

■ What to Tell a Panicked Client about Class Actions

BY BARRY BELL AND CAROLYN RAINES

For some business clients, class actions are a way of life, and the Class Action Fairness Act, *American Pipe* tolling, and other class action arcana are the stuff of casual conversation. For many others, though, a class action complaint marks the beginning of an alien and alarming experience. This article identifies five questions your clients may ask if they find themselves defending a class action for the first time. The answers may be obvious to members of this Section, but they may surprise

novice clients. And even if your novice clients don't ask the questions, you need to make sure they know the answers.

Where Is the Risk?

Clients want to know right away about the merits. "Can we win a motion to dismiss, or a motion for summary judgment? If not, what is a jury likely to do?" In class actions, though, the first question should be "Can we win on the motion for class certification?" Lose this motion, and the costs may be enormous. Win, and the case may simply evaporate.

The defining feature of a class action is the way it "aggregates" claims. The "class" is a collection of persons who have the same complaint; they all bought the same defective product, or they all got sick from the same food additive, or they all worked extra hours without being paid overtime. Typically, each person has a

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■ CAFA and Its Impact on Class Action Litigation

BY MARISSA L. QUIGLEY

While it may be too soon to tell whether the Class Action Fairness Act of 2005 (CAFA) will succeed in the long run in accomplishing its aims of eliminating forum shopping and promoting fairer class settlements, it appears that in the three years since its enactment, CAFA is headed in the right direction. The trends have shown a dramatic increase in class action suits being removed and originally filed in federal court, rather than in plaintiff-friendly state courts. CAFA has also led to heightened judicial scrutiny of class action settlements, even more so than under the prior standard set forth in the federal rules.

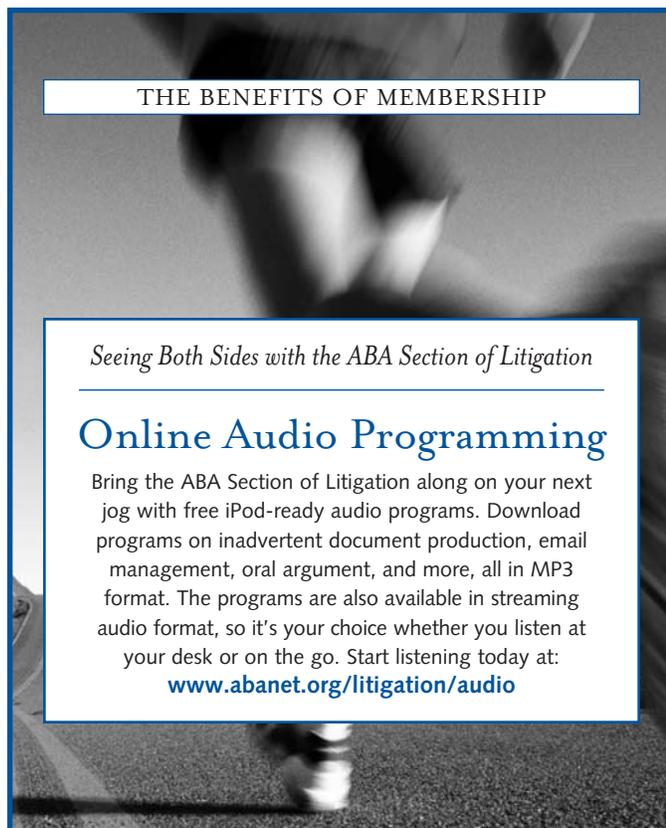
The Basics of CAFA

CAFA was signed into law on February 18, 2005, and applies to any class action commenced after that date. Congress aimed to eliminate the common result of class actions where most class members receive little to no benefit, while certain plaintiffs and counsel receive disproportionately large awards.¹ Moreover, Congress was concerned about the prevalence of forum shopping by class action plaintiffs' attorneys, who typically sought state courts that had demonstrated bias against out-of-state defendants,

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Letter from the Chairs

As the fallout of the financial crisis leads to class actions and securities litigation, the Commercial and Business Litigation Committee is focusing on key issues for trial lawyers related to the crisis. Specifically, this issue of the newsletter addresses the latest developments related to class action litigation, as well as e-discovery and securities law challenges. More broadly, the committee will focus on such timely issues and provide opportunities for members to connect and share best practices in a variety of ways during the remainder of the bar year. A few of these events and opportunities are highlighted as follows:



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Program

We sponsor a variety of CLE programming at two annual meetings—the Section Annual Conference each spring and the ABA Annual Meeting each summer. This year, the Section Annual Conference will be in Atlanta, Georgia, April 29–May 1, and the ABA Annual Meeting will be in Chicago, Illinois, July 30–August 2. Please save these dates and plan to attend both meetings. In addition to providing top-notch CLE programs, these meetings provide invaluable opportunities to meet and to share ideas and experiences with lawyers and judges from all over the country.

Committee Networking Events

At the Section Annual Meeting in Atlanta, we will hold a committee dinner on Wednesday, April 28, and a networking luncheon on Thursday, April 29. We encourage you to watch for email notices of the “no-host” dinner and RSVP quickly, as the dinners are popular and the limited seating tends to go fast. At the networking luncheon, we will exchange ideas and best practices on the topic of meeting the needs of commercial and business clients during times of financial turmoil.

Website

We urge you to take some time to check out the content available on the website (www.abanet.org/litigation/committees/commercial), including information about our subcommittees (and how to contact subcommittee chairs), articles, program materials, links to other helpful legal sites, and information about upcoming meetings and programs. We are committed to providing up-to-date information that will help you stay abreast of current developments, both in the Section and in your practice.

Thank you for your interest in the work of our committee. The Section of Litigation is the leading voice of trial lawyers in this country, and we are proud to be a part of it. We look forward to working with you, and invite you to contact us with any ideas or suggestions you may have for how to continue to meet our goals.

David Coale
Barbara Dawson
Lamont Jefferson
Cochairs, Commercial & Business Litigation Committee

Letter from the Editor

This issue of *Commercial & Business Litigation* focuses on class actions. This issue contains articles on the Class Action Fairness Act, handling electronic discovery, and how to allay your client's fears when they are defending a class action for the first time. This issue also contains articles on the Supreme Court's decision in *Tellabs, Inc. v. Makor Issues & Rights, Ltd.*, and two recent circuit court decisions that address and limit the ability for the plaintiff's counsel to forum shop. In addition, this issue contains a handy roster of the Commercial & Business Litigation Subcommittee chairs.

If you have any comments about this issue, or if you wish to contribute articles to future issues of *Commercial & Business Litigation*, please contact me at stioa@pepperlaw.com. Upcoming newsletter themes and the submission dates for articles are as follows:

SUMMER 2009: ENERGY
Submission Deadline: May 1, 2009

FALL 2009: BANKRUPTCY
Submission Deadline: August 18, 2009

A standard article is roughly 1,500 words, with all citations in the form of endnotes. The article should be written in MS Word format, and may be submitted to my attention by email. You will be notified shortly after your submission if your article was selected for publication.

As always, thank you for your interest in the ABA and the Committee on Commercial & Business Litigation.

