Legal Backgrounder

WLF Washington Legal Foundation

Advocate for freedom and justice®
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Vol. 24 No. 38 November 20, 2009

REMOVING THE "FAIL-SAFE" CLASS ACTION UNDER CAFA

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Congress passed the Class Action Fairness Act ("CAFA") nearly five years ago to ensure that defendants targeted by large class-action lawsuits filed in state courts would be able to remove such litigation to federal court. In response, the plaintiffs' bar has resorted to a new and creative tactic for defeating removal under CAFA: pleading a "fail-safe" class—that is, one in which a person's membership in a proposed class turns on the merits of the person's underlying claim. Plaintiffs in such fail-safe class actions then argue that a defendant seeking to remove a case cannot establish the existence of federal jurisdiction under CAFA unless the defendant submits evidence of the number of persons who were subject to the allegedly wrongful conduct. Doing so, however, would effectively require the defendant to concede liability on a massive scale in order to gain entry into federal court. In this LEGAL BACKGROUNDER, we discuss potential strategies for removing fail-safe class actions under CAFA while avoiding dangerous concessions.

What Is A "Fail-Safe" Class Action? A "fail-safe" class action is one in which the putative class is defined by reference to the merits of the underlying claims, such as a class of "all consumers who were defrauded by ABC Corporation" or "all employees who were illegally underpaid by XYZ Corporation." Under such class definitions, a consumer whom ABC Corporation did not defraud or an employee whom XYZ Corporation did not illegally underpay would not be members of the class. These lawsuits have been termed "fail-safe" class actions because the plaintiffs' lawyers who advance them cannot lose. If ABC Corporation and XYZ Corporation did not do anything wrong, then there are no members of the class—and thus no one whose claims would be precluded by a judgment in the defendants' favor. Moreover, in these cases, plaintiffs often avoid alleging a systematic wrong—for example, that a defendant defrauded every customer or underpaid every employee—but rather contend that the defendant had an unspecified "pattern" or "practice" of committing the alleged wrong.

Many courts have recognized that a fail-safe class definition is improper.[1] For example, the *Manual of Complex Litigation* advises federal judges not to certify such classes: "The order defining the class should avoid subjective standards * * * or terms that depend on resolution of the merits (*e.g.*, persons who were discriminated against)."[2] Thus, at the class-certification stage, the defendant will have powerful arguments against certification of the putative class. But despite Congress's purpose in enacting CAFA—to provide a federal forum for many large class actions, defendants targeted by fail-safe class-action lawsuits in state courts may have difficulty removing these actions to federal court.

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Fail-safe putative class actions are hard to remove under CAFA because defendants must prove that CAFA's amount-in-controversy requirement is met. CAFA confers federal jurisdiction over covered class actions only if, after aggregating the claims of the putative class, "the matter in controversy exceeds the sum or value of $5 million, exclusive of interest and costs." 28 U.S.C. § 1332(d)(2). Every federal appellate court to consider the question has held that a defendant seeking to remove a case under CAFA bears the burden of establishing by a preponderance of the evidence that the jurisdictional elements—including the amount-in-controversy requirement—are satisfied.[3] In these cases, plaintiffs typically argue that the only way that the defendant can satisfy this burden is by submitting evidence that the putative class is so numerous that at least $5 million is at stake. But when the plaintiffs have defined a class in terms of the underlying merits, they are effectively requiring a defendant to show, in a consumer fraud case, for example, how many of its customers the defendant defrauded. In other words, by pleading a fail-safe class action, the plaintiff is seeking to force a defendant to concede liability as the price of admission to federal court.

Removing the Fail-Safe Class Action. That result is clearly undesirable for defendants. That said, a defendant seeking to remove a fail-safe class action need not actually prove the plaintiffs' case for them in order to remove the action under CAFA. There are several steps—all short of conceding liability on a massive scale—that defendants can take to persuade courts that CAFA's amount-in-controversy requirement has been satisfied.

First, however, there is an important caveat. In the Third and Ninth Circuits, if a plaintiff alleges in the complaint that the amount in controversy is less than $5 million, the case may be removed only if the defendant proves "to a *legal certainty* that the amount in controversy exceeds the statutory minimum."[4] Other courts reject the imposition of this heightened—and often-insuperable—standard because it frustrates the "primary purpose" of CAFA—to provide a federal forum to class action defendants.[5] In circuits where the legal-certainty standard applies, however, defendants generally should not even attempt to satisfy it.

In all other courts—or in the Third and Ninth Circuits when the plaintiff has not alleged an amount in controversy—the defendant's burden is simply to establish by a preponderance of the evidence that the amount at stake in the lawsuit exceeds $5 million. The easiest way to do that is to assume that the plaintiff's allegations must be treated as correct; estimate the size of each class member's claim; and then multiply that amount by the estimated size of the class.

Frequently the hardest part of establishing the amount in controversy is estimating the size of the putative class. As noted above, in fail-safe class actions, plaintiffs often allege merely that the defendant had a "pattern" or "practice" of committing the alleged wrong, thus leaving ambiguous the possible size of the putative class. Rather than attempt to actually show how many customers or employees were affected by the alleged wrong—which potentially could be taken as a concession of liability—the defendant instead should provide evidence as to the total number of people who were potentially affected by the alleged practice. In calculating the amount in controversy, the plaintiff's allegations should be assumed to be true.[6] Accordingly, if a plaintiff alleges a "practice" of committing some wrong, a 100-percent violation rate should be assumed because that would represent the maximum win for plaintiffs, and thus the outer contours of the amount put at stake by the complaint.

In a number of recent decisions, district courts have adopted this approach in calculating the amount in controversy in fail-safe class actions. For example, in *Helm v. Alderwoods Group, Inc.*, 2008 WL 2002511 (N.D. Cal. May 7, 2008), the plaintiffs purported to represent a putative class of "all non-exempt employees who were not paid their regular or statutorily required rate of pay for all hours worked."[7] During removal, the defendant calculated the amount in controversy by estimating the size of the class as consisting of all non-exempt employees.[8] The plaintiffs challenged this assumption, arguing that the defendant was required to submit evidence proving how many employees "actually experienced wage and hour violations."[9] The court disagreed, explaining that that inquiry is "the ultimate question the litigation presents, and defendants cannot be expected to try the case themselves for purposes of establishing jurisdiction, and then admit to the opposing party and to the Court that a certain number of * * * violations did indeed occur."[10] Because the complaint "provides no information indicating that the size of the class is not at least relatively congruent with the total number of potentially-affected employees," the court held that the defendant properly used a 100-percent violation rate to calculate the amount in controversy.[11]

The court reached the same result in *Muniz v. Pilot Travel Centers LLC*, 2007 WL 1302504 (E.D. Cal. May 1, 2007). As the court explained, a defendant removing a class action under CAFA is not obligated to

"research, state, and prove the plaintiff's claims for damages."[12] Accordingly, because the "plaintiff include[d] no fact-specific allegations [in the complaint] that would result in a putative class or violation rate that is discernibly smaller than 100%," the defendant may properly use that rate in calculating the amount in controversy.[13]

Similarly, in *White v. Playphone, Inc.*, 2009 WL 499103 (W.D. Wis. Feb. 27, 2009), the plaintiff sued on behalf of a putative class of customers who were charged by defendants for services that were not authorized. The court rejected the contention that, because "the complaint does not indicate how often unauthorized charges occurred," the defendant must prove how many unauthorized charges were made.[14] Instead, because "plaintiff alleges that defendants 'repeatedly' made unauthorized charges, * * * the complaint puts into controversy the propriety of all of defendants' charges."[15]

Once the size of the putative class has been estimated, the defendant next must calculate the size of each member's claim. Most defendants generally would be best served by avoiding the suggestion that the aggregate amount in controversy is so enormous as to put stars in the plaintiffs' lawyers' eyes. At the same time, when the facts support it, a defendant should use a calculation method that comfortably exceeds $5 million. Indeed, a court that is uncomfortable with assuming a 100-percent violation rate may be mollified by a showing that each class member's claim is so large that the jurisdictional threshold is satisfied even if only a very small percentage of potentially affected customers or employees are part of the putative class. For example, if a company accused of having a "practice" of defrauding its customers had a million customers during the relevant period, CAFA's jurisdictional threshold would be met if defrauded customer had claims of $5 and every customer was assumed to have been defrauded. If, however, each customer's claim would be for $50 or $100, then CAFA would be satisfied even if only 10 or 5 percent, respectively, of customers had been defrauded.

In calculating each class member's claim for damages, the defendant should first look for claims for statutory damages. Such claims simplify the calculation because the amount of damages prescribed by statute is a definite figure that the defendant need not support with evidence.

By contrast, if the plaintiff seeks only compensatory damages or restitution, the defendant must supply its own estimate of the per-plaintiff amount. One defensible method of estimation is to use the amount of damages that the named plaintiffs allege that they themselves suffered. The defendant then can argue that the named plaintiffs are bound by their allegation in the complaint that their claims are typical of those of the putative class.

Defendants also can try to quantify claims for attorneys' fees or punitive damages, which courts have held should be included in the amount-in-controversy calculation.[16] An award of attorneys' fees may be estimated by looking to the amount of fees that plaintiffs' counsel was awarded in previous class action settlements, which are public information. Moreover, the Supreme Court has indicated that, historically, punitive-to-compensatory ratios of as high as three to one have been acceptable and that, when compensatory damages are "substantial," a ratio of 1:1 may reach the constitutional limit.[17] Thus, a defendant can credibly argue that a complaint seeking punitive damages on behalf of a class would put $5 million in controversy whenever the compensatory damages can be quantified at $1.25 million or higher. In our experience, however, courts that doubt that compensatory damages alone exceed $5 million are hesitant to allow claims for punitive damages or attorneys' fees to nudge the amount in controversy across the jurisdictional threshold.[18]

Conclusion. Fail-safe class actions present defendants with unique challenges in removing cases under CAFA. Plaintiffs often argue that the defendant can meet its burden of satisfying CAFA's amount-in-controversy requirement only by effectively conceding at least $5 million in liability. But as we have discussed above, there are ways that defendants can avoid this problem by estimating the size of the putative class to equal the total number of persons—often the defendant's customers or employees—who potentially may have been affected by the alleged wrongdoing. Even if removal is unsuccessful, to the extent the plaintiffs argued in seeking remand that determining membership in the class requires a determination of the merits, that argument can be turned against them at the class-certification stage. Finally, because under CAFA the discovery of new facts supporting removal can take place at any time during a litigation, the defendant should be alert for opportunities to try to remove the case again if additional facts showing that the amount in controversy exceeds $5 million come to light.

ENDNOTES

[1] *See*, *e.g.*, *Chiang v. Veneman*, 385 F.3d 256, 272 (3d Cir. 2004) (rejecting proposal to define class as "those who were in fact discriminated against" because a "class definition is inadequate if a court must make a determination of the merits of the individual claims to determine whether a particular person is a member of the class.") (internal quotation marks omitted); *Colindres v. QuitFlex Mfg.*, 235 F.R.D. 347, 368 (S.D. Tex. 2006) (rejecting class of "those subjected to discriminatory practices" as improperly "us[ing] terms that depend on resolving the claims on the merits"); *Forman v. Date Transfer, Inc.*, 164 F.R.D. 400, 403 (E.D. Pa. 1995) (rejecting class of "all residents and businesses who received unsolicited facsimile advertisements" as improperly "requir[ing] a mini-hearing on the merits of each [class member's] case"); *Hagen v. City of Winnemucca*, 108 F.R.D. 61, 63-64 (D. Nev. 1985) (rejecting putative class of "all persons whose constitutional rights have been violated" because 'the court would have to pass on the merits of the claim at the class certification stage in order to tell who was included in the class").

[2] MANUAL OF COMPLEX LITIGATION § 21.222 (4th ed. 2004); *see also* 5-23 JEROLD S. SOLOVY ET AL., MOORE'S FEDERAL PRACTICE ¶ 23.21[3][c] (Supp. 2008) (class definition may not require court to "make a determination of the merits of individual claims to determine whether a particular person is a member").

[3] *See Bell v. Hershey Co.*, 557 F.3d 953, 956 (8th Cir. 2009); *Amoche v. Guarantee Trust Life Ins. Co.*, 556 F.3d 41, 48 (1st Cir. 2009); *Lowdermilk v. U.S. Bank Nat'l Ass'n*, 479 F.3d 994, 998 (9th Cir. 2007); *Blockbuster, Inc. v. Galeno*, 472 F.3d 53, 58 (2d Cir. 2006); *Brill v. Country wide Home Loans, Inc.*, 427 F.3d 446, 448 (7th Cir. 2005).

[4] *Morgan v. Gay*, 471 F.3d 469, 474 (3d Cir. 2006) (emphasis added); *accord Lowdermilk*, 479 F.3d at 999-1000.

[5] *Bell*, 557 F.3d at 956-57; *see also Amoche*, 556 F.3d at 49 (noting in dicta that "[i]t is far from evident to us * * * why the defendant should be put to a higher standard simply because the plaintiffs have pled an amount under $5 million").

[6] *See Rippee v. Boston Mkt. Corp.*, 408 F. Supp. 2d 982, 986 (S.D. Cal. 2005) (inquiry is what amount is put "in controversy" by the complaint, not what the defendant actually "would owe").

[7] 2008 WL 2002511, at *4.

[8] *Id.*

[9] *Id.*

[10] *Id.* at *5.

[11] *Id.*

[12] 2007 WL 1302504, at *2.

[13] *Id.* at *4.

[14] 2009 WL 499103, at *4.

[15] *Id.*

[16] *See*, *e.g.*, *Gibson v. Chrysler Corp.*, 261 F.3d 927, 945 (9th Cir. 2001) ("It is well established that punitive damages are part of the amount in controversy in a civil action."); *Galt G/S v. JSS Scandinavia*, 142 F.3d 1150, 1156 (9th Cir. 1998) ("where an underlying statute authorizes an award of attorneys' fees, either with mandatory or discretionary language, such fees may be included in the amount in controversy").

[17] *See State Farm Mut. Auto. Ins. Co. v. Campbell*, 538 U.S. 408, 425 (2003).

[18] *See*, *e.g.*, *Guerrero v. Mobilefunster, Inc.*, 2009 WL 195918 (N.D. Cal. Jan. 26, 2009) (concluding that amount of punitive damages put in controversy by complaint asserting claims on behalf of failsafe class is "too speculative").