum wage and overtime claims supports the argument that classwide litigation may provide the only practical opportunity for resolution of certain claims, considering the costs of litigation. Helpfully, the Court provided an indication of what "modest" means, by repeating the analysis from *Bell* that even a recovery of \$37,000 could be insufficient incentive for an individual lawsuit, and thus a reasonable figure to support a finding of class certification. The Court also noted that even when the award size is sufficient to incentivize individual litigation, the class device may be necessary to ensure effective enforcement of rights [*Gentry v. Superior Court*, 42 Cal. 4th at 458, 64 Cal. Rptr. 3d 773, 165 P.3d 556 (2007); see *Bell v. Farmers Ins. Exchange*, 115 Cal. App.

4th 715, 9 Cal. Rptr. 3d 715 (2004)].

Opt-Out Provision in *Gentry*. In addressing the 30-day opt-out provision of the arbitration agreement, the *Gentry* Court found some procedural unconscionability. The Court explained that *Gentry*'s assent to the provision was not "an authentic informed choice," because the handbook explaining the arbitration agreement's features was factually lopsided and signaled that the employee should accept arbitration. The handbook failed to mention significant drawbacks of the agreement, such as the curtailed limitations period, damages limitations, and attorney's fee uncertainty. That Circuit City's nine-page single-spaced description of the arbitration features detailed these facts did not save the defendant. Thus, attorneys drafting arbitration agreements and explanatory documents should remember that both the agreement itself and the explanations must be balanced and clear. Warning the employee to consult with an attorney is not enough. In addition, the handbook's expression of a pro-arbitration position further supported a finding of procedural unconscionability [*Gentry v. Superior Court*, 42 Cal. 4th at 470-471, 64 Cal. Rptr. 3d 773, 165 P.3d 556 (2007)].

Denial of Certiorari. A year later, the United States Supreme Court denied Circuit City's petition for a writ of certiorari to the California Supreme Court. The denial was unsurprising. First, one should bear in mind that the nation's highest court only takes about 80 of 1,800 cases (4%) each year. And given that the high court primarily focuses on issues of federal law, arbitration provision interpretation does not provide much of a basis for review. This is because the Supreme Court's seminal class arbitration decision, *Green Tree Financial Corp. v. Bazzle*, 539 U.S. 444, 123 S. Ct. 2402, 156 L. Ed. 2d 414 (2003), held that an arbitration provisions must be interpreted according to principles of state contract law. This squarely placed the ball in the state's courts, as it were. As can be seen below, several states have reached conclusions similar to those of the California Supreme Court. As of now, it is difficult to see a justification for the federal courts to upset this course, in light of the state courts' role in developing state common law.

Other important cases. Other courts have reached conclusions similar to those of the California Supreme Court in examining the law of other states. *Skirchak v. Dynamics Research Corp.*, 508 F.3d 49 (1st Cir. 2007) (finding class action waiver unconscionable under Massachusetts law); *Vasquez-Lopez v. Beneficial Oregon, Inc.*, 210 Or. App. 553, 152 P.3d 940 (2007) (finding class action waiver unconscionable under Oregon law); *Dale v. Comcast Corp.*, 498 F.3d 1216 (11th Cir. 2007) (finding class arbitration agreement substantively unconscionable under Georgia law); *Riensch v. Cingular Wireless, LLC*, 2006 U.S. Dist. LEXIS 93747 (W.D. Wash. 2006) (finding class action waiver in arbitration agreement substantively unconscionable under Washington law); *but see Gay v. Creditinform*, 2007 U.S. App. LEXIS 29302, Case No. 06-4036 (3rd Cir. Dec. 19, 2007) (finding class action waiver in arbitration agreement enforceable); *Anderson v. Comcast Corp.*, 500 F.3d 66 (1st Cir. 2007) (finding class action waiver in arbitration agreement enforceable).

Conclusion. *Gentry* marks a milepost in the road away from class arbitration waivers. It relies on recent California, non-California, and federal cases invalidating such waivers in employment and consumer contracts. However, the Court fell short of categorically banning these waivers, and the issue remains hotly debated. So the future of class arbitration waivers and arbitration agreements generally remains uncertain.

Therefore, in drafting arbitration agreements and litigating them, practitioners should be attentive not only to the several factors set forth in the *Gentry* opinion, but also to the rationales underlying them. Thoroughness in this regard will comport with existing law and maximize chances of anticipating future developments in the area.

Lexis Nexis Related References

For complete discussion of class-wide arbitration, see Cabraser, CALIFORNIA CLASS ACTIONS PRACTICE AND PROCEDURE, Ch. 12, *Class-Wide Arbitration*, § 12.03 (Matthew Bender).

For discussion relating to overtime claims, see Cabraser, CALIFORNIA CLASS ACTIONS PRACTICE AND PROCEDURE, Ch. 18A, *Certification of Overtime Claims*, § 18A.02 (Matthew Bender).

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