Class Action Watch

MAY 2009

Mortgage-Backed Securities Litigation: Hedge Funds vs. Banks

by Charles M. Miller

Countrywide Home Loans, Inc. became the largest mortgage originator in the nation, originating more than $400 billion in mortgages in both 2006 and 2007.[1] The value of its originations exceeded those of Chase and Bank of America combined.[2] But approximately 40% of those loans were "non-conforming," meaning they did not qualify to be purchased by Fannie Mae or Freddie Mac.[3]

The Subprime Fallout

These non-conforming loans included subprime mortgages, "exotic" negative amortizing mortgages, interest-only loans, and "teaser rate" adjustable-rate mortgages. Origination fees on these non-conforming loans were high—providing quick profits. They were then packaged into mortgage backed securities ("MBS") which were sold to investment Trusts. Securitization shifted the credit risk of the securitized loans from Countrywide to the MBS investors.

In 2008, Countrywide, now owned by Bank of America, was the target of suits brought by various state attorneys general alleging that the corporation had issued thousands of mortgages that it knew the borrowers could not service.[4] The lawsuits also claimed that it had misled many consumers by misinforming them about the workings of the non-conforming loans. To settle those cases, Countrywide agreed to no longer issue subprime and negative amortizing mortgages, to reduce issuance of no-documentation mortgages (colloquially, "liar loans"), and to limit broker origination commissions. Most importantly, it agreed to modify up to $8.4 billion dollars worth of securitized mortgages. Countrywide has since stated that it may modify as much as $91 billion worth of mortgages—88% of which have been securitized. These modifications arguably impact the ability of the MBS investors to realize the contracted rate of return on the mortgages in which they invested. This, unsurprisingly, has led to class action litigation.

The Litigation

On December 1, 2008, *Greenwich Financial Services Distressed Mortgage Fund 3, LLC, v. Countrywide Financial Corporation* was filed in New York state court. The plaintiffs seek to represent a class of investors in 373 tranches of

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Fifth Circuit Applies CAFA to LA AG Action

by Christopher K. Ralston & Bryan Edward Bowdler

When Hurricane Katrina made landfall in Southeast Louisiana on August 29, 2005, it caused severe damage along the entire Gulf Coast of the United States. It also resulted in a tremendous number of lawsuits.

With this deluge of litigation, the Louisiana Attorney General filed a state court lawsuit against numerous insurance providers and companies that provided consulting or software to these insurers. The case, styled as a parens patriae action, and based on Louisiana's anti-trust statute, was removed to federal court under the Class Action Fairness Act of 2005 (CAFA). Eventually, the United States Court of Appeals for the Fifth Circuit was asked to see whether

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FROM THE EDITOR

The Federalist Society publishes *Class Action Watch* to apprise both our membership and the public at large of recent trends and cases in class action litigation that merit attention. We hope you find this and future issues thought-provoking and informative. Comments and criticisms about this publication are most welcome. Please e-mail: info@fed-soc.org.

Recent Wave of Case Law Rejects "Concealed Defect" Class Actions

by Troy M. Yoshino & Patrick R. Perez

The last several years have seen a number of decisions invalidating common theories asserted in concealed defect class actions as a matter of law. This article summarizes some of the newest developments.

The Nature of Concealed Defect Class Actions

Concealed defect class actions generally allege that a particular product contained a defect that a manufacturer knew about but fraudulently failed to disclose. Over the years, these cases have involved virtually every product in the market, from automobiles to consumer electronics to pharmaceuticals and medical devices.

Such actions are often criticized because they hinge on an amorphous and subjective allegation of "defect." All products fail at some rate, so a fundamental question in these cases is what constitutes a "defect" and whether a defendant knew that the product was "defective." It is not unusual to see cases alleging that a product was "defective" simply because it did not perform as long, or as well, as the consumer expected, or that the defendant had requisite "knowledge" of said defect because it had collected information about product performance.

In addition, many concealed defect class actions involve thousands, or even millions, of putative class members that have never even experienced the defect or problem alleged. Thus, some critics question whether concealed defect class actions violate the basic principle of "no injury, no tort."[1]

Criticism is compounded because the vast majority of concealed defect cases involve fraud-based allegations, significant punitive damage claims are often in play. Most products sell by the thousands, if not millions. Thus, both the reputational and monetary exposure created by allegations often involve bet-the-company stakes. For example, in 1999, after an adverse summary judgment ruling that swept in not only injured owners but all "potential purchasers" of laptops containing allegedly defective microcode that could potentially cause data corruption,[2] Toshiba paid over $2 billion in settlement and nearly $150 million in attorneys' fees to avoid further litigation.[3] Similarly in 2001, after being targeted with claims that roughly 10% of tires produced over a fifteen-year period contained an alleged manufacturing flaw, Cooper Tires entered into a settlement that plaintiffs valued between $1 billion and $3 billion.[4]

Consumers Cannot Assert Claims Based Upon Their Unilateral Expectations of Product Performance

Plaintiffs' most common, recent argument is that they were "defrauded" into purchasing a defective product that did not meet their expectations of performance.[5] In many instances, the expectations at issue are completely subjective. In some cases, however, they are linked to puffery in advertising, or defendant's internal objectives regarding "useful life," warranty rates, or other customer-satisfaction metrics. All of these assertions ignore the well-established legal principle that "parties' expectations [about how long a certain product will last], standing alone, are irrelevant without any contractual hook on which to pin them,"[6] according to critics. In most instances, the only contractual expectation between a defendant and consumers is a product warranty. In such cases, the "rules of warranty… [should] determine the quality of the product the manufacturer promises and thereby determine the quality he must deliver."[7] Nonetheless, U.S. courts have entertained concealed defect claims based on non-warranty expectations for years.

Recently, however, the trend has reversed. In *Long v. Hewlett-Packard Co.*, the Northern California District Court rejected plaintiffs' allegations that Hewlett Packard (HP) had concealed a known defect in an inverter contained in certain "Pavilion" notebook computers.[8] The plaintiffs claimed that HP had committed fraud and violated various consumer protection statutes because this part was "substantially certain to fail within [the notebook computers'] five year useful life."[9] But the court rejected this assertion, explaining that

> a consumer's only reasonable expectation was that the Pavilions would function properly for the duration of HP's limited one-year warranty…. Accordingly, HP's alleged failure to disclose the inverter defect is not actionable….[10]

Daugherty v. American Honda Motor Co. provides another example. That case involved an allegedly known-but-concealed defect in F22 engines manufactured by Honda that resulted "in the slippage or dislodgment of the front balancer shaft oil seal."[11] *Daugherty* rejects concealed defect theories as a matter of law because the

> only expectation buyers could have had about the F22 engine was that it would function properly for the length of Honda's express warranty, and it did. Honda did nothing that was likely to deceive the general public by failing to disclose that its F22 engine might, in the fullness of time, eventually dislodge the front balancer shaft oil seal and cause an oil leak.[12]

Other recent cases have followed similar reasoning, including *Blennis v. Hewlett-Packard Co.*,[13] *Oestreicher v. Alienware Corp.*,[14] and *Buller v. Sutter Health*.[15]

