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BUSINESS LITIGATION

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IN THIS ISSUE

In this article, Edward S. Sledge, IV and Christopher S. Randolph, Jr. discuss attempts by plaintiffs' attorneys to evade federal jurisdiction under the Class Action Fairness Act (CAFA), 28 U.S.C. § 1332(d), by stipulating that less than the federal jurisdictional minimum is in controversy. This article then explains that the United States Supreme Court is poised to end these attempted end runs around CAFA in Standard Fire Insurance Co. v. Knowles.

Setting the Edges: Defending Against Plaintiff End Runs Around CAFA

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In most any sport, the hometown favorite enjoys an edge over the visiting team "invited" to compete in hostile territory. But, in the bloodsport known as class action litigation, this home turf advantage often assures plaintiffs' attorneys will exploit state procedural rules to land blows against defendants in the form of unreasonable discovery orders, *ex parte* certification of classes, and massive settlements. The Class Action Fairness Act of 2005 (CAFA) promised to level the playing field in large class actions by broadening federal jurisdiction. But plaintiffs' attorneys have managed to evade CAFA and keep large class actions that affect the national economy in state courts where procedural rules provide fewer protections to defendants than federal courts,[1] thereby enabling plaintiffs to force defendants to settle often meritless claims for millions of dollars. Like a skilled running back on a toss sweep, plaintiffs have successfully run around federal jurisdiction in many class actions by purporting to limit the amount that they will seek on behalf of putative classes to less than the federal jurisdictional minimum. With its recent grant of certiorari in *Standard Fire Insurance Co. v. Knowles*,[2] the Supreme Court is now poised to end these efforts that undermine CAFA.

1. *Hostile Environment: The Playing Field Pre-CAFA*

Congress enacted CAFA to correct a jurisdictional anomaly that prevented removal of large class actions from state jurisdictions whose laws offer fewer protections to defendants and unnamed members of putative classes than the federal forum. Congress found that despite their effect on the national economy and the massive sums involved, class actions were generally "adjudicated in state courts, where the governing rules are applied inconsistently (frequently in a manner that contravenes basic fairness and due process considerations)."[3] Plaintiffs' attorneys became infamous for seeking "drive-by" certifications whereby *ex parte* certification orders were issued on the same day or shortly after the filing of the class action complaint.[4] Often defendants were simultaneously served with the class action complaint and the class certification order. Not surprisingly, class action filings became concentrated in a few plaintiff-friendly venues. For example, over a two-year period, one Alabama state court certified 35 class actions while all federal district courts combined certified only 38 class actions.[5] In Madison County, Illinois, plaintiffs' attorneys filed over 100 class actions in 2003 alone.[6]

Plaintiffs' attorneys ran up the score against defendants. As one example, a small group of plaintiffs' attorneys obtained settlements worth between $3.39 and $3.83 billion, and received over $420 million in fees from those settlements, in nineteen class actions filed in Arkansas state courts soon before the enactment of CAFA.[7] These settlement values say nothing about the strength of the claims asserted; because the exposure in class actions is often sufficient to bankrupt defendants, defendants were faced with an unenviable choice after certification: settle

[1] *See Smith v. Bayer Corp*., 131 S. Ct. 2368, 2378 (2011).
[2] The Supreme Court heard oral arguments in *Knowles* on January 7, 2013.
[3] S. REP. NO. 109-14, at 4 (2005), *as reprinted in* 2005 U.S.C.C.A.N. 3.
[4] *Id*.
[5] Victor E. Schwartz, et al., *Federal Courts Should Decide Interstate Class Actions: A Call for Federal Class Action Diversity Reform*, 37 HARV. J. LEGIS. 483, 499 (2000).
[6] S. REP. NO. 109-14, at 13 (2005).
[7] Brief of the Manufactured Housing Institute, et al. as Amici Curiae Supporting Petitioner, *Standard Fire Ins. Co. v. Knowles* (2012) (No. 11-1450) at App. 10-13.