Angelo A. Stio III

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The “Holistic” Approach to Scienter under *Tellabs*

BY WILLIAM E. GRAUER, MARY KATHRYN KELLEY, AND PETER M. ADAMS

Under the Private Securities Litigation Reform Act of 1995 (PSLRA), a securities fraud plaintiff must allege “facts giving rise to a strong inference” of scienter.¹ Because the PSLRA did not define a “strong inference,” the circuit courts reached differing conclusions when called upon to interpret and apply this pleading standard. On June 21, 2007, the Supreme Court resolved this split when it decided *Tellabs, Inc. v. Makor Issues & Rights, Ltd.* In *Tellabs*, the Court held that “[t]o qualify as ‘strong’ . . . an inference of scienter must be more than merely plausible or reasonable—it must be cogent and at least as compelling as any opposing inference of non-fraudulent intent.”² When facing a Rule 12(b)(6) motion to dismiss, the Court directed district courts to: (1) “accept all factual allegations in the complaint as true”; (2) “consider the complaint in its entirety [i.e., “holistically”] . . . [and determine] whether all of the facts alleged, taken collectively, give rise to a strong inference of scienter, not whether any individual allegation, scrutinized in isolation, meets the standard”; and (3) “take into account plausible competing inferences.”³

Some commentators interpreted *Tellabs* as a win for the defendants,⁴ based largely on the Court’s directive to lower courts to “consider plausible non-culpable explanations for the defendant’s conduct.”⁵

Others argued the opinion established a plaintiff-friendly pleading standard because it requires courts “not to scrutinize each allegation in isolation but to assess all the allegations holistically.”⁶ While the ultimate impact of *Tellabs* is likely to vary by circuit,⁷ it does appear that “courts have taken their role in ‘holistically’ analyzing a complaint’s scienter allegations—and defendants’ plausible counterpoints—seriously.”⁸ Indeed, several recent circuit court opinions confirm this view and, importantly, suggest that in applying *Tellabs* in a rational manner, lower courts are taking into account the larger context of the defendants’ overall business realities—a development that should provide defendants some reassurance.

The central proposition of this article is that the “holistic” approach should be viewed as a two-way street, allowing

courts to consider the overall business realities facing the defendant in context. Because of this, in several recent cases, defendants have started to affirmatively embrace the holistic approach articulated in *Tellabs*.

Mizzaro v. Home Depot, Inc.

The Eleventh Circuit recently decided *Mizzaro*, a case in which the plaintiffs sued Home Depot and six of its officers and directors for allegedly obtaining excessive rebates from vendors, and for failing to inform investors that the company’s financial results were inflated because of these rebates.⁹ According to the plaintiffs, Home Depot stores routinely

and illegitimately processed return-to-vendor (RTV) chargebacks for defective merchandise as part of a company-wide scheme to inflate profits. The defendants moved to dismiss, and the district court granted the motion without leave to amend because the plaintiffs failed to adequately plead scienter.

On appeal, the Eleventh Circuit conducted an extensive review of the complaint, its scienter allegations, and the underlying facts of the case. The plaintiffs alleged that the “widespread nature or duration of the fraud leads to a strong inference that

it was ‘orchestrated at corporate headquarters.’”¹⁰ Despite its “surface appeal,” the court rejected the plaintiffs’ argument for three reasons. First, the court concluded that “the alleged fraud appears to have been a simple one, and, if it occurred, plainly did not require the participation of upper management, let alone the CEO or the CFO of the company.” Second, the plaintiffs’ confidential witnesses did not mention “any directive or conversation coming from the individual defendants . . . ordering them to commit RTV fraud or instructing them how to do it. . . . Indeed, the amended complaint fails to cite even one communication of any kind from the individual defendants.”¹¹ Third, and perhaps most importantly, the court reasoned that the “most plausible inference to draw from the amended complaint’s allegations, taken together, is that the RTV fraud began at the store level in response to

Holistic Is as Holistic Does

Historically in securities litigation, it is common for defendants, in motions to dismiss, to attack each separate piece of evidence allegedly supporting an inference of scienter. Defendants often assert that if each separate piece of evidence is neutral or unsupported, the complaint must fail (i.e., ten times zero is still zero). In response, plaintiffs often argue that even if each piece of evidence in a vacuum can be challenged, the court must look at the complaint “as a whole” to see if it raises a strong inference of scienter. As shown previously, the central thesis of this article is that on careful analysis, this “holistic” approach is often more favorable to the defense and, after *Tellabs*, should be embraced and argued by both parties in a securities motion.

pressure on store managers to reduce shrink [i.e., inventory that is lost or damaged due to shoplifting, theft, store use, or damage by store employees].”¹²

The plaintiffs also alleged that the defendants “‘must have known’ everything that was happening in a company as large as Home Depot, which operates over 2000 stores.” But considering the business realities of Home Depot’s operations coupled with the plaintiffs’ allegations (or lack thereof), the court concluded that the complaint “did not come close” to “showing how knowledge of the fraud would or should have percolated up to senior management.” For one, the amount of fraud was speculative because the plaintiffs’ back-of-the-envelope estimate of \$1 billion, “although surely a significant sum,” was not an overwhelming percentage of Home Depot’s business, and the estimate, based on fraud occurring at one or two stores, was “far too shaky a foundation on which to make any reasonable calculus of the total amount of the fraud.”¹³ Second, the type of fraud would be difficult for senior management to detect because it was simple and did not require “sophisticated accounting cover-up.”¹⁴ Third, the amended complaint was silent regarding suspicious stock sales, “an omission that weighs against inferring scienter.”¹⁵ But, most importantly, the court did not accept the plaintiffs’ inference that Home Depot’s 2004 overhaul of its RTV processing system suggested fraud. Instead, the court reasoned:

Large corporations like Home Depot make incremental improvements to their business operations all the time, and, from the amended complaint, BEAR [Home Depot’s new automated system for handling RTV chargebacks] appears to be nothing more than that. . . . Cutting through the jargon, [the Home Depot documents quoted in the complaint] say nothing more than that Home Depot is trying to create a more centralized system for handling RTV chargebacks. We do not believe that reasonable people would infer much from the design and implementation of a system that appears to do little more than increase management’s control and improve management’s access to information.¹⁶

In short, to demonstrate an alleged “company-wide scheme” and to plead scienter, the plaintiffs relied on the following chain of evidence: (1) confidential employee witnesses, (2) newspaper articles, (3) internal Home Depot documents, (4) a whistleblower complaint, and (5) commentary on the SEC’s inquiry into Home Depot’s practices. Despite this evidence, the Eleventh Circuit’s application of the “holistic” approach under *Tellabs* resulted in dismissal. Even if some evidence in isolation created an inference of wrongdoing, looking at the evidence as a whole, and in the larger context of the defendants’ overall business operations, created a stronger inference of ordinary, non-culpable business activities.

Metzler Inv. GMBH v. Corinthian Colleges, Inc.

In *Metzler*, plaintiff investors sued the operator of private, for-profit vocational colleges (Corinthian) and several officers.¹⁷ The plaintiffs alleged that the defendants engaged in a variety of false and deceptive schemes “designed to maximize the amount of federal Title IV funding—a major source of Corinthian’s revenue—that [its vocational] schools receive.”¹⁸ The

plaintiffs claimed that the defendants falsified financial aid applications, encouraged students to falsify applications, manipulated student enrollment, manipulated student grades, exposed the company to bad debt to maximize federal funding, and manipulated job placement data. The plaintiffs supported these allegations with

confidential witness statements from former employees. The district court dismissed the case for failure to state a claim, and the plaintiffs appealed. On appeal, the Ninth Circuit upheld the district court’s order, holding that plaintiffs failed to adequately plead scienter under *Tellabs*.