Courts thus, with increasing frequency, are beginning to counter that defendants do not conceal defects, but rather, by their warranties, "presage[] the likelihood that the goods will fail to perform and specif[y] a particular remedy in that eventuality."[16]

Defendants Have No Duty to Disclose Concealed Defects Even When They Are Allegedly Known

As the case law has evolved, plaintiffs' counsel have increasingly argued that the warranty's disclosure applies only to "unknown" or "unexpected defects," and thus the alleged failure to disclose a "known defect" is actionable.[17]

Such "knowledge," however, may be irrelevant. As the Second Circuit observed in a breach of warranty case that was an early precursor to modern concealed defect class actions: because companies "must predict rates of failure of particular parts… and thus can always be said to 'know' that many parts will fail after the warranty

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The Third Circuit Joins the Majority with *In Re Hydrogen Peroxide*

by Ian Simmons & Alexander Okuliar

On December 30, 2008, the Court of Appeals for the Third Circuit issued an important ruling on class certification in *In re Hydrogen Peroxide Antitrust Litigation*, considering the appropriate "standards a district court applies when deciding whether to certify a class," particularly with respect to the predominance inquiry under Rule 23(b)(3).[1] The appellate panel issued three key holdings: (1) lower courts must make findings at the certification phase based on "[f]actual determinations" weighed on "a preponderance of the evidence" basis; (2) lower courts must resolve disputes of fact and law even if they overlap with the merits of a plaintiff's claim; and (3) the court must take equal account of all expert testimony of the parties.[2] The court vacated the Eastern District of Pennsylvania decision and remanded the matter for handling consistent with its holdings.[3]

The Third Circuit's decision puts to rest years of lower court confusion in that circuit about the correct standards at the certification phase. Rule 23 does not articulate any pertinent standards, and the Supreme Court has offered only ambiguous and somewhat contradictory guidance, leaving the matter to percolate in the circuits. Courts have struggled for years to harmonize the Court's instructions to refrain from an inquiry into the merits of a case while still conducting a rigorous analysis of the Rule 23 factors.[4] Some circuits took a conservative approach and refused to consider the merits of a plaintiffs' case, including the mechanics of a plaintiff's theory of injury; or to make findings of fact, lest they be taken as rulings on the merits.[5] Other circuits reconciled the various Supreme Court decisions by acknowledging the need to look beyond the pleadings and consider the merits as needed to resolve Rule 23 issues.[6]

The Third Circuit has typically followed the conservative line and taken a deferential stance to certification, strictly avoiding any merits issues, giving credence to a plaintiff's allegations, defaulting to certification when in doubt, and in many circumstances offering plaintiffs a presumption of common proof of impact.[7] This began to change in the early part of the decade with a panel decision in *Newton v. Merrill Lynch, Pierce, Fenner & Smith, Inc.*, in which the court acknowledged that in "reviewing a motion for class certification, a preliminary inquiry into the merits is sometimes necessary to determine whether the alleged claims can be properly resolved as a class action."[8] Later decisions, however, called the *Newton* language into doubt. With *Hydrogen Peroxide*, the Third Circuit firmly and clearly breaks from its past and joins a growing majority of courts that require heightened standards of review for class certification.[9]

Early Attempts to Develop Certification Standards and Resulting Confusion

Damages plaintiffs must satisfy each of the Rule 23(a) factors: numerosity, commonality, typicality, and adequacy; as well as the twin requirements of predominance and superiority under Rule 23(b)(3).[10] The party moving for certification bears the burden of establishing that all the requirements of the Federal Rules are met; however, the Rules supply little guidance as to the proper standard of "proof" for class certification.[11]

The Supreme Court attempted to define the burden of proof and the scope of inquiry for class certification in a trio of prominent opinions between 1974 and 1982: *Eisen v. Carlisle & Jacquelin*, *Coopers & Lybrand v. Livesay*, and *General Telephone Co. of the Southwest v. Falcon*. The first, *Eisen*, dealt with a district court decision about whether the plaintiffs or defendant should have to pay for class notice under Rule 23(e). The lower court resolved the issue by holding a mini-trial and finding that the defendants were more likely going to lose the case. As a result, the district court judge reasoned that the defendant should bear the greater burden of class notice (90%).

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After *Bridge* : RICO Class Actions at a Crossing

by Karl E. Neudorfer & Erika Birg

Last summer, it appeared as though the U.S. Supreme Court potentially had lifted the gates for a flood of class actions alleging violations of the Racketeer Influenced and Corrupt Organizations Act (RICO), 18 U.S.C. §§ 1961–68. In June 2008, the Court decided *Bridge v. Phoenix Bond & Indemnity Company*, in which it held that a plaintiff need not prove that he or she actually relied on the defendant's allegedly false statement in making a complaint based on predicate acts of mail fraud.[1] Specifically, the Court stated: "[n]o showing of reliance is required to establish that a person has violated § 1962(c) by conducting the affairs of an enterprise through a pattern of racketeering activity consisting of acts of mail fraud."[2]

In the abstract, such a broad statement could lead practitioners to conclude that rejection of the first-party reliance requirement would inundate the courts with new class RICO claims predicated on mail fraud. The requirement of proof of reliance by individual plaintiffs historically had been one of the class action defense bar's strongest weapons in showing that individual questions would predominate a class case, thus destroying the efficiencies class litigation is intended to foster.[3] Indeed, prior to *Bridge*, one of the leading class action treatises concluded that "RICO claims typically are inappropriate for class treatment" in part because of "the statutory requirement that each plaintiff establish…reliance."[4] By eliminating the first-party reliance requirement, *Bridge* appeared to create the potential for a significant increase in the number of class RICO claims being filed.

However, *Bridge* is not without boundaries. RICO's civil action provision gives a private right of action only to persons injured in their business or property "by reason of" a predicate RICO violation.[5] Drawing on the Court's earlier RICO jurisprudence,[6] *Bridge* explained that this phrase continues to require proof of both "but for" causation and proximate causation:[7]

> Of course, none of this is to say that a RICO plaintiff who alleges injury "by reason of" a pattern of mail fraud can prevail without showing that *someone* relied on the defendant's misrepresentations…. In most cases, the plaintiff will not be able to establish even but-for causation if no one relied on the misrepresentation…. In addition, the complete absence of reliance may prevent the plaintiff from establishing proximate cause.[8]

In other words, while *Bridge* may have eliminated the requirement that RICO plaintiffs show first-party reliance as a substantive element of a RICO claim predicated on mail fraud, RICO's "by reason of" language continues to require proof of proximate cause—and proof of reliance generally will be needed to show proximate cause.

Not quite a year has passed since *Bridge* was decided. There are only a handful of cases that evaluate Rule 23's prerequisites to class certification in light of the *Bridge* opinion, and those cases are not models of consistency. However, the lower court class decisions that have been handed down since *Bridge* suggest that the opinion may not have opened the door to unbridled RICO class litigation, as *Bridge*'s elimination of the first-party reliance requirement potentially suggested.