meritless claims for large sums or risk trial.[8] Plaintiffs' attorneys also forced defendants to spend millions of dollars in complying with massive discovery requests.[9] A defendant in an Arkansas class action, for instance, estimated that compliance with a discovery request that it ultimately had to satisfy would cost $45 million.[10] Nor would class members necessarily benefit from large class action settlements, as individual class members were often left with a release of their claims in exchange for a tiny share of a settlement that may have had little value after accounting for attorney fees and costs.[11] Plaintiffs' attorneys kept large class actions out of federal court because complete diversity of citizenship was often lacking or no individual plaintiff had a claim worth more than $75,000. Given this environment, state court class action filings proliferated in the years preceding the 2005 enactment of CAFA.[12]

2. Leveling the Playing Field: Enactment of CAFA

CAFA expanded federal jurisdiction over class actions to help ensure that large class actions affecting the national economy were litigated in a federal forum where procedural rules require greater consideration of the interests of defendants and unnamed plaintiffs than many state procedural rules.[13] Congress recognized that under pre-CAFA law "class action lawyers typically misuse[d] the jurisdictional threshold to keep their cases out of federal court" and noted as an example of such "misuse" the inclusion in class action complaints of stipulations purporting to limit the amount in controversy to less than the jurisdictional minimum.[14] Congress sought to curb this practice by requiring aggregation of the claims of putative class members in determining the amount in controversy. CAFA extended federal jurisdiction to class actions where this aggregate value exceeds $5 million and minimal diversity exists.[15]

3. Plaintiffs' End Runs Around CAFA

Despite CAFA, plaintiffs' attorneys in many large class actions continue their efforts to evade federal jurisdiction through, among other ploys, statements in or attached to complaints that purportedly stipulate that the named plaintiff will not seek more than $5 million for the class, a practice that federal courts have largely countenanced. These federal courts have held that damage stipulations are effective to escape federal jurisdiction, reasoning that a plaintiff can disclaim the right to recover certain damages and that judicial estoppel or state procedural rules would bar a plaintiff from amending the stipulation once back in state court.[16] Federal courts have also reasoned that the amount in controversy in a class action may be limited to the amount stated in an *ad damnum* clause, regardless of whether a sworn stipulation is also filed.[17] State legislatures have facilitated

[8] *See Matter of Rhone-Poulenc Rorer, Inc*., 51 F.3d 1293, 1298 (7th Cir. 1995) (Posner, C.J.)
[9] *See* Brief of Manufactured Housing Institute, et al., *supra* note 7, at 11-16.
[10] *Id*. at 14.
[11] S. REP. NO. 109-14, at 14-20.
[12] Between 1988 and 1998 class action filings in state courts against Fortune 500 companies increased over 1000 percent. Schwartz, et al., *supra* note 5, at 488.
[13] S. REP. NO. 109-14, at 5.
[14] S. REP. NO. 109-14, at 10-11.
[15] 28 U.S.C. §§ 1332(d)(2), (d)(6).
[16] *See Rolwing v. Nestle Holdings, Inc*., 666 F.3d 1069, 1072 (8th Cir. 2012); *Morgan v. Gay*, 471 F.3d 469, 477 & n.9 (3d Cir. 2006); *Harris v. Sagamore Ins. Co*., No. 2:08CV00109 JLH, 2008 WL 4816471, at *3 (E.D. Ark. Nov. 3, 2008); *see also Arnold v. State Farm Fire & Cas. Co*., 277 F.3d 772, 775 n.3 (5th Cir. 2001) (pre-CAFA).
[17] *Lowdermilk v. U.S. Bank Nat'l Ass'n,* 479 F.3d 994, 1003 (9th Cir. 2007). *But see Frederick v. Hartford Underwriters Ins. Co*., 683 F.3d 1242, 1247 (10th Cir. 2012) ("[A] plaintiff's attempt to limit damages in the

the evasion of CAFA (whether purposeful or not). In 2011, Arkansas enacted a statute that provides that a statement of damages in a complaint "is binding on the plaintiff with respect to the amount in controversy" *until* the statement of damages is amended.[18] Other states have similar procedural rules that prevent recovery in excess of the amount stated in an *ad damnum* clause while still allowing *ad damnum* clauses to be amended.[19]