The plaintiffs’ alleged scienter was based principally on three factors: (1) insider trading by certain officers during the class period; (2) a “sophisticated information management system” that monitored company-wide enrollment and other data; and (3) one individual defendant’s involvement in the company’s revenue recognition policies and his rejection of alternate accounting methods.

The plaintiffs argued that the insider trading by the individual defendants was evidence of scienter. However, according to the court, “a more careful look at the transactions tells a different story.”¹⁹ The stock sales did not raise a strong inference of scienter because there was “nothing particularly suspicious about the ‘timing of [these] sales.’” Instead, the court examined the trading patterns of the individual defendants and found that they “sold in a manner consistent with their pre-Class Period sales [because] they regularly sold as their options vested.”²⁰

As for Corinthian’s “sophisticated information management system,” the court was unwilling to infer scienter based on “corporate management’s general awareness of the day-to-day workings of the company’s business.”²¹ Instead, the court reasoned: “Viewed under the rubric of the *Tellabs* Court’s instruction to comparatively weigh inferences, it is more ‘cogent and at least as compelling’ to conclude that

The “holistic” approach should be viewed as a two-way street, allowing courts to consider the overall business realities in context.

Corinthian maintained its information tracking systems for the necessary and legitimate purpose of running its business.”²²

The plaintiffs also alleged that the CFO’s insistence on an improper method of revenue recognition raised a strong inference of scienter. The court, however, did not agree because the complaint “does not tie the disputed revenue recognition practice . . . to [plaintiffs’] more general theory that Corinthian invented the presence of students in order to increase access to federal financial aid.” Further, plaintiffs failed to “allege that Corinthian’s external auditors counseled against the [improper revenue recognition]” or that the CFO

“admitted or was aware it was improper.”²³

Last, the court addressed what it called the complaints “most persuasive allegation of scienter”—the CFO’s Spring 2004 comments to admissions officers, telling them “they are in the gray area in dealing with unqualified students.”²⁴ Despite this, and “viewing the [complaint] in its totality,” the plaintiffs failed to raise a strong inference of scienter based on the “gray area” comments

because there was a more plausible inference based on common sense and the realities of Corinthian’s business. Applying the “holistic” prescription from *Tellabs*, the Ninth Circuit reasoned:

[T]he *Tellabs* Court’s directive that a complaint must be read in its entirety cuts both ways. Although a defendant cannot gain dismissal by decontextualizing every statement in a complaint that goes to scienter, a plaintiff cannot avoid dismissal by reliance on an isolated statement that stands in contrast to other insufficient allegations [citing *Tellabs*]. [The CFO’s] “gray area” statement is susceptible to [plaintiff’s] characterization that it was intended as a winking suggestion that admissions officers should perpetrate fraud. But it is equally susceptible to an interpretation, not unlikely given its utterance at a company-wide meeting, that [the CFO] was simply making a broader exhortation to improve business.²⁵

N.J. Carpenters Pension & Annuity Funds v. Biogen Idec Inc.

The First Circuit’s recent *Biogen* opinion also dismissed a complaint based on a holistic consideration of the defendant’s business realities.²⁶ In *Biogen*, the plaintiffs sued the defendant, a drug company, and several of its senior

executives for allegedly misrepresenting the safety and marketability of a new drug (TYSABRI). In 2004, the defendant Biogen applied for and received accelerated approval from the FDA for TYSABRI, a promising new drug for treating multiple sclerosis and autoimmune diseases. However, several months later, on February 18, 2005, the company learned that two clinical-trial patients had contracted an “opportunistic infection” known as progressive multifocal leukoencephalopathy (PML), and one of these patients had died.²⁷ Within 10 days, the Company decided, based on consultation with the FDA, to suspend all clinical trials and to withdraw TYSABRI from the market. The stock market’s reaction to the withdrawal announcement was swift and severe. On February 28, 2005, the day of the announcement, the price of Biogen shares declined 42.5 percent, falling from \$67.28 to \$38.65. The plaintiffs filed suit two days later, asserting claims under sections 10(b) and 20(a).²⁸ The defendants moved to dismiss, and the district court granted the motion because the plaintiffs had failed to adequately plead scienter. The plaintiffs appealed.

On appeal, the First Circuit conducted an exhaustive review of the complaint and a detailed analysis of the plaintiffs’ scienter allegations. To start, the court outlined the chain of events leading up to the litigation, including a discussion of (1) TYSABRI and its effects; (2) the drug’s path to the market and the FDA approval process; (3) the withdrawal of TYSABRI from the market; (4) the plaintiffs’ allegations of insider trading; and (5) the FDA’s subsequent investigation of the incident and TYSABRI’s later return to the market. Against this factual backdrop, the court evaluated the plaintiffs’ scienter allegations under *Tellabs*.

One of the plaintiffs’ primary scienter arguments alleged that the defendants knew, prior to February 18, 2005, of opportunistic infections associated with the use of TYSABRI, including PML, but failed to disclose these risks. The plaintiffs claimed that in view of these known risks, the defendants’ market projections were too optimistic.²⁹

Before addressing the specifics of the theory, the court acknowledged the practical realities of Biogen’s business:

The situation involved here is paradigmatic of securities fraud cases against drug development companies where a promising drug or medical device is approved by the FDA and then later proves to have health risks that affect the market for the drug. . . . [But] the investing public is well aware that drug trials are exactly that: trials to determine the safety and efficacy of experimental drugs. And so trading in the shares of companies whose financial fortunes may turn on the outcome of such experimental drug trials inherently carries more risk than some other investments. This is true even when the FDA has given fast-track approval to a new drug.³⁰

Courts should not permit the plaintiffs to plead scienter based on scattered allegations that are divorced from the realities of a defendant’s business and operations.

The court then turned to the plaintiffs' bases for arguing that the TYSABRI infections gave rise to a strong inference of fraud, namely: (1) information disclosed when the drug was initially approved in November 2004; (2) hearings held by the FDA Advisory Committee after TYSABRI's withdrawal; (3) the "black-box" warning labels that were required by the FDA when TYSABRI was later reintroduced to the market; and (4) information from several confidential witnesses. The circuit court considered the facts and circumstances at issue holistically, and found that the plaintiffs had not plead a plausible inference of scienter. The court recognized that it must "take as true from plaintiffs' allegations that one of the potential risks of TYSABRI . . . was the risk of opportunistic infections . . . [t]his risk was one reason for the continued scrutiny of the drug which did occur, during the remaining two years of trials and in examining post-marketing experiences."³¹ The court found that the plaintiffs' allegation that the defendants hid data from the FDA was not compelling because it was not "based on any FDA finding that this was true," and there was no evidence supporting such an inference.³²

The court also rejected the plaintiffs' claim that certain after-the-fact statements, made by a Biogen employee and an FDA employee at the post-withdrawal Advisory Committee hearings, were probative of scienter. The Biogen employee had presented data at the hearings showing that 5 out of 3900 clinical-trial patients (0.2 percent) who received TYSABRI developed non-PML opportunistic infections. The court held

There is no basis to conclude that these results, excluding the PML infections, were statistically significant. There is no plausible inference from the reports of just five patients with non-PML opportunistic infections that the defendants knew of any causal relationship between the use of TYSABRI and the separate opportunistic infections diagnosed for the five patients, and then intentionally withheld data. . . . Some adverse events may be expected to occur randomly, especially with a drug designed to treat people that are already ill.³³

Thus, the court clearly acknowledged the "business realities" confronting a drug company like Biogen, and demonstrated that it believed these realities rebutted the plaintiffs' proposed inferences of securities fraud.