Bridge and its Predecessors in the Supreme Court's RICO Jurisprudence

Bridge arose out of a program run by the Cook County, Illinois Treasurer's Office under which the county sold tax liens it had acquired on properties owned by delinquent taxpayers. Sales of the liens were made through public auction. But instead of making cash bids, prospective buyers bid in percentages of the penalties delinquent property owners would be required to pay in order to clear the liens. The bidder willing to accept the lowest penalty would win the auction, thus obtaining the right to purchase the lien in exchange for payment of the delinquent taxes. If the property owner did not redeem the property during the statutory redemption period, then the auction-winning lienholder effectively would have purchased the property for the cost of the delinquent taxes.[9]

Because the subject properties could be obtained at such a low cost, the auctions typically attracted a number of bidders willing to accept a zero percent penalty from property owners. A number of auctions thus resulted in a tie among zero-percent bidders. To ensure that parcels would be distributed fairly among all zero-percent bidders, the county began allocating parcels on a "rotational" basis. However, problems arose when some zero-percent bidders bid on certain parcels themselves and on other parcels through an agent, resulting in those bidders ultimately being awarded a disproportionately large number of properties.[10]

The county instituted a "Single, Simultaneous Bidder Rule" to prevent this sort of manipulation. Under the rule, bidders were required to submit bids in their own name rather than in the name of an agent or employee, and to submit an affidavit swearing that the bid was in compliance with the rule. *Bridge* arose when one group of bidders alleged that another group repeatedly violated the Single, Simultaneous Bidder Rule by submitting bids

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Second Circuit Affirms Dismissal of "Foreign-Cubed" Securities Class Action

by George T. Conway III

In recent years, with increasing frequency, the securities plaintiffs' bar has been filing what have been called "foreign-cubed" or "f-cubed" class actions in American courts—litigation so named because the plaintiffs are *foreign* investors who seek damages from *foreign* issuers to recover losses from purchases the investors made on *foreign* exchanges. Although many of these cases have been dismissed, the plaintiffs' bar has nonetheless achieved significant success in prosecuting some f-cubed class actions. The fundamental question of whether these cases can be brought at all has divided federal district judges, and the securities plaintiffs' bar has taken advantage of the resulting confusion to obtain billions of dollars in settlements from foreign issuers.[1] The proliferation of f-cubed class actions has accelerated during the ongoing global financial crisis, as plaintiffs' lawyers and their clients have targeted foreign financial institutions that have suffered significant losses on mortgage-related and other investments in the U.S.[2]

Late last year, however, the Second Circuit issued a decision that significantly clarified the law governing f-cubed class actions. *Morrison v. National Australia Bank Ltd.*[3] affirmed the dismissal of an f-cubed case and carefully circumscribed the ability of the plaintiffs' bar to bring similar suits in the future. The case was closely watched by the securities industry and by trade organizations, and a number of amici curiae, including the Securities Industry and Financial Markets Association, the U.S. Chamber of Commerce, the Association Française des Enterprises Privées, the Association of Corporate Counsel, and the Washington Legal Foundation, filed or joined briefs supporting the defendants. The court of appeals invited the Securities and Exchange Commission to weigh in, and the SEC did so, with a brief supporting the plaintiffs.

The decision's importance arises from the similarity of its fact pattern with those of many other f-cubed securities class actions. The pattern goes something like this: A foreign company, most or all of whose equity trades on foreign exchanges, suffers and discloses a business reversal in its operations in the United States. The company's stock price falls on the foreign exchanges. American plaintiffs' lawyers succeed in recruiting foreign shareholders to file a class action against the foreign company in the United States, and then argue that the American securities laws should apply because the foreign plaintiffs suffered losses caused by "fraud" in the foreign company's American operations. Some district judges have dismissed claims like these; others have not.

National Australia Bank fit this pattern perfectly. The defendant issuer was National Australia Bank, or NAB, Australia's oldest bank. The bank's stock price on the Australian Stock Exchange dropped significantly in 2001 because of a large loss it had taken at HomeSide Lending, a Florida mortgage servicing company that was then NAB's wholly-owned subsidiary. The loss came from NAB's decision to write down the value of HomeSide's mortgage servicing rights, highly volatile and thinly-traded instruments that can be valued only with great difficulty through the use of complex predictive models. Australian purchasers of NAB's ordinary shares brought a class action in the Southern District of New York against NAB under Section 10(b) of the Securities Exchange Act of 1934 and SEC Rule 10b-5. The Australian named plaintiffs contended that a worldwide foreign class was proper under American law because the "fraud" allegedly had occurred at HomeSide, in Florida.[4]

The district court dismissed the case for lack of subject-matter jurisdiction,[5] and the Second Circuit affirmed. The court of appeals began its analysis by noting that it had never before addressed a similar case; the case was "the first 'foreign-cubed' securities class action to reach this Circuit" and thus presented a

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Fifth Circuit Expands False Claims Act *Qui Tam* Provisions in Time for Debate over Stimulus Package Fraud

by Randy J. Maniloff

> The potential for fraud exists in any government program and, certainly, in the situation presented by Hurricane Katrina where mass amounts of federal funds were expended in emergency and less-controlled conditions.
>
> *Branch Consultants v. Allstate,* Fifth Circuit [1]

Coincidentally, on the same day the Fifth Circuit was addressing the potential for fraud in government programs, President Barack Obama signed into law the American Recovery and Reinvestment Act.[2] This Act, generally referred to as "the Stimulus Package," is designed to jump-start the nation's struggling economy and combat rising unemployment by devoting $787 billion to a combination of tax cuts and investments in infrastructure, healthcare, energy, and education.[3]

As the Fifth Circuit noted about the potential for fraud in government programs, it is inherent, especially in those programs involving the emergency spending of mass amounts of federal funds. The Stimulus Package easily satisfies these criteria.

Indeed, the federal government has already announced guidelines aimed at mitigating Stimulus Package fraud and abuse.[4] Kinney Poynter, executive director of the National Association of State Auditors, Comptrollers and Treasurers described as follows the challenge of overseeing so much money being spent so quickly: "Speed and accuracy typically don't go hand in hand."[5] The Stimulus Package also contains no specific funding for state and local government oversight and accountability.[6] Not to mention that budget crunches have left many state auditing offices understaffed already.[7]

Hurricane Katrina provides a recent and well-documented example of what can happen when mass amounts of federal funds are expended in emergency and less-controlled conditions. By August 30, 2007, two years after Katrina struck, the U.S. Department of Justice's Hurricane Katrina Fraud Task Force had prosecuted more than 768 people with various hurricane fraud-related crimes. This is on top of state and local prosecutions.[8] Less than a year after Katrina hit it was reported that the federal government paid as much as $1.4 billion for fraudulent hurricane relief.[9]

The expenditure of large amounts of federal funds, under emergency conditions, is not unique. However, one aspect of the Stimulus Package is: its promised transparency. The federal government's website (www.recovery.gov), created for this specific purpose, states:

> The Recovery and Reinvestment Act is an extraordinary response to a crisis unlike any since the Great Depression. With much at stake, the Act provides for unprecedented levels of transparency and accountability so that you will be able to know how, when, and where your tax dollars are being spent. Spearheaded by a new Recovery Board, this Act contains built-in measures to root out waste, inefficiency, and unnecessary spending. This website, Recovery.gov, will be the main vehicle to provide each and every citizen with the ability to monitor the progress of the recovery.