By purporting to limit the amount in controversy to less than the federal jurisdictional minimum, plaintiffs' attorneys have limited defendants' access to federal courts to defendants' detriment. Some states have lax certification standards that allow certification of classes that could never be certified in federal court.[20] Defendants in some state courts must also continue to spend millions of dollars to comply with discovery requests broader than those normally allowed in federal court. And most, if not all, state courts maintain broad discretion to impose draconian sanctions—including measures as extreme as entry of a default judgment[21]—for noncompliance with those discovery requests. Despite statements purporting to limit the amount in controversy to $5 million, plaintiffs are free to demand settlements several times that amount knowing that the costs of complying with discovery may run into the tens of millions of dollars.

4. Defending Against Plaintiffs' End Runs Around CAFA

Defendants have presented a number of arguments in opposition to plaintiffs' attorneys' "binding stipulations" and efforts at making end runs around CAFA. As a preliminary matter, the decisions that allow plaintiffs to circumvent CAFA with a statement that the amount in controversy is less than the federal jurisdictional minimum rest on a shaky foundation. The decisions rely on dicta from outside of the class action context and prior to CAFA's enactment that suggest that "binding stipulations" may limit the amount in controversy.[22] Courts have also relied on dicta written prior to the effective date of the Federal Rules of Civil Procedure that suggest that the damages stated in an *ad damnum* clause limit the amount in controversy.[23]

Moreover, it is, at best, questionable that a sworn stipulation, or especially an *ad damnum* clause, could limit the amount in controversy in any case. Federal Rule of Civil Procedure 54(c) provides that a "final judgment should grant the relief to which each party is entitled, even if the party has not demanded that relief in its pleadings," and courts applying this rule hold that a plaintiff in a diversity action may recover in federal court damages greater than the amount stated in the complaint regardless of the effect given

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complaint is not dispositive when determining the amount in controversy.").

[18] ARK. CODE ANN. § 16-63-221(b); *see* 2 DAVID NEWBERN, ET AL., ARKANSAS CIVIL PRACTICE & PROCEDURE § 11:11 (5th ed. 2012) (explaining that Ark. Code Ann. § 16-63-221(b) is directed toward "recent federal decisions allowing plaintiffs to avoid removal under the Class Action Fairness Act by recognizing demands and stipulations limiting the damages sought").

[19] *See, e.g., Bijou v. Young-Battle*, 969 A.2d 1034, 1048 (Md. Ct. Spec. App. 2009).

[20] Brief for the Arkansas State Chamber of Commerce as Amicus Curiae Supporting Petitioner, *Standard Fire Ins. Co. v. Knowles* (2012) (No. 11-1450).

[21] *See, e.g., Southern College of Naturopathy v. State ex rel. Beebe*, 203 S.W.3d 111, 122 (Ark. 2005).

[22] *DeAguilar v. Boeing Co*., 47 F.3d 1404, 1412 (5th Cir. 1995); *Matter of Shell Oil Co*., 970 F.2d 355, 356 (7th Cir. 1992).

[23] *Morgan v. Gay*, 471 F.3d 469, 474 (3d Cir. 2006) (citing *St. Paul Mercury Indem. Co. v. Red Cab Co*., 303 U.S. 283, 294 (1938)).

an *ad damnum* clause in state court.[24] And, as plaintiffs' attorneys (and defendants) surely recognize, most states have similar procedural rules that likely make a purported limitation on damages meaningless.[25]

Reliance on state rules of judicial estoppel and state rules regarding the effect of *ad damnum* clauses also has the ill effect of allowing state procedural rules to dictate whether federal jurisdiction exists. This reliance is at odds with well-settled authority. "The determination of the value of the matter in controversy for purposes of federal subject matter jurisdiction is a federal question and naturally is decided under federal, not state, standards."[26] It is also axiomatic that state procedural rules are inapplicable in federal court.[27] State rules that limit recovery to the amount stated in an *ad damnum* clause are inconsistent with Federal Rule of Civil Procedure 54(c).