Conclusion

Tellabs compels a district court to consider the complaint in its entirety, and to inquire whether all of the facts alleged, taken collectively, give rise to a strong inference of scienter (and not whether any individual allegation, scrutinized in isolation, meets the standard).

Recent circuit court decisions, such as *Mizzaro*, *Metzler*, and *Biogen*, provide reassurance to the defendants that courts may apply *Tellabs*' "holistic" approach in a rational,

even-handed manner. Courts should not permit the plaintiffs to plead scienter based on scattered allegations that are divorced from the realities of a defendant's business and operations.

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1. 15 U.S.C. § 78u-4(b)(1).

2. *Tellabs, Inc. v. Makor Issues & Rights, Ltd.*, 127 S.Ct. 2499 (2007).

3. *Id.* at 2509 (emphasis added).

4. See, e.g., Alan I. Rylesberg, et al., *Tellabs Decision Should Reduce Frivolous Fraud Suits*, SECURITIES LAW 360, Jul. 5, 2007; Stephen Labaton, *Investors' Suits Face Higher Bar, Justices Rule*, N.Y. TIMES, June 22, 2007; Richard D. Bernstein, et al., *Lower Courts' Handling of Tellabs' Inference of Scienter*, N.Y.L.J., Dec. 11, 2007.

5. *Tellabs* at 2510.

6. *Id.* at 2511. See, e.g., James B. Fipp, Case Note, 8 WYO. L. REV. 629 (2008) (arguing that *Tellabs* reduces the heightened pleading standard by allowing plaintiffs to benefit from facts not pled with particularity); Jeffrey B. Maletta, et al., *Supreme Court Clarifies "Strong Inference" Pleading Standard Under the PSLRA*, SECURITIES ENFORCEMENT ALERT, June 2007, ("While the Court rejected the anomalously pro-plaintiff standard adopted by the Seventh Circuit, the Supreme Court's holding and other language in the opinion suggest a somewhat more plaintiff-friendly view of securities class actions than had previously prevailed in many circuits."). Plaintiffs may also assert that the Court in *Tellabs* did not preclude them from using vague and general allegations to survive a motion to dismiss (i.e., a court must consider all allegations in the complaint, not just particularized ones, when assessing scienter). Gregg L. Weiner, *Supreme Court Raises the Bar for Securities Fraud Plaintiffs, but Questions Remain*, 18 NO. 1 ANDREWS MERGERS & ACQUISITIONS LITIG. REP. 12 (2007) (stating that the holistic approach of *Tellabs* allows plaintiffs to rely on omissions and ambiguities after their weight is discounted). See also *Tellabs*, 127 S.Ct. at 2516 (Alito, J., concurring in judgment) (lamenting the court's failure to exclude facts not stated with particularity from the "strong-inference" test).

7. See, e.g., Eric Rieder and Rosemarie Blase, *Tellabs' Impact Varies By Judicial Circuit*, SECURITIES LAW 360, Aug. 22, 2008.

8. Robert Malioneck, et al., *Tellabs v. Makor, One Year Later*, SECURITIES LAW 360, Jul. 21, 2008.

9. *Mizzaro v. Home Depot, Inc.*, 2008 WL 4498940 (11th Cir. Oct. 8, 2008).



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10. *Id.* at *16.

11. *Id.*

12. *Id.* at *17.

13. *Id.* at *17–18 (recognizing that “the purported fraud totaling \$1 billion represents less than 2% of Home Depot’s annual sales, which amounted to \$53.6 billion in fiscal year 2001 and rose to \$64.8 billion in fiscal year 2003”).

14. *Id.* at *18–19 (stating that “[o]ne problematic inventory would not put upper management on notice of widespread and pervasive fraud”).

15. *Id.* at *20.

16. *Id.*

17. *Metzler Inv. GMBH v. Corinthian Colleges, Inc.*, 540 F.3d 1049 (9th Cir. 2008).

18. *Id.* at 1055.

19. *Id.* at 1067.

20. *Id.*

21. *Id.* at 1068. In *South Ferry LP, #2 v. Killinger*, 542 F.3d 776 (9th Cir. 2008), the 9th Circuit also addressed the related issue of the impact of *Tellabs* on the “core-operations” inference that plaintiffs sometimes attempt to invoke. This will be the subject of an upcoming article.

22. *Id.*

23. *Id.* at 1069.

24. *Id.*

25. *Id.*

26. *N.J. Carpenters Pension & Annuity Funds v. Biogen Idec Inc.*, 537 F.3d 41 (1st Cir. 2008).

27. *Id.* at 41.

28. *Id.* at 43, 47.

29. *Id.* at 53. Plaintiffs’ second scienter theory rested on the claim that defendants “affirmatively stated that TYSABRI was safe when used in combination with other drugs when in fact they had no reasonable basis to believe so.” The court rejected this argument based on rational opposing inferences. For example, plaintiffs alleged that defendants had no basis to say that TYSABRI was safe when used with AVONEX, another Biogen drug for treatment of multiple sclerosis. However, “the FDA had approved TYSABRI for use with AVONEX after contemplating any safety risks.” *Id.* at 54. The court added, “Based on these undisputed facts, we find the defendants’ inference more compelling: up until the first diagnosis of PML, no significant safety risk had been associated with use of TYSABRI as a combination therapy.” *Id.* at 55.

30. *Id.* at 47–48.

31. *Id.*

32. *Id.* at 50.

33. *Id.* (quoting *In re Carter-Wallace, Inc. Sec. Litig.*, 220 F.3d 36, 41 (2d Cir. 2000)).

Alternative Privilege Log Techniques in an E-discovery World

BY ELIZABETH T. TIMKOVICH AND MEGHAN A. O'DONNELL

Any litigator involved in the collection, review, and production of documents in today's world of electronically stored information (ESI) has likely dealt with the costly and time-consuming "morass" of e-discovery.¹ Thanks to the ability of people and companies to store increasing amounts of information using numerous types of electronic media, the volume of electronic documents subject to discovery has exploded in recent years. This is especially true for large class actions, antitrust investigations, and other information-heavy disputes. Many in the legal community have written on the need to improve and streamline e-discovery rules and techniques for collecting and reviewing ESI. There is another costly by-product of e-discovery, though, that also screams to be addressed: preparation of the privilege log.