Many states have also developed websites to monitor the spending of their own Stimulus Package dollars and private oversight efforts are also underway.[10]

False Claims Act's *Qui Tam* Provisions

With so many eyes following the Stimulus money—at least for now, until complacency invariably sets in for some—there is no doubt that some fraud will be detected and addressed. Of course, not everyone who detects fraud is going to be content to merely report it to the appropriate authority and move on. Opportunities will likely exist for some fraud detectors to share in the financial benefit of their efforts by pursuing claims under the False Claims Act's *qui tam* provisions.[11]

The False Claims Act is a federal statute, originally enacted in 1863, that provides for civil penalties against any person who, among other things, knowingly presents a false or fraudulent claim for payment to a contractor, grantee, or other recipient if the United States government provided any portion of the money or property which is requested or demanded.[12]

The False Claims Act also contains *qui tam* provisions that, in certain circumstances, permit suits by private parties, on behalf of the United States, against anyone who violates the Act.[13] The Act allows for a successful plaintiff, called a relator, to receive a percentage of any recovery based on the relative role of the relator and government in the case.[14] The Act contains certain provisions designed to ensure that the person bringing the action is the "original source" of the information on which the action is based.[15] The Act also does not require that the relator have any relationship to the allegedly fraudulent party or transaction.[16]

Needless to say, this is a vast oversimplification of a complex area of the law. The False Claims Act has centuries old underpinnings,[17] a labyrinth of procedural requirements,[18] a body of case law interpreting it that is legion[19] and has been the subject of significant scholarly attention—much of it devoted to its general use and Constitutional issues.[20] Even the name *qui tam* (pronounced kwe-tam) is complex. It is short for the Latin phrase *qui tam pro domino rege quam pro se ipso in hac parte sequitur*, which means "who pursues this action on our Lord the King's behalf as well as his own."[21]

But despite its size and complexity, the core purpose of the False Claims Act's *qui tam* provisions is the same today as it was when enacted in the nineteenth century:

> The statute is a remedial one. It is intended to protect the treasury against the hungry and unscrupulous host that encompasses it on every side, and should be construed accordingly. It was passed upon the theory, based on experience as old as modern civilization, that one of the least expensive and most effective means of preventing frauds on the treasury is to make the perpetrators of them liable to actions by private persons acting, if you please, under the strong stimulus of personal ill will or the hope of gain. Prosecutions conducted by such means compare with the ordinary methods as the enterprising privateer does to the slow-going public vessel.[22]

Job growth is clearly one of the goals of the Stimulus Package. If nothing else, it will succeed in creating employment opportunities for lawyers with False Claims Act experience.

Branch Consultants v. Allstate

Branch Consultants (2009) has expanded plaintiffs' ability to bring *qui tam* actions under the False Claims Act. At issue before the Fifth Circuit was an appeal of the Eastern District of Louisiana's dismissal of Branch Consultant's False Claims Act *qui tam* complaint against eight insurance companies and six adjusting firms. Branch's claim was based on fraud allegedly committed by the insurer-defendants in their role as participants in FEMA's "Write Your Own" flood insurance program (WYO). Under this program, private insurance companies issue and service flood insurance policies, but any claims are paid from the federal treasury.[23]

In the ordinary course, participating WYO insurers are required to comply with certain FEMA rules to ensure accurate estimates of flood damage. However, following Hurricane Katrina, FEMA was forced to waive certain of their rules in order to expedite payments to insureds.[24] In general, a significant issue in the adjustment of Katrina claims (and source of substantial litigation) was the apportionment between wind damage and flood damage. According to Branch, waiver of the FEMA rules "created a perverse incentive for WYO insurers to understate losses due to wind (which an insurer would be required to pay under the insured's homeowner's policy) and overstate losses due to flood, thereby shifting the loss from the WYO insurers to the federal government."[25]

At the time that Branch filed its *qui tam* action, a similar action—*Rigsby*—had already been filed and was under seal—pursuant to False Claims Act provisions.[26] It was alleged in the *Rigsby* complaint that four insurers in the WYO program "'made a corporate decision to misdirect and misallocate claims from those of hurricane coverage to flood claims' payable by the federal government."[27] The Rigsby plaintiffs made general allegations of fraud against the four WYO insurer-defendants and also made specific allegations of fraud against State Farm.[28]

In the *Branch Consultants* complaint, Branch—just as the Rigsbys had done—generally alleged that the WYO insurer defendants defrauded the National Flood Insurance Program by improperly attributing wind damage and other non-flood losses to the flood policies subsidized or underwritten by the government. By doing so, the defendants were allegedly able to avoid attributing such losses to causes that were covered by homeowners policies largely underwritten by themselves.[29]

However, Branch also went a step further, by detailing fifty-seven claimed instances of fraud, including the homeowner's address, insurance company and policy number, the amount of flood damage paid by the federal government, and a dollar amount and explanation of the 'true' flood damage to the properties. *Branch*, like *Rigsby*, named State Farm and Allstate as defendants, but also named WYO insurers that the Rigsbys did not sue.[30]

The district court granted the defendants' motion to dismiss the Branch complaint on the basis of the False Claims Act's "first-to-file" bar.[31] This provision deprives the court of jurisdiction over a *qui tam* suit if the claim has already been filed by another. The district court held that the Branch complaint alleged the "same general conduct and theory of fraud" as the *Rigsby* complaint "regardless of whether Branch alleged different details, different geographic locations, or other participants in the alleged scheme."[32]

The *qui tam* provision's first-to-file bar is designed to balance two competing policy goals: encourage whistleblowers with genuinely valuable information to act as private attorneys general in bringing suits for the common good, while discouraging opportunistic plaintiffs from filing parasitic lawsuits that merely feed off previous disclosures of fraud.[33]

On appeal to the Fifth Circuit, the court upheld the dismissal of State Farm and Allstate on the basis that the first-to-file bar cannot be avoided by "simply adding factual details or geographic locations to the essential or material elements of a fraud claim against the same defendant described in a prior compliant."[34] This would not help to reduce fraud because once the government has the essential facts of the fraud, it can discover related fraud itself. This would also lead to infinite copy cat *qui tam* suits by simply alleging one additional instance of the previously exposed fraud.[35]

However, the Fifth Circuit was not as generous to the other defendants in the Branch suit. The court noted that no circuit has directly addressed the issue before it—whether allegations in a first-filed action can bar a subsequent *qui tam* action based on related allegations but filed against unrelated defendants.[36] Looking to analogous situations for guidance, such as an action filed against a corporation followed by a subsequent action alleging fraud against the corporation's subsidiaries, the *Branch Consultants* court concluded as follows:

> [T]here might be situations in which the allegations in a first-filed complaint pertain to such a narrow or readily-identifiable group of potential wrongdoers that § 3730(b)(5) acts to bar subsequent allegations against previously unnamed defendants. But that is not the case here. *Rigsby* does not allege a true industry-wide fraud or concerted action among a narrow group of participants. Rather, looking only at the facts pleaded (not any public information, which is not part of the first-to-file analysis), *Rigsby* implicates, at most, four specific WYO insurers among the approximately ninety-five WYO insurers conducting business in the Louisiana and Mississippi areas during Hurricane Katrina. Thus, *Rigsby* tells the government nothing about which of the ninety-one other WYO insurers (and adjusting firms working for or with those insurers), if any, actually engaged in any fraud.
>
> * * *
>
> Thus, in combing through a host of WYO insurers and identifying those specific insurers and adjusting firms that may have committed wind/water fraud, Branch likely revealed instances of fraud that would have otherwise eluded the government.

