Legal Opinion Letter

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FOURTH CIRCUIT RULING PERMITS BROAD CIRCUMVENTION OF CLASS ACTION FAIRNESS ACT

by
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To remedy some of the longstanding and well-documented abuses of the class-action device, Congress enacted the Class Action Fairness Act of 2005, commonly known as CAFA. One of the abuses that prompted Congress to act was the filing of interstate class actions in state courts, where, on matters ranging from class certification to settlement approval, judges are far more likely than their federal counterparts to issue rulings that favor plaintiffs' lawyers, to the detriment of defendants and plaintiff class members alike. Plaintiffs' lawyers often manipulated their pleadings to defeat diversity jurisdiction and thereby prevent defendants from removing the case to federal court from the state court where plaintiffs originally filed. To ensure that large class actions could be litigated in federal court, where Congress believed they belong, CAFA expanded diversity jurisdiction and liberalized removal practice.

With characteristic resilience, plaintiffs' lawyers have responded to CAFA by devising a new form of pleading manipulation to keep class actions in state court. Plaintiffs' lawyers now frequently plead class actions as *counterclaims* in state-court actions, typically those in which the defendant—who becomes the named plaintiff in the counterclaim class action—has been sued to collect a relatively small debt. When a counterclaim defendant removes the case to federal court, class-action counsel argue that CAFA incorporates the "background" principle that counterclaim defendants have no authority to remove—even though that principle derives from a 1941 Supreme Court case, *Shamrock Oil & Gas Corp. v. Sheets*, which interpreted a statute with a different text, history, and purpose. In a recent decision, *Palisades Collections LLC v. Shorts*, a divided panel of the U.S. Court of Appeals for the Fourth Circuit endorsed this argument and placed its imprimatur on the new class-action-by-counterclaim tactic.

In that case, AT&T Mobility sold an account debt of approximately $800 to Palisades, which filed a collection action against the account holder, Charlene Shorts, in West Virginia state court. While the case was pending, a federal district court in West Virginia ruled in another case, *CitiFinancial, Inc. v. Lightner*, that a counterclaim defendant has no authority to remove a class action under CAFA. A few weeks later, class counsel in *CitiFinancial* entered an appearance on behalf of Shorts in her case; filed a class-action counterclaim against Palisades, alleging violations of the West Virginia Consumer Credit & Protection Act; and added AT&T Mobility as an "additional" counterclaim defendant. The counterclaim class action sought tens of millions of dollars on behalf of tens of thousands of wireless subscribers.

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AT&T Mobility removed the case to federal court, but the district court remanded it to state court. The district court acknowledged that the class action would have been removable if it had been pleaded as a stand-alone suit, but held that it was not removable because CAFA does not authorize removal by counterclaim defendants—even those, like AT&T Mobility, that were not the original plaintiffs and therefore did not choose the state-court forum.

AT&T Mobility appealed to the Fourth Circuit. It argued that CAFA's removal provision, unlike the statute at issue in *Shamrock Oil*, uses broad language—including the phrase "any defendant"—that covers counterclaim as well as original defendants. It also argued that CAFA should be interpreted to authorize removal by counterclaim defendants even if its language were deemed ambiguous, because Congress cannot be presumed to have authorized the very sort of tactic—manipulating pleadings to keep class actions in state court—that CAFA was enacted to prevent. A majority of the Fourth Circuit panel disagreed, and affirmed the district court's holding that a counterclaim defendant may not remove under CAFA, even when, as in *Palisades*, the counterclaim defendant is not the original plaintiff.

Judge Niemeyer wrote a lengthy dissent. He found the majority's reading of CAFA to be "demonstrably at odds" with CAFA's "plain language," which "unambiguously" grants removal authority to "any defendant," a phrase that easily encompasses a counterclaim defendant. The dissent explained that CAFA expands removal authority "beyond the limits" of the statute at issue in *Shamrock Oil*, which interpreted the narrower phrase "*the* defendant" to exclude an original plaintiff that became a counterclaim defendant. Judge Niemeyer also concluded that *Shamrock Oil* does not apply "even apart from the amendments made by CAFA," because the holding of that case is limited to counterclaim defendants that—unlike AT&T Mobility—were plaintiffs in state court.

AT&T Mobility filed a petition for rehearing en banc. The Fourth Circuit denied the petition, but Judge Niemeyer again wrote a dissent. He emphasized that the issue of statutory interpretation is an "important" one and that the majority's decision creates "an unfortunate loophole" in CAFA that "only the Supreme Court can now rectify."

Indeed, "loophole" may not be an adequate term. The rule adopted by the panel majority is tantamount to a determination that CAFA's removal provision simply has no application to the very substantial proportion of class actions that can be pleaded as counterclaims. Those include "consumer protection" class actions like the one in *Palisades*, a category comprising more than one fifth of all class actions filed in or removed to federal court in the first half of 2007.

Professor Jay Tidmarsh of the Notre Dame Law School has rightly noted that *Palisades* and cases like it are "just the tip of an approaching iceberg," and he is a *defender* of the post-CAFA tactic of keeping class actions in state court by pleading them as counterclaims. As a result of the Fourth Circuit's ratification of the tactic, both the size and the speed of the iceberg Professor Tidmarsh identified are sure to increase, unless the Supreme Court accepts Judge Niemeyer's invitation to prevent plaintiffs' lawyers from circumventing CAFA in this way. AT&T Mobility has filed a petition for certiorari, which is now pending in the Supreme Court. In the meantime, Judge Niemeyer's comprehensive dissent in *Palisades* will provide powerful ammunition to counterclaim defendants that find themselves victims of the tactic in courts in which its availability remains an open question.

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