Typically, a privilege log consists of a spreadsheet or table identifying responsive documents that have been withheld from production as privileged by listing, at a minimum, each document's custodian, author, addressees, creation or last modification date, subject matter, and basis for privilege (e.g., attorney-client privilege, work-product immunity). Thanks to modern e-discovery software, some of these identification fields—i.e., custodian, last modification date, and (for some types of documents) author and addressees—can be automatically populated from each electronic document's metadata.² The remaining fields, however, must typically be manually filled by the attorneys preparing the privilege log (the "privilege loggers"). For example, for an email chain between an attorney and a client regarding an ongoing class action dispute, a privilege logger might have to type the following phrases into the respective privilege log fields: "email chain between attorney and client, requesting and providing legal advice of Attorney Smith regarding instant litigation."

This manual data entry can be extremely time-consuming (not to mention mind-numbing), especially in cases where large numbers of documents are being withheld and individual privilege descriptions must be entered for each. And because attorneys are typically the professionals tasked with privilege log preparation, drafting and revising log entries is extremely expensive to the client. As a result, it is not unheard of in certain discovery-heavy disputes for the costs of preparing a large commercial party's privilege log to rival or even surpass the costs incurred in conducting the underlying review of the collected documents. It is clear, therefore, that many litigants would greatly benefit from an alternative to the traditional, manually constructed privilege log.

Proposed Alternatives

Provided all parties agree, the following proposed alternatives to the traditional privilege log format and content (at least with respect to ESI) could result in a quick, easy, and relatively inexpensive privilege log. For example, litigants could agree to exchange privilege logs identifying withheld electronic documents solely by specified portions of the documents' already-existing metadata. A typical electronic document's metadata identifies, among other things: the custodian, document type (e.g., email, Word document, Excel spreadsheet, etc.), date last modified or sent, file name, and, if an email or email chain, the author and addressees in the most recent email. If the parties can agree to populate their privilege logs with such inherent metadata and forego additional descriptions requiring manual data entry, creation of each privilege log should be as simple as exporting the desired metadata fields into an Excel spreadsheet. Most e-discovery review tools on the market today—such as Kroll Ontrack Inview, CaseCentral, Concordance—allow such data exports to be very easily accomplished and readily accessible.

Should the parties desire more information than is provided in inherent metadata, the following additional steps could be taken to add category and/or keyword information to the log (while still avoiding manual data entry). If documents were categorized during electronic review, then metadata fields could be created—depending on which e-discovery software is being used—that would identify which substantive categories were selected for each document. Also, litigants could run keyword searches against the pool of withheld documents to identify those containing specific names (e.g., of attorneys), privilege-indicating legends such as "attorney-client," or other significant words or phrases. Metadata fields could be created for the documents identified in each search, reflecting the applicable search term(s) found therein. The identification of such keywords or phrases in the withheld documents could be useful not only to justify or challenge privilege claims, but also to more easily identify those documents likely or unlikely to have especial relevance to the litigation.

This technique of searching out and providing additional descriptive data based on keyword searches will certainly require more time and review-tool expertise than the simple exportation of inherent metadata described in the preceding paragraph, but it is still a much faster and less costly alternative to the manual privilege log that is currently used wide and far.

Caveats

Of course, use of the alternative privilege logging techniques proposed here will not work well for every kind of case (e.g., cases in which the bulk of documents to be reviewed and produced consist of paper documents rather than ESI), and many log entries are bound to be challenged. For example, log entries relying on inherent metadata alone may not provide accurate privilege descriptions for redacted documents or for email chains. (As previously noted, the inherent author and addressee metadata for email chains captures only the identities of those individuals listed in the topmost email of a chain.) Litigants may wish, therefore, to request additional privilege log requirements, beyond use of inherent metadata, for these or other special types of documents. Also, if the proposed search term technique for supplementing inherent

metadata is pursued, an opposing party may challenge the log entries for documents that do not contain any of the searched-for terms.

Such potential challenges should not, however, dissuade parties from pursuing an alternative privilege log arrangement. After all, even traditional, more narrative privilege logs are subject to frequent challenge. Each party could agree, at a minimum, to produce as its primary privilege log a metadata-based log and

to then supplement that log with additional requested data (perhaps in the form of more traditional narrative statements) for those documents specifically challenged by its opponent. The parties might also grant each other a “quick peek” at the challenged documents.³ If nothing else, this approach should greatly cut down on the number of withheld documents for which traditional narrative logging is required. Litigants could drill down on just those documents—perhaps those with categories or search hits indicating a high degree of relevance—for which additional information is actually desired. Litigants might be most willing to agree to such an arrangement where all parties to the dispute wish to avoid high discovery costs, or where expedited discovery is required.

Rule 26 Is Not Violated

Litigants’ use of the proposed metadata-based privilege logging techniques should not violate Rule 26 of the Federal Rules of Civil Procedure pertaining to discovery and assertions of privilege. The pertinent section of Rule 26 requires

only that a party make privilege claims expressly and that it describe the withheld material well enough to permit its opponent to test the privilege claim’s validity.⁴ The rule does not specify the precise level of detail required for an express claim of privilege, nor does it mandate the parameters of a “log.” Instead, it states the following:

When a party withholds information otherwise discoverable by claiming that the information is privileged or subject to protection as trial-preparation material, the party must: (1) expressly make the claim; and (2) describe the nature of the documents, communications, or tangible things not produced or disclosed—and do so in a manner that, without revealing information itself privileged or protected, will enable other parties to assess the claim.⁵

Moreover, the Notes of the Advisory Committee on the 1993 amendments to Rule 26(b)(5) strongly indicate that metadata-based privilege logs would satisfy Rule 26. The Notes state:

The party must also provide sufficient information to enable other parties to evaluate the applicability of the claimed privilege or protection. . . . *The rule does not attempt to define for each case what information must be provided when a party asserts a claim of privilege or work product protection. Details concerning time, persons, general subject matter, etc., may be appropriate if only a few items are withheld, but may be unduly burdensome when voluminous documents are claimed to be privileged or protected, particularly if the items can be described by categories.*

Furthermore, the Notes of the Advisory Committee on the 2006 amendments helpfully explain:

Parties may attempt to minimize [e-discovery] costs and delays by agreeing to protocols that minimize the risk of [privilege] waiver. They may agree that the responding party will provide certain requested materials for initial examination without waiving any privilege or protection—sometimes known as a “quick peek.” The requesting party then designates the documents it wishes to have actually produced. . . . *Other voluntary arrangements may be appropriate* depending on the circumstances of each litigation.⁶

From the previous excerpts, it is clear that no federal procedural rule prohibits use of the alternative privilege log forms proposed by this article, although parties considering the use of such logs are still advised to check their local court rules. Use of metadata-based privilege logs for withheld electronic documents could save attorneys and their clients

The use of metadata-based privilege logs for withheld electronic documents could save attorneys and their clients considerable time and money.

considerable time and money, and should, therefore, be considered by parties seeking to reduce their e-discovery costs.

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1. See, e.g., Interim Report on the Joint Project of The American College of Trial Lawyers Task Force on Discovery And The Institute for the Advancement of the American Legal System (Aug. 1, 2008) at 3 (“Electronic discovery . . . is described time and time again as a ‘morass.’ . . . The bigger the case, the more the abuse and the bigger the nightmare.”).