Thus, the Fifth Circuit held that the False Claims Act's first-to-file rule was not a bar to the Branch complaint against all defendants except State Farm and Allstate.[37]

CONCLUSION

There is no doubt that the False Claims Act's *qui tam* provisions will be busy once the numerous government programs to be funded by the Stimulus Package get underway. Even without the transparency set to accompany the Stimulus Package, some fraud would be detected. But with Stimulus Package spending to be under a microscope, fraud detection is poised to be significant.

It is too soon to say if *Branch Consultants's* narrow interpretation of the False Claims Act's first-to-file bar will result in an increase in the number of *qui tam* actions that can be brought following an initial *qui tam* filing related to the same scheme. That will depend upon the scope of the program, number of participants and whether the initial *qui tam* action alleged program-wide fraud or involved a concerted action among a narrow group of participants.

Just as the Stimulus Package will be accompanied by individuals looking to unlawfully profit from the federal government's largesse, they will be followed closely behind by some looking to profit off of the profiteers. Whether such actions serve the public good has been the subject of much debate and no consensus has been reached.[38] One comprehensive empirical study of this issue concluded that "[W]hile *qui tam* provisions lead to frivolous suits, they still serve the public interest through both enhanced detection and deterrence, although the degree to which they serve this interest is not nearly as great as proponents argue."[39]

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Endnotes

1 United States *ex rel.* Branch Consultants v. Allstate Ins. Co., No. 07-31191, 2009 U.S. App. LEXIS 3503, at *22-3 (5th Cir. 2009).

2 American Recovery and Reinvestment Act of 2009, Pub. L. No. 111-5.

3 *Id.*, § 3; *see also* Laura Meckler, *Obama Signs Stimulus Into Law*, Wall St. J., Feb. 18, 2009, *available at* http://online.wsj.com/article/SB123487951033799545.html.

4 Initial Implementing Guidance for the American Recovery and Reinvestment Act of 2009, *available at* (last viewed Mar. 27, 2009) http://www.recovery.gov/files/Initial%20Recovery%20Act%20Implementing%20Guidance.pdf.

5 Carolyn O'Hara, *Concerns Emerge on Prevention of Stimulus Fraud*, Online Newshour, Mar. 19, 2009, available at http://www.pbs.org/newshour/updates/business/jan-june09/stimulus_fraud_03-19.html.

6 *Id.*

7 *Id.*

8 U.S. Department of Justice Hurricane Katrina Fraud Task Force, *Second Year Report to the Attorney General* 3, September 2007, *available at* http://www.usdoj.gov/katrina/Katrina_Fraud/docs/09-04-07AG2ndyrprogrpt.pdf.

9 *Report: $1.4 Billion Went to Fraudulent Aid for Katrina Victims*, Fox News, June 14, 2006, *available at* http://www.foxnews.com/story/0,2933,199348,00.html.

10 *See* StimulusWatch.org (created by Jerry Brito, senior research fellow at the Mercatus Center at George Mason University); *see also* Tracking State's Spending Trackers, *available at* www.propublica.org/special/chart-tracking-states-spending-trackers, for a list of each state's efforts and websites devoted to transparency vis-à-vis Stimulus spending.

11 31 U.S.C. §§ 3729-3733.

12 31 U.S.C. § 3729(a)(1), (c).

13 United States *ex rel.*Laird v. Lockheed Martin Eng'g & Science Serv. Co., 336 F.3d 346, 351 (5th Cir. 2003); 31 U.S.C. § 3730.

14 31 U.S.C. § 3730(d).

15 31 U.S.C. § 3730(e).

16 United States *ex rel.* Atkinson v. Pa. Shipbuilding Co., 473 F.3d 506, 523 n.23 (3rd Cir. 2007) ("Although the FCA was most concerned with encouraging whistle-blowing by insiders with first-hand knowledge, neither the text of the FCA nor its legislative history suggests that non-insiders should never be able to bring *qui tam* actions. The public disclosure and original source provisions provide sufficient protection against inappropriate suits by relators without sufficient direct and independent knowledge.")

17 "Statutes providing for actions by a common informer, who himself has no interest whatever in the controversy other than that given by statute, have been in existence for hundreds of years in England, and in this country ever since the foundation of our Government[.]" United States *ex rel.* Marcus v. Hess, 317 U.S. 537, 542 (1943) (quoting Marvin v. Trout, 199 U.S. 212, 225 (1905)).

18 31 U.S.C. § 3730.

19 Shepardizing 31 U.S.C. § 3729 (defining a False Claims Act violation and the basis for a *qui tam* claim) at the time of this writing returned 2,754 citing decisions.

20 Christina Orsini Broderick, *Note: Qui Tam Provisions and the Public Interest: An Empirical Analysis*, 107 Colum. L. Rev. 949, 949 (2007).

21 Vt. Agency of Natural Res. v. United States *ex rel.* Stevens, 529 U.S. 765, 769, n.1 (2000).

22 United States v. Griswold, 24 F. 361, 366 (D. Or. 1885).

23 United States *ex rel.* Branch Consultants v. Allstate Ins. Co., No. 07-31191, 2009 U.S. App. LEXIS 3503, at *4-5 (5th Cir. 2009).

24 *Id.* at *5.

25 *Id.* at *6.

26 By way of background, the Rigsby action was filed by Richard "Dickie" Scruggs, the once powerhouse, and now disgraced, plaintiffs' lawyer well-known for massive settlements in asbestos, tobacco and Katrina insurance litigation. Mr. Scruggs plead guilty in 2008 to attempted judicial bribery in unrelated Katrina litigation. The *Rigsby* action marches on, but without Mr. Scruggs, who is currently making license plates at a federal prison in Kentucky.

27 Branch Consultants at *6.

28 *Id.*

29 *Id.* at *8-9.

30 *Id.*

31 31 U.S.C. § 3730(b)(5).

32 Branch Consultants at *10.

33 *Id* at 12.

34 *Id.* at *17.

35 *Id.*

36 *Id.* at 20.

37 As an aside, the Office of Inspector General of the Department of Homeland Security concluded in a September 2008 report that, based on the claims that it examined, the National Flood Insurance Program did not pay for wind damage and engineering reports generally supported flood damage. Office of Inspector General of the Department of Homeland Security, *Hurricane Katrina: Wind Versus Flood Issues* 5, September 2008, *available at* http://www.dhs.gov/xoig/assets/mgmtrpts/OIG_08-97_Sep08.pdf.

38 *See* Broderick, *supra* note 20, at 949.

39 *Id.* at 951.

Second Circuit Affirms Dismissal of "F-Cubed" Securities Class Action

Continued from page 6

"novel" and "unusual fact-pattern" for the court.[6] The court nevertheless observed that "the usual rules" governing the extraterritorial application of the federal securities laws "still apply."[7] The "usual rules" involved the application of what the Second Circuit has called the "conduct test" for jurisdiction under the federal securities laws: "subject matter jurisdiction exists over the claims only if 'the defendant's conduct in the United States was more than merely preparatory to the fraud, and particular acts or culpable failures to act within the United States directly caused losses to foreign investors abroad.'"[8] Application of the conduct test requires a court to "identify which action or actions constituted the fraud and directly caused harm, ... and then determine if that act or those actions emanated from the United States."[9]

The Second Circuit held that the presumption against extraterritoriality did not require the court to adopt a "bright-line ban" that would "declin[e] jurisdiction over all 'foreign-cubed' securities fraud actions."[10] That "'longstanding principle'" of statutory construction maintains that that "legislation of Congress, unless a contrary intent appears, is meant to apply only within the territorial jurisdiction of the United States."[11] The presumption flows from a number of considerations, one being "the commonsense notion that Congress generally legislates with domestic concerns in mind,"[12] another being that it "serves to protect against unintended clashes between our laws and those of other nations which could result in international discord."[13] The Second Circuit concluded that this canon of statutory construction did not mandate a black-letter rule, because in its view extraterritorial application of American securities laws presented less potential for international discord than other kinds of statutes: "anti-fraud enforcement objectives are broadly similar as governments and other regulators are generally in agreement that fraud should be discouraged."[14]

The court also stated that it was "leery of rigid bright-line rules because we cannot anticipate all of the circumstances in which the ingenuity of those inclined to violate the securities laws should result in their being subject to American jurisdiction."[15] Still, the court emphasized that "we are an American court, not the world's court, and we cannot and should not expend our resources resolving cases that do not affect Americans or involve fraud emanating from America."[16] "In our view," the Second Circuit accordingly concluded, "the 'conduct test' balances the[] competing concerns adequately."[17] The court "declined to place any special limits beyond the 'conduct test' on 'foreign-cubed' securities fraud actions."[18]

The court thus went on to apply its longstanding "conduct test," and, in doing so, noted that the analysis "boils down to what conduct comprises the heart of the alleged fraud."[19] The parties presented competing views of the alleged fraud: The plaintiffs argued that the heart of the claimed fraud took place in Florida, given "that the alleged manipulation of the [mortgage servicing rights] in Florida made up the main part of the fraud since those false numbers constituted the misleading information passed on to investors through NAB's public statements."[20] Essentially, the plaintiffs argued that the conduct test could be met by but-for causation: "if HomeSide had not created and sent artificially inflated numbers up to its parent company, there would have been no fraud, no harm to purchasers, and no claims under Rule 10b-5."[21] In contrast, the defendants emphasized that the conduct test required *direct* causation, and that "the only conduct that directly caused harm to investors occurred in Australia": that without "the allegedly false and misleading public statements" made by NAB in Australia, "no misinformation would have been reported, no investors would have been defrauded, and no actionable claims would have existed under Rule 10b-5."[22]

The court of appeals agreed with the defendants. "[T]he actions taken and the actions not taken by NAB in Australia," the court concluded, were "significantly more central to the [alleged] fraud and more directly responsible for the harm to investors than the manipulation of the numbers in Florida."[23] The court based this conclusion upon three factors. The first was the fact that it was NAB in Australia, not HomeSide in Florida, that was "the publicly-traded company," and that accordingly it was NAB's Australian "executives—assisted by lawyers, accountants, and bankers—[who took] primary responsibility for the corporation's public filings, for its relations with investors, and for its statements to the outside world."[24] This fact was critical to the causation analysis because the plaintiffs had relied on Rule 10b-5(b), which "focuses on the accuracy of *statements* to the public and to potential investors," and "[l]iability [thus] requires a false or misleading statement" to investors.[25]

The second "significant factor at play," the court explained, was the striking absence of any allegation that the alleged fraud affected American investors or America's capital markets."[26] The fact that the plaintiffs "do not contend that what [defendants] allegedly did had any meaningful effect on America's investors or its capital markets... weighs against our exercise of subject matter jurisdiction."[27]

The third and final factor highlighted by the Second Circuit was the "lengthy chain of causation between the American contribution to the [alleged] misstatements and the harm to investors."[28] "HomeSide sent allegedly falsified numbers to Australia," the court observed, but the plaintiffs did not "contend that HomeSide sent any falsified any falsified numbers directly to investors."[29] Instead, the "numbers had to pass through a number of checkpoints manned by NAB's Australian personnel before reaching investors."[30] As a result, there was a "lengthy chain of causation between what HomeSide did and the harm to investors," which "weighs against our exercise of subject matter jurisdiction."[31] "This particular mix of factors," concluded the court, "add[s] up to a determination that we lack subject matter jurisdiction."[32]

Although the Second Circuit's refusal to adopt a bright-line rule barring f-cubed cases stands in some tension with the Supreme Court's case law on the presumption of extraterritoriality, the result reached by the Second Circuit in *National Australia Bank* is nonetheless consistent with the presumption and represents a significant victory for foreign companies. In particular, the Second Circuit's take on the presumption against extraterritoriality—that it should apply less vigorously in securities litigation because other nations prohibit securities fraud—cannot be squared with the Supreme Court's extraterritoriality precedents, particularly those of recent years. The Supreme Court has emphasized that the presumption against extraterritoriality fully applies even when other nations generally prohibit the same conduct prohibited under American law. The reason is that the remedies here and abroad may differ, and differ quite significantly: as the Court has explained, "even where nations agree" on what should be illegal, they could "disagree dramatically about appropriate remedies," creating the risk that "apply[ing] our remedies would unjustifiably permit [foreign] citizens to bypass their [countries'] own less generous remedial schemes, thereby upsetting a balance of competing considerations that their own domestic... laws embody."[33]

Still, the bottom-line result reached by Second

Circuit—affirmance of a dismissal—is consistent with the result compelled by the presumption against extraterritoriality. And the ruling will have a broader practical effect than the court's stated reliance on a "particular mix of factors" involving "novel[]" and "unique" circumstances would at first suggest. For the particular circumstances present in *National Australia Bank*—harm caused by statements made abroad, absence of domestic effect, and a lengthy chain of causation between domestic conduct and foreign harm—may be found in most of the f-cubed class actions that have been brought in recent years. The decision makes clear that the crucial consideration in determining whether a United States court can hear an "f-cubed" case is where the issuer prepares and issues its disclosures, and for a foreign issuer, that is almost always in a foreign country. Accordingly, when foreign investors suffer losses on foreign exchanges as the result of statements made in foreign countries by foreign issuers, those investors will now find it very difficult to maintain claims under the American securities laws in the typical f-cubed class action. If district courts faithfully follow *National Australia Bank*, much of the current wave of "f-cubed" securities class action litigation will be dismissed.