There are additional problems with applying state rules of judicial estoppel and state rules regarding the effect of *ad damnum* clauses. Differences between state and federal procedural rules and rules of judicial estoppel[28] could affect the calculation of the amount in controversy. If a court looked to state procedural rules in determining the amount in controversy, the amount in controversy for jurisdictional purposes could be different from the amount that could be recovered if the case stayed in federal court and was litigated under federal procedural rules. Since rules on judicial estoppel, stipulations, and the effect of *ad damnum* clauses may vary from state to state, reliance on state rules would necessarily lead to the inconsistent application of the federal removal statute—an outcome federal courts have sought to avoid.[29]

Even assuming *arguendo* that a stipulation or *ad damnum* clause may limit the amount in controversy outside the class action context, such purported limitations would be irrelevant in the jurisdictional analysis in a class action removed under CAFA for several independent reasons.

First, a stipulation can have no effect on the valuation of the claims of the unnamed members of a putative class because it cannot bind persons who are not yet parties to a case. CAFA requires the aggregation of the claims of the members of the putative class in determining the amount in controversy.[30] A stipulation could only limit the amount in controversy if it could bind the unnamed members of the class at the time of removal, which in virtually any case would be prior to certification. Since the Supreme Court has explained that "an uncertified class action cannot bind proposed class members"[31] it is inconceivable that the named plaintiff in a

[24] *See, e.g., Steinmetz v. Bradbury Co., Inc*., 618 F.2d 21, 24 (8th Cir. 1980).
[25] *See Burns v. Windsor Ins. Co*., 31 F.3d 1092, 1097 n.11 (11th Cir. 1994) (noting that *ad damnum* clauses are not binding under most states' procedural rules).
[26] 14AA CHARLES ALAN WRIGHT, ET AL., FEDERAL PRACTICE AND PROCEDURE § 3702 (4th ed. 2012); *see also Shamrock Oil & Gas Corp. v. Sheets*, 313 U.S. 100, 104 (1941).
[27] *Hanna v. Plumer*, 380 U.S. 460 (1965).
[28] Several circuits treat judicial estoppel as procedural under *Erie*. *See, e.g., G-I Holdings, Inc. v. Reliance Ins. Co.*, 586 F.3d 247, 261 (3d Cir. 2009); *Eastman v. Union Pac. R.R. Co*., 493 F.3d 1151, 1156 (10th Cir. 2007); *Jarrard v. CDI Telecomms., Inc*., 408 F.3d 905, 914 (7th Cir. 2005); *Rissetto v. Plumbers and Steamfitters Local 343*, 94 F.3d 597, 603 (9th Cir. 1996); *Edwards v. Aetna Life Ins. Co*., 690 F.2d 595, 598 n.4 (6th Cir. 1982); *Allen v. Zurich Ins. Co*., 667 F.2d 1162, 1167 n.4 (4th Cir. 1982).
[29] *See Shamrock Oil & Gas Corp.*, 313 U.S. at 104; *Bell v. Hershey Co*., 557 F.3d 953, 958 (8th Cir. 2009); *Burns*, 31 F.3d at 1097 & n.11.
[30] 28 U.S.C. § 1332(d)(6).
[31] *Smith v. Bayer Corp.*, 131 S. Ct. 2368, 2381 n.11 (2011).

class action could waive the rights of the unnamed members of a putative class to certain relief. Even if none of the unnamed class members ultimately chose to opt out of the class action following certification and were thus *later* bound by a statement limiting damages, it is the amount at stake at the time of removal that matters in a jurisdictional analysis.[32]

Second, the plain text of CAFA bars consideration of any purported waiver of relief by a named plaintiff. CAFA provides that "the *claims* of the individual class members *shall* be aggregated" in determining the amount in controversy.[33] A "claim" is a right to recovery regardless of the relief sought.[34] CAFA mandates that the jurisdictional inquiry focus on the combined value of the claims of the individual members of the putative class—not on the relief sought for the putative class by the named plaintiff. The directive that federal courts to look at the aggregate value of the individual claims, not the amount that could be awarded to a certified class, also makes it irrelevant whether a class action ultimately certified in state court would include only those plaintiffs who agreed to a damages stipulation. A federal court must look at the aggregate value of the claims of both the plaintiffs who may ultimately choose to opt out and the plaintiffs who choose to be bound by a damages stipulation.

Third, a named plaintiff's obligations to the unnamed class members bar his waiver of the damages available to class members. A named plaintiff "has a fiduciary duty to its fellow class members" and "can't throw away what could be a major component of the class's recovery."[35]

Fourth, even if a stipulation or *ad damnum* clause could limit the amount that a named plaintiff could seek for a class, the federal rules governing class actions and many state analogues of those rules obligate courts to ensure that a class action settlement is fair to the unnamed class members.[36] Courts have refused to approve unfair class action settlements.[37] Some courts have held even outside the class action context that a stipulation may bind litigants but cannot force a court to approve a settlement that it believes is unfair.[38] A court reviewing the fairness of a proposed settlement may refuse to honor a stipulation that limits the recovery of the unnamed class members to $5 million when their actual damages exceeded that amount.

Fifth, plaintiffs' efforts to evade federal jurisdiction through damage stipulations undermine the purpose of CAFA, which was to allow removal of large class actions affecting the national economy.[39] As noted above, Congress specifically mentioned damage stipulations as an example of the jurisdictional gamesmanship that it sought to end.[40]

Several federal district and circuit courts have discussed a presumed lack of prejudice to the parties in holding that a disclaimer of certain

[32] *St. Paul Mercury Indem. Co. v. Red Cab Co.*, 303 U.S. 283, 293 (1938).
[33] 28 U.S.C. § 1332(d)(6) (emphasis added).
[34] *United States v. Tohono O'Odham Nation*, 131 S. Ct. 1723, 1731 (2011).
[35] *Back Doctors, Ltd. v. Metro. Prop. and Cas. Ins. Co*., 637 F.3d 827, 830-31 (7th Cir. 2011); *see also Manguno v. Prudential Prop. and Cas. Ins. Co*., 276 F.3d 720, 724 (5th Cir. 2002).
[36] Fed. R. Civ. P. 23(e)(2)
[37] *See, e.g., In re Katrina Canal Breaches Litig*., 628 F.3d 185, 196 (5th Cir. 2010).
[38] *See, e.g., Rutherford v. Rutherford*, 98 S.W.3d 842, 845 (Ark. App. 2003).
[39] S. REP. NO. 109-14, at 5 (2005), *as reprinted in* 2005 U.S.C.C.A.N. 3.
[40] *Id*. at 10-11.

relief may limit the amount in controversy. These courts noted that a class member who objects to a stipulation may opt out of a class[41] and that a defendant may attempt a second removal if the plaintiffs ultimately amend their complaint to remove the $5 million cap on the value of relief sought.[42] But the correct focus in a removal inquiry is not on what may happen down the road and any potential prejudice to a defendant but is instead on whether federal jurisdiction exists at the time of removal. CAFA requires aggregation of the value of the claims of the putative class members at the time of removal, and plaintiffs cannot be bound to a stipulation made before they even become parties to the case.

5. Will the Supreme Court Set the Edge in Standard Fire Insurance Co. v. Knowles*?*

The Supreme Court is positioned to end plaintiffs' end runs around CAFA. The Supreme Court granted certiorari in *Standard Fire Insurance Co. v. Knowles* to determine whether, in the light of its previous holding that a proposed class action cannot bind non-parties, a named plaintiff may defeat a defendant's right of removal under CAFA by stipulating that he will seek no more than $5 million for the putative class when the amount in controversy, absent the stipulation, would exceed $5 million.[43] The Supreme Court granted certiorari to review a decision of the Western District of Arkansas[44] that the Eighth Circuit declined to review. The district court in *Knowles* found that, absent the stipulation, the amount in controversy exceeded $5 million,[45] but then held that the stipulation limited the amount that the class could recover.[46]

It appears that the Supreme Court was particularly bothered by the ruling of the district court given that the Supreme Court took the unusual step of granting certiorari absent a ruling on the case by an appellate court.[47] The Supreme Court also held just last year that a class member is not a party to a class action prior to certification and it is difficult to see how a stipulation could limit the amount that non-parties may recover. As explained in several amicus briefs filed in *Knowles*, the recognition of purported damage limitations completely undermines the purpose of CAFA by keeping large class actions in fora that continue to be hostile to defendants.

Knowles promises to be a significant development in the law. The case has the potential to end an abusive evasion of CAFA that has cost defendants millions of dollars in legal fees, discovery expenses, and settlement of meritless claims in state court. But *Knowles* will also be the Supreme Court's first discussion of the calculation of the amount in controversy under CAFA and its first meaningful discussion of the effect of damage stipulations since dicta penned in February 1938[48]—prior to the effective date of the Federal Rules of Civil Procedure. The

[41] *Morgan v. Gay*, 471 F.3d 469, 476 n.7 (3d Cir. 2006); *see also Knowles v. Standard Fire Ins. Co*., No. 4:11-CV-04044, 2011 WL 6013024, at *6 (W.D. Ark. Dec. 2, 2011).
[42] *See, e.g.*, *Knowles*, 2011 WL 6013024, at *5.
[43] Question Presented, *Standard Fire Ins. Co. v. Knowles*, No. 11-1450, http://www.supremecourt.gov/qp/11-01450qp.pdf.
[44] *Knowles*, 2011 WL 6013024.
[45] *Knowles*, 2011 WL 6013024, at *3.
[46] *Id*. at *4.
[47] Indeed, the Supreme Court reverses the lower court in about 75 percent of the cases where it grants oral argument. Diarmuid F. O'Scannlain, *A Decade of Reversal: The Ninth Circuit's Record in the Supreme Court Through October Term 2010*. 87 NOTRE DAME L. REV. 2165, 2166 n.6 (2012).
[48] *St. Paul Mercury Indem. Co. v. Red Cab Co.*, 303 U.S. 283, 294 (1938).

Supreme Court should uphold the purposes of CAFA and reverse the district court.

6. Other Plays: Alternate Arguments Against Stipulations

The Supreme Court should bar the use of purported damage limitations to evade federal jurisdiction in class actions. Although an affirmance of the district court would be a serious blow to class action defendants, defendants could still advance other arguments explaining why a stipulation cannot limit the amount in controversy. For instance, a stipulation may not limit the amount in controversy to less than the jurisdictional minimum if it limits damages but does not limit the value of any injunctive relief requested.[49] A stipulation may also not be adequately broad if it limits the relief that plaintiffs may "seek" but does not limit what they may "accept."[50] Applicable state law may also prevent plaintiffs from disclaiming certain types of relief.[51] It is also unlikely that applicable state law would have addressed whether relief is actually limited to the amount stipulated by the named plaintiff in a purported class action. Absent such controlling authority on the issue, a plaintiff cannot satisfy his burden in a motion to remand of establishing that it is legally certain that the federal jurisdictional minimum cannot be recovered.[52]

The Supreme Court stands ready to end an abusive practice that has allowed plaintiffs' attorneys to evade rules intended to level the playing field in class action litigation. The Supreme Court heard oral arguments on January 7, 2013, and is expected to issue an opinion by the end of its term in June.

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[49] *Fetters v. United Parcel Serv., Inc*., No. 1:06-CV-0542, 2006 WL 2375493 (S.D. Ind. Aug. 16, 2006).
[50] *In re 1994 Exxon Chem. Fire*, 558 F.3d 378, 389 (5th Cir. 2009).
[51] *See, e.g., Gilman v. Arthur J. Gallagher & Co*., No. H-09-2355, 2009 WL 5195956, at *10 (S.D. Tex. Dec. 21, 2009).
[52] *1994 Exxon Chem. Fire*, 558 F.3d at 389-90; *see also St. Paul Mercury Indem. Co*., 303 U.S. at 289 ("It must appear to a legal certainty that the claim is really for less than the jurisdictional amount to justify dismissal.").

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