2. Commonly referred to as “data about data,” metadata

tracks and reveals data about document attributes, such as name, size, type, where it is located, and ownership. Metadata for an email, e.g., is “data stored in the email about the email,” such as addressees and received date. Metadata for other electronic documents reveals “[p]roperties about the file stored in the file, as opposed to document content,” including author, creation, and revision dates. The Sedona Conference Glossary: E-Discovery & Digital Information Management, Second Edition (Dec. 2007).

3. See FED. R. EVID. 502.

4. See FED. R. CIV. P. 26(b)(5).

5. *Id.*

6. *Id.* (emphasis added).



Recent Rulings Limit Plaintiffs' Choice of Forum Tactics

BY PETER L. SIMMONS AND MITCHELL EPNER

Two recent decisions—one from the Fifth Circuit, sitting *en banc*, and the other from the Federal Circuit—may curtail a practice by product liability and patent litigants alike who choose a forum with no particular connection to the lawsuit just because they perceive it to be pro-plaintiff, and justify the choice solely on the grounds that a few units of the accused product were sold in the district. Defendants whose products are sold nationwide, and whose activities therefore potentially subject them to jurisdiction throughout the country, have long bemoaned that they are called upon to defend suits in districts where they do not logically belong, but their efforts to transfer venue under 28 U.S.C § 1404(a) have largely been rebuffed. Now, the Fifth Circuit in *In re Volkswagen of America*,¹ and shortly thereafter, the Federal Circuit in *In re TS Tech*,² have both held that mandamus is available to a defendant who is denied transfer under Section 1404(a), and both courts granted mandamus and ordered transfer out of the Eastern District of Texas where the only facts tying the cases to the district were that it was the plaintiffs' forum of choice, and that some modest quantity of the accused products were sold in the district.

The Fifth Circuit: *Volkswagen*

In *Volkswagen*, the *en banc* Fifth Circuit reversed the decision of the lower court not to transfer a product liability case from the Eastern District of Texas (Marshall) to the Northern District of Texas (Dallas). The automobile accident that gave rise to the *Volkswagen* suit; the witnesses to and the physical and documentary evidence regarding the accident; and all of

the living plaintiffs were located in the Northern District of Texas. Only the plaintiffs' choice of forum and the fact that the accused product was sold in the Eastern District of Texas connected the case to the Eastern District. Even though both districts are within the same state, the Fifth Circuit held that the location of the witnesses, the availability of compulsory process over those witnesses, the costs that those witnesses would incur in traveling over 100 miles to testify, and the location of physical and documentary evidence in the transferee district all favored transfer.

Notably, the Fifth Circuit rejected the idea that the current practice of producing most documents electronically neutralizes the significance of the location of the sources of proof—“That access to some sources of proof presents a lesser inconvenience now than it might have absent recent developments does not render this factor superfluous.”³

Most significant, though, the Fifth Circuit categorically rejected the two pivotal factors that the district court relied upon in denying transfer: plaintiffs' choice of forum, and the fact that the product was available for purchase within the Eastern District.

The Court of Appeals held that the plaintiffs' choice of forum was “not an independent factor within the . . . §1404(a) analysis,” but rather merely “places a significant burden on the movant to show good cause for the transfer.”⁴ The Fifth Circuit held that “[w]hen the movant demonstrates that the transferee venue is clearly more convenient . . . it has shown good cause and the district court should therefore grant the transfer.”⁵

With regard to the sale of the allegedly defective product within the Eastern District of Texas, the Fifth Circuit held “the district court’s provided rationale that the citizens of Marshall have an interest in this product liability case because the product is available in Marshall, and that for this reason jury duty would be no burden, stretches logic in a manner that eviscerates the public interest that this factor was meant to capture.”⁶ The Fifth Circuit noted that the “district court’s provided rationale could apply virtually to any judicial district or division in the United States,” and that the residents of the Eastern District of Texas were “not in any relevant way connected to the events that gave rise to this suit.”

Plaintiffs can no longer assume that they have virtually unfettered discretion to choose the forum for litigation most to their liking.

The Federal

Circuit: *TS Tech*

In *TS Tech*, the Federal Circuit applied *Volkswagen* and granted mandamus to reverse the refusal to transfer a patent litigation from the Eastern District of Texas to the Southern District of Ohio. The *TS Tech* plaintiff alleged that vehicle headrest assemblies manufactured by defendants and sold throughout the United States infringed upon its patent. The allegedly

infringing devices were manufactured in Ohio and the key witnesses all lived in Ohio, Michigan, and Canada. Unlike in *Volkswagen*, the transferee forum likely could not exercise compulsory process over all witnesses (such as those in Canada).

Yet the Federal Circuit held that the transfer motion was required to have been granted, noting that the district court erred in ignoring two factors favoring transfer—the greater distance that witnesses would have to travel to testify in Texas rather than in Ohio, and the location of sources of proof in and near Ohio.⁷ Moreover, the *TS Tech* court held that the district court erred in holding that the sale of allegedly infringing devices in the Eastern District of Texas created a localized public interest in that district. “As in [*Volkswagen*], there is no relevant connection between the actions giving rise to this case and the Eastern District of Texas except that certain vehicles containing *TS Tech*’s headrest assembly have been sold in the venue. None of the companies have an office in the Eastern District of Texas; no identified witnesses reside in the Eastern District of Texas; and no evidence is located within that venue.” The Federal Circuit held that because the allegedly infringing headrests were sold throughout the

United States, “the citizens of the Eastern District of Texas have no more or less of a meaningful connection to this case than any other venue.”⁸

Mandamus Relief Available

Having found error in the failure of the district court to grant transfer, both the Fifth Circuit and the Federal Circuit held that mandamus was the appropriate remedy. Each appellate court quoted Judge Posner’s opinion in *In re Nat’l Presto Industries* that “[a petitioner] would not have an adequate remedy for an improper failure to transfer the case by way of an appeal from an adverse final judgment because [the petitioner] would not be able to show that it would have won the case had it been tried in a convenient [venue].”⁹

Conclusion

Neither decision turned on a jurisdictional analysis. In both cases, the defendant was subject to personal jurisdiction in the disputed forum. Instead, what this pair of recent cases suggests is that while nationwide sales of an accused product may create personal jurisdiction in all federal districts, plaintiffs can no longer assume that they have virtually unfettered discretion to choose the forum for litigation most to their liking. Rather, when the only connection between plaintiffs’ chosen forum and the lawsuit is that the product at issue is sold in that district (as it is in many other districts), and the defendant can demonstrate that some other district would be a more convenient forum, a transfer under Section 1404(a) likely will be available with immediate appellate review to enforce it.

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1. *In re Volkswagen of America, Inc.*, 545 F.3d 304 (5th Cir. 2008).

2. *In re TS Tech USA Corp.*, ___ F.3d ___, 2008 WL 5397522 (Fed. Cir. Dec. 29, 2008).

3. *Volkswagen*, 545 F.3d at 316–17.

4. *Id.* at 314 n.10.

5. *Id.* at 315.

6. *Id.* at 318.

7. *TS Tech*, 2008 WL at 5397522, at *4.

8. *Id.*

9. *In re Nat’l Presto Indus. Inc.*, 347 F.3d 662, 663 (7th Cir. 2003).



What to Tell a Panicked Client

(Continued from page 1)

small claim. If the court “certifies” the class, though, every person will try his or her claim at the same time. That means each person who paid the same bogus \$5 charge will prosecute the same lawsuit. If the defendant had millions of customers, and the charge appeared monthly on each customer’s bills—well, you get the picture.

Aggregation is not hard to explain or understand. Less obvious, though, is the way it diminishes the relevance of the lawsuit’s merits. In many class actions, the conduct at issue is pretty innocuous (at least in the client’s eyes) and the client may think “This is a frivolous claim and we’d rather pay you than them.” God bless such clients, but they need to make that call with a full understanding of the math. It may be worth going to trial when there is only a 10 percent chance of losing on a single \$100,000 claim, but a 10 percent chance of losing on 10,000,000 claims of \$5 each may cause some serious heart palpitations.

In fact, very few class actions ever reach a jury because very few defendants want to risk a really bad day. (And, conversely, very few contingent fee plaintiffs’ lawyers want to risk a goose egg after years of work on a class action.) Most of the time, both sides decide it is better to settle than to let a jury decide.

How Great Is the Risk?

Once you explain why class certification is so important, the client will want to talk about the odds. You can explain that the likelihood of certification depends, among many other things, on the jurisdiction; the type of relief being sought (injunction or damages or both); the nature of the claims; whether any statutes authorize, simplify, or forbid class treatment; and past judicial decisions involving similar lawsuits. The odds of certification also depend on bits of fact and law that have the disconcerting habit of changing during a lawsuit. Regardless, the client needs to understand that the class certification decision depends generally on whether many different persons have arguably been harmed in the same way by the same conduct. One of the client’s first tasks is to help you investigate whether, or the extent to which, it arguably did the same thing to many different potential class members. “Arguably” is a keyword: This investigation is not the same as deciding whether the conduct was unlawful—or even whether it happened at all.

How Much Will This Cost?

Clients always want to know about costs, and class actions are notoriously costly. Indeed, the costs of discovery in terms of business disruption as well as attorney fees, expert fees, court costs, and so on, can be staggering. Discovery battles are front

and center because, among other reasons, unchecked discovery can lead to other claims on behalf of other classes in other jurisdictions, and because class discovery will often probe a defendant’s sensitive business information as well as its electronic data. The main reason discovery is so critical for class action defendants, though, is because the burden is so uneven. Courts generally allow only limited discovery from named plaintiffs, any they aren’t likely to have much information in any event. And courts generally forbid any discovery at all from “putative” class members who are not actually named as plaintiffs. In contrast, details about the defendant’s relevant policies and practices, and about the alleged wrongdoing and its extent, are central to the lawsuit. And that pesky plaintiff camel always wants to stick its nose farther under the defendant’s tent.

Discovery costs in class actions are a critical part of any reasonable risk analysis. The costs are driven primarily by the strategies on the class plaintiffs’ side, and they may vary significantly. But even if the claims are weak on the merits, the costs of discovery and document preservation may be enormous. It is essential to develop an early and comprehensive plan for controlling discovery and its costs, including a plan for electronic discovery that will avoid later duplicative efforts or spoliation claims.

Who Is My Adversary?

Clients may focus their attention first on the plaintiffs listed in the Complaint. Information about those specific plaintiffs may be important in a class action lawsuit, but usually it doesn’t much matter. Why not? Attorney fees.

Class action lawsuits are almost always brought on a straight contingency fee basis, and in class actions seeking damages, courts typically measure attorney fees awards as a percentage of the “common fund” created by any settlement or judgment. Class actions sometimes yield very high contingency fees for plaintiffs’ counsel or, conversely, none at all.

Successful named plaintiffs sometimes receive very modest “bonuses” for the time they spent on the lawsuit, but for the most part, they receive the same small amounts as other class members. In many instances, named plaintiffs can even be replaced if they decide for some reason that they don’t want to continue with the lawsuit.

The ones with the biggest potential upside in a class action are thus the plaintiffs’ lawyers. They owe fiduciary duties to the named plaintiffs and to the class members they seek to represent. But plaintiff’s counsel calls the shots.

What Do We Do First?

In every lawsuit, clients expect and deserve an early game plan for conducting a factual investigation, identifying and preserving documents (including electronic data), developing a cost-effective discovery plan, and so on. For the most part, the initial tasks in a class action are the same as for other lawsuits, but writ large.



CAFA and Its Impact

(Continued from page 1)

There are, however, some differences that matter. For example, it is now essential to run the traps of the Class Action Fairness Act (which is much too complicated to summarize here) to decide whether the client has a choice between state and federal court. As another example, it is important to decide on the order and timing of dispositive motions and the motion for class certification. If a dispositive motion is granted first, the class certification decision may become irrelevant. If the class certification motion is granted first, the dispositive motion will apply to everyone who remains in the class. For this reason, an early class certification is sometimes a good thing for defendants; certification followed promptly by a judgment on the merits will prevent a stream of individual lawsuits on the same subject. Conversely, and as noted previously, a denial of class certification will often mean no decision on the merits is ever reached.

Nothing prevents a defendant from trying to accelerate the class certification decision, including by filing a motion to deny class certification. This tactic might, of course, be a really bad idea if the defenses against certification are questionable and the potential liability is large. The tactic, though, is the kind of thing a client needs to consider early in the lawsuit.

Yet another difference that matters concerns class action settlements. Clients should begin thinking early about the timing and contours of any class settlement overtures. At first blush, this topic is no different for conventional and class action lawsuits. Class action settlements, however, present a host of complicated (and sometimes nonintuitive) issues. Even before the court decides whether the case can be tried on a class basis, the parties can agree on a settlement that will include certification of a “settlement class.” The court must approve this settlement, but once the approval is secured, the settlement terms will apply to the entire class in the same way as a judgment. If the price is right, a settlement can buy peace from many claims and reduce defense costs. Who negotiates the settlement terms for the class members? Have you been reading carefully?

Most of the time, the first steps in defending a class action involve internal investigations, litigating discovery battles while controlling costs, and constantly reassessing the risks and possible exit strategies. As class action defense counsel, your first, middle, and last steps also include making sure your client understands how class actions work.

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which in turn kept cases of national importance out of federal court.²

CAFA impacts class action litigation in three primary ways: CAFA expands diversity jurisdiction for class actions; makes it easier to remove class actions, and expedites review of remand rulings; and establishes guidelines for settlements and judgments to ensure class counsel does not benefit to the detriment of class members.

Impact on Federal Jurisdiction

Undoubtedly, CAFA's most significant impact is through its provisions on federal jurisdiction. Before CAFA, only cases where complete diversity of citizenship existed between every named plaintiff and the defendants could be brought in federal court, and each individual claim was required to meet the \$75,000 threshold. CAFA amended 28 U.S.C. § 1332, the federal diversity statute, to grant federal district courts original jurisdiction over cases where the amount in controversy exceeds \$5,000,000, where the plaintiff class is greater than 100 members, and where diversity exists between only one plaintiff class member and one defendant.³

Certain exceptions to this framework are articulated in the statute. Under the so-called “interests of justice” exception, if more than one-third but less than two-thirds of the class members and the primary defendant are citizens of the state where the case was originally filed, the district court may consider six enumerated factors to determine whether proceeding in federal court would be appropriate:

- (1) whether the claims involve matters of interstate interest
- (2) whether the claims will be governed by state law where the case was originally filed
- (3) whether the class action was pleaded to avoid federal jurisdiction
- (4) whether the forum has a distinct nexus with the class members, the alleged injury, or the defendants
- (5) whether a “substantially larger” number of the class members are citizens of one state, and the out-of-forum members are citizens of a “substantial number” of other states
- (6) whether one or more class actions with similar claims have been filed in three years prior to the case's filing.⁴

The second major exception, known as the “home state controversy” exception, requires the court to decline jurisdiction if more than two-thirds of the plaintiffs are citizens of the forum state and all the primary defendants are citizens of the home state.⁵ Similarly, the dispute might be a “local



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controversy,” meaning that at least one key defendant is a resident of the forum, his or her conduct forms a significant basis for the claims, the injuries resulting from that conduct occurred in the forum, and no similar claims have been filed against any of the defendants in the prior three years.⁶

There are also specific exceptions for derivative suits, or disputes solely related to the internal affairs of a corporation or business entity arising solely under state law and securities fraud suits.⁷ CAFA is also inapplicable where the primary defendants are states, state officials, or other government entities against whom a district court could not grant relief.⁸

Impact on Removal

In addition to creating original jurisdiction in federal courts for qualifying class actions, CAFA also relaxed the removal rules to make it easier for defendants to remove class actions even where plaintiffs originally filed in state court. Under

28 U.S.C. §1441, a defendant seeking to remove must do so within one year of the date of the complaint’s filing, obtain the consent of all defendants, and then establish independent grounds for subject matter jurisdiction, either based on federal question jurisdiction, or diversity jurisdiction based on complete diversity between plaintiffs and defendants.

However, under CAFA, there is no one-year time limit on removal—a matter may be removed at any stage of the proceedings. CAFA also eliminates the requirement that a removing defendant obtain the consent of all defendants prior to seeking removal. And of course, the biggest challenge to removal—establishing jurisdiction in federal court—is overcome through CAFA’s creation of original jurisdiction in federal court, as explained previously.⁹ In addition, a party may appeal an order denying or granting a remand motion to the court of appeals, pursuant to an expedited review process.¹⁰



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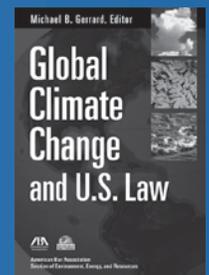
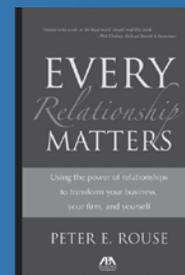
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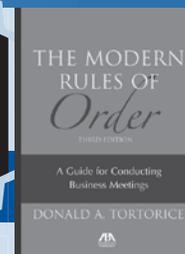
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Impact on Class Action Settlements

Congress's primary goal in enacting CAFA was to promote fairness in settlement of class actions. In furtherance of these goals, CAFA contains a "Consumer Class Action Bill of Rights" that calls for increased judicial involvement in class action settlements. Specifically, CAFA created rules related to coupon settlements and negative value settlements, which have in turn increased judicial scrutiny as to the fairness of class action settlements.

As to coupon settlements, where class action members receive redeemable coupons in order to collect their portion of the judgment, if an attorney seeks a contingency fee, it must be based only on those coupons that are redeemed. The court may also hold a hearing, including expert testimony, to consider the appropriateness of hourly based fees. In addition, the court must hold a separate hearing and make written findings as to whether the coupon settlement is fair, reasonable, and adequate for class members. Last, the court has discretion to order the amount of any unredeemed coupons, or any portion thereof, be donated to charity or a government organization.¹¹

As to negative value settlements, where the individual recovery of each class member is less than the portion of attorney fees owed by each class member (resulting in individual class members owing money), CAFA provides that such a settlement will only be approved where individual class members receive some nonmonetary benefit that balances out the monetary loss.

Litigation Trends Since CAFA Enactment

According to the Federal Judicial Center, CAFA increased the number of class actions in federal court by 46 percent for the first two years after its enactment.¹² In the first year following CAFA's enactment, approximately 364 additional class actions were placed in federal court. In 7 of the 12 circuits, the number of class actions in federal court at least doubled.

Contrary to predictions by CAFA's opponents that class action plaintiffs would never file in federal court because of increased costs and difficulties associated with conflict of law issues, most of these cases originated in federal court, as opposed to being removed there. The pre-CAFA average for class action filings in federal court was 11.9 per month, and the post-CAFA average is now 34.5 per month. Although there was an initial spike in motions to remove to federal court immediately following CAFA, this number has since leveled out to ranges similar to figures in the pre-CAFA era. The Federal Judicial Center's researchers posit that this statistic may be due to class action plaintiffs and their attorneys choosing to file in federal court from the outset, to avoid unnecessary costs and delays associated with removal and remand proceedings.¹³

As to evaluation of the overall fairness of settlements under CAFA since its enactment, both federal courts to consider the issue have determined that CAFA require a higher level of scrutiny than the existing federal rules for class action settlements.¹⁴ *Figueroa* went through a lengthy analysis of CAFA's heightened scrutiny standard as applied to coupon settlements. More recently, *New Jersey Carpenters* went further, to apply the heightened scrutiny standard not just to coupon settlements, but to all forms of class action settlements under CAFA.

Conclusion

While CAFA is still young as far as reform legislation goes, it appears that in its early stages, CAFA has gotten the attention of litigants and judges alike. Both defendants and class action plaintiffs have shown a trend toward taking advantage of CAFA's creation of original jurisdiction in federal court. Meanwhile, district court judges have responded to CAFA's settlement provisions by subjecting class action settlements to stricter scrutiny than that which was provided for class action settlements under the federal rules. Based on the initial data regarding federal court class actions, it appears CAFA is achieving Congress's goals of giving major class action cases their day in federal court.

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1. 28 U.S.C. § 1711(a)(3).
2. 28 U.S.C. § 1711(a)(4).
3. 28 U.S.C. § 1332(d)(2).
4. 28 U.S.C. § 1332(d)(3).
5. 28 U.S.C. § 1332(d)(4)(B).
6. 28 U.S.C. § 1332(d)(4)(A).
7. 28 U.S.C. § 1332(d)(9).
8. *See* 28 U.S.C. 1332(d)(5).
9. 28 U.S.C. § 1453(b).
10. 28 U.S.C. § 1453(c).
11. 28 U.S.C. § 1712(a) through (d).

12. *See* Thomas E. Willging and Emery G. Lee III, The Impact of the Class Action Fairness Act of 2005 on Federal Courts, Federal Judicial Center, Third Interim Report, April 2007, available online only at [www.fjc.gov/public/pdf.nsf/lookup/cafa0407.pdf/\\$file/cafa0407.pdf](http://www.fjc.gov/public/pdf.nsf/lookup/cafa0407.pdf/$file/cafa0407.pdf).

13. *Id.*

14. *See* *Figueroa v. Sharper Image Corp.*, 517 F.Supp.2d 1292 (S.D. Fla. 2007); *New Jersey Carpenters Vacation Fund v. HarborView Mortg. Loan Trust*, ___ F. Supp.2d ___, 2008 WL 4369840 (S.D.N.Y., Sept. 24, 2008).

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