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Endnotes

1 For more extensive discussions of the phenomenon of and the issues surrounding f-cubed securities litigation, see George T. Conway III, *The Rise and (Coming) Fall of "F-Cubed" Securities Litigation*, Engage, Feb. 2009, at 33; Hanna L. Buxbaum, *Multinational Class Actions Under Federal Securities Law: Managing Jurisdictional Conflict*, 46 Colum. J. Transnat'l L. 14 (2007); Stephen J. Choi and Linda J. Silberman, *Transnational Litigation and Global Securities Class Actions*, http://ssrn.com/abstract=1327502; John C. Coffee, Jr., *Securities Policeman to the World? The Cost of Global Class Actions,* N.Y.L.J., Sept. 18, 2008, at 5; Andrew Longstreth, *Coming to America*, Am. Law., Nov. 2006, *available at* 11/2006 Am. Law. S53 (Westlaw); Mary Jacoby, *For the Tort Bar, A New Client Base: European Investors*, Wall St. J., Sept. 2, 2005, at A1.

2 *See*, *e.g.*, Cornwell v. Credit Suisse Group, No. 08 Civ. 3758 (VM) (S.D.N.Y. filed Apr. 21, 2008); In re Société Générale Sec. Litig., No. 08 Civ. 2495 (GEL) (S.D.N.Y. filed Mar. 12, 2008); In re UBS AG Sec. Litig., No 07 Civ. 11225 (RJS) (S.D.N.Y. filed Dec. 13, 2007).

3 547 F.3d 167 (2d Cir. 2008), *petition for cert. filed*, 2009 WL 770682 (U.S. filed Mar. 23, 2009) (No. 08-1191).

4 *See id.* at 168-71.

5 In re Nat'l Austl. Bank Sec. Litig., No. 03 Civ. 6537 (BSJ), 2006 WL 3844465 (S.D.N.Y. Oct. 25, 2006), *aff'd sub nom.* Morrison v. Nat'l Austl. Bank Ltd., 547 F.3d 167 (2d Cir. 2008), *petition for cert. filed*, 2009 WL 770682 (U.S. filed Mar. 23, 2009) (No. 08-1191).

6 547 F.3d at 172.

7 *Id.*

8 *Id.* (quoting Alfadda v. Fenn, 935 F.2d 475, 478 (2d Cir. 1991)).

9 *Id.* at 173.

10 *Id.* at 175.

11 *Id.* at 174 (quoting Smith v. United States, 507 U.S. 197, 204 (1993)).

12 *Smith*, 507 U.S. at 204 n.5.

13 EEOC v. Arabian Am. Oil Co., 499 U.S. 244, 248 (1991).

14 547 F.3d at 175.

15 *Id.*

16 *Id.*

17 *Id.*

18 *Id.*

19 *Id.*

20 *Id.*

21 *Id.*

22 *Id.* at 175-76.

23 *Id.* at 176.

24 *Id.*

25 *Id.*

26 *Id.*

27 *Id.*

28 *Id.*

29 *Id.*

30 *Id.* at 176-77.

31 *Id.* at 177.

32 *Id.*

33 F. Hoffmann-La Roche Ltd. v. Empagran S.A., 542 U.S. 155, 167 (2003).

Fifth Circuit Applies CAFA to LA AG Action

Continued from page 1

the litigation was properly removed pursuant to CAFA. In a two-to-one panel decision, the Fifth Circuit held that federal jurisdiction existed under CAFA, affirming the district court's denial of the state's motion to remand based upon lack of jurisdiction.[1]

I. The State Court Petition and the District Court's Decision

Attorney General Charles Foti's suit was filed on November 7, 2007, in the Civil District Court for the Parish of Orleans, against Allstate Insurance Company, Lafayette Insurance Company, Xactware Solutions, Inc., Marshall & Swift/Boeckh, LLC ("MSB"), Insurance Services Office, Inc. ("ISO"), State Farm and Casualty Company, USAA Casualty Insurance Company, Farmers Insurance Exchange, Standard Fire Insurance Company, and McKinsey & Company, Inc. ("McKinsey").[2] The petition asserted a cause of action under the Louisiana Monopolies Act,[3] alleging that the defendants acted together in order to suppress competition in the insurance industry in Louisiana.[4] The state alleged that the insurance companies had engaged "in a scheme to thwart policyholder indemnity" by

> manipulat[ing] Louisiana commerce by rigging the value of policyholder claims and raising the premiums held in trust by their companies for the benefit of policyholders to cover their losses as taught by McKinsey Corporation.[5]

According to the state, beginning in the 1980s, McKinsey had developed a strategy for insurance companies meant to maximize their profits at the expense of policyholders by advising insurance companies to "deny, delay, and defend" in order to undervalue claims and avoid "premium leakage."[6] ISO and MSB, according to Louisiana, "strengthened" the McKinsey strategy by providing software and other programs that "were manipulated to reduce the value of claims."[7] The result of these alleged acts was to reduce the value of and underpay on claims following Hurricanes Katrina and Rita.[8] As a result, according to the state, there was "[a]n agreement, combination or conspiracy between all the defendants, and other unnamed competing insurance companies, [that] existed, at all material times …, to horizontally fix the prices of repair services utilized in calculating the amount(s) to be paid under the terms of the Louisiana insured's insurance contracts with insurers for covered damage to immoveable property."[9] The case asserted that the defendants engaged in price fixing. Louisiana sought damages, including treble damages, and injunctive relief.[10]

The defendants timely filed a notice of removal to transfer this lawsuit to the United States District Court for the Eastern District of Louisiana.[11] The defendants argued that removal was proper under CAFA.[12] The thrust of the defendants' argument was that although the case was styled as a parens patriae action, it was truly a "class action" under CAFA, and, as such, removable to federal court.[13] The defendants argued that the district court must look beyond the pleadings and that Louisiana cannot avoid CAFA by styling its class action claims as a parens patriae action.[14] Alternatively, the defendants argued that the action was a "mass action" under CAFA and therefore removable.[15] The state moved to remand the case to state court arguing that CAFA was inapplicable because the case was not a class action; the general understanding of Congress was that CAFA was inapplicable to state attorneys general's parens patriae actions.[16] The state also argued that the Eleventh Amendment required remand.[17]

But after a hearing on the motion, the district court denied Louisiana's motion.[18] District Judge Jay Zainey agreed with the defendants that the state was required to "pierce the pleadings" to determine the real nature of the action; the judge concluded that the real parties in interest were the policyholders and that the state was a nominal party to the action.[19] Louisiana sought permission from the district court to appeal the denial of its motion to remand, and the district court granted the request.[20]

II. Parens Patriae Actions and CAFA

The *Caldwell* case involves the intersection of parens patriae actions and CAFA. As such, a brief discussion of both is warranted.

The Latin term "parens patriae" means the "parent of the country," and is the term used to label actions to vindicate a state's sovereign and quasi-sovereign interests.[21] The parens patriae concept originated under English law.[22] It typically referenced "the King's power as guardian over people who lacked the legal capacity to act for themselves."[23] American courts have expanded this concept.[24]

As the concept has developed in American courts, for a state to have standing to assert a parens patriae claim, the state must assert an interest related its sovereign interests.[25] When a state asserts a sovereign interest, it "does not involve the States stepping in to represent the interests of particular citizens who, for whatever reason, cannot represent themselves."[26] If the state is doing so, it is merely a nominal party without any real interest of its own, and "to have … standing the State must assert an injury to what has been characterized as a 'quasi-sovereign' interest, which is a judicial construct that does not lend itself to a simple or exact definition."[27]

In one example where the Supreme Court has limited the reach of parens patriae actions, involving a state's standing to sue for violations of federal anti-trust laws, the Supreme Court held that while the state could sue for damages under the Sherman Act in the state's proprietary capacity, it did not have standing to bring a parens patriae action to recover injuries to its general economy.[28]

CAFA, by contrast, enacted in 2005, was designed to address perceived widespread "abuses of the class action device."[29] Congress, in passing CAFA, noted a litany of such abuses, including: harming class members with legitimate claims; harming defendants that have acted responsibly; and undermining public respect for the judicial system.[30] To help stem some of these abuses, CAFA did two things. First, it expanded the federal courts' jurisdiction over interstate class actions.[31] Second, it subjected class actions to new procedures designed to impose more scrutiny on settlements.[32] In sum, the Act was designed for more class actions to be heard and decided by federal rather than state courts.[33]

CAFA also created a new type of action permitting removal to federal court: the "mass action."[34] A "mass action" is defined as "any civil action… in which monetary relief claims of 100 or more persons are proposed to be tried jointly on the ground that the plaintiff's claims involve common questions of law or fact."[35] CAFA specifically excludes from the definition of a mass action lawsuits when all of the claims arise from an event in the state where the action was filed and that allegedly resulted in injuries in that state or contiguous states, claims that are joined by the defendant, claims asserted on behalf of the general public pursuant to state statutes, and claims that are consolidated solely for pretrial proceedings.[36]

III. The Fifth Circuit's Decision

The Fifth Circuit affirmed the district judge's decision on appeal, and held that the case was removable under CAFA. The issue in the case, as the Fifth Circuit discerned it, was whether "the Attorney General is only a nominal party, and [whether] the policy holders are the real parties in interest," and if so, "then the nature of the claims asserted must be examined in order to determine if they are removable under CAFA."[37] The court began its discussion by examining the jurisprudence regarding parens patriae actions.[38] It defined the issue fairly narrowly, as whether the real parties in interest were "the individual policyholders or the State."[39] The court concluded that the policyholders were.[40]

Quoting a district court from New Jersey, the Fifth Circuit stated that "[t]he state is the real party in interest when an action concerns a type of 'injury' that the state either has addressed or would likely attempt to address through its laws to further the 'well-being of its populace.'"[41] As an initial matter, it agreed with the state that the attorney general did have authority to bring a parens patriae action alleging violations of Louisiana's anti-trust laws.[42] However, section 137 of the Louisiana Monopolies Act provides for the recovery of treble damages and states that "any *person* who is injured in his business or property by reason of any act or thing forbidden by [the Louisiana Monopolies Act]… shall recover threefold damages sustained by him."[43] The language of section 137, according to the Fifth Circuit, was clear in that "individuals have the right to enforce this provision."[44] The court also pointed to a lawsuit which, in its view, "makes clear that [the state] is seeking to recover damages by *individual policyholders*."[45]

The court was "mindful" of the fact that Louisiana also sought injunctive relief as part of its petition, and stated that "[i]f Louisiana were only seeking that remedy, which is clearly on behalf of the State, its argument that it is the only real party in interest would be much more compelling."[46] It raised the possibility that, upon remand to the district court, the state's claims could be severed so that the claims that were removable under CAFA would remain in federal court but that Louisiana's other cases would be remanded to state court.[47]

While the Fifth Circuit never explicitly stated so, this portion of its decision was necessary considering the exclusion of claims "asserted on behalf of the general public (and not on behalf of individual claimants or members of a purported class) pursuant to a state statute specifically authorizing such action."[48] This exclusion from the definition of mass action appears to be designed to exclude parens patriae actions from the gambit of CAFA. By holding that the policyholders were the true parties in interest (and not the state), the action was, according to the Fifth Circuit, removable under the CAFA mass action provision.

From there, the court held that the action was properly removed "because the requirements of a 'mass action' are easily met given the factual circumstances of this case."[49] Specifically, the court stated that the action involved over 100 claimants whose claims were proposed to be tried jointly on the ground that the claims involve common questions of law or fact.[50] The aggregate amount at issue was at least $5 million, the case had minimal diversity, and the case was brought in a representative capacity.[51] The Fifth Circuit also held that because the case was properly removed as a "mass action" under CAFA, there was no need to consider whether the case could proceed as a "class action" under CAFA.[52]

Finally, the Fifth Circuit addressed Louisiana's argument that the Eleventh Amendment prevented the case from being removed.[53] The court had previously addressed the issue of Eleventh Amendment immunity in the context of a class action brought by Louisiana in *Louisiana v. AAA Insurance Company* (hereinafter "*Road Home*").[54] There, a different panel of the Fifth Circuit held that because the state joined private parties in the lawsuit, the state waived its Eleventh Amendment immunity.[55] The majority in *Allstate* stated that it was bound by the court's decision in *Road Home* because the policyholders are the real parties in interest, despite the fact that Louisiana was the only named plaintiff.[56]

IV. The Dissent

Judge Southwick dissented from the majority's opinion. In dissent, Southwick stated that he would not have reached the issue of who the real party in interest was.[57] Instead, the court "should determine what the case is, not what it must be if all of the relief requested is to be part of the litigation."[58] While Southwick agreed that the court was not bound by the plaintiff's label of the case, he "did not agree… that piercing the pleadings reveals a federal case."[59]

The dissent starts with the underlying propositions that a plaintiff is the master of his complaint, and that doubts as to the propriety of removal are resolved in favor of remand.[60] With that, the judge stated that the attorney general "has simply filed a defective pleading under Louisiana law";[61] in order to be a class action under CAFA, the case must be brought under a statute or rule that authorizes a representative action as a class action.[62] But here the case was not brought under Louisiana's version of Rule 23, and Southwick did not believe that the Louisiana Monopolies Act "cast the Attorney General in the role of a Rule 23 class representative every time he seeks to enforce its provisions."[63] Further, Southwick stated that CAFA's mass action provision did not confer federal jurisdiction, "simply because the removing party suggests that the best way to cure a defective pleading is to join 100 additional parties."[64] Southwick also expressed what he referred to as "prudential concerns" as to why the case should be remanded to state court.[65] Considering the fact that CAFA eliminated the one-year limitation on removal, Southwick opined that the case should be remanded to state court so that the issues decided by the majority (namely who the real parties in interest are and whether the attorney general can seek treble damages through a parens patriae action) could be decided by the state court.[66]

CONCLUSION

To date, the Fifth Circuit's decision in *Caldwell* has yet to be relied on by another court determining whether a lawsuit titled as a parens patriae action is removable under CAFA. *Caldwell* does, however, show that the Fifth Circuit takes seriously Congress' statement that CAFA's "application should not be confined solely to lawsuits that are labeled 'class actions' by the named plaintiff or the state rulemaking authority," and that "lawsuits that resemble a purported class action should be considered class action[s] for the purpose of applying [CAFA]."[67]

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Endnotes

1 Louisiana, ex rel, James D. Caldwell v. Allstate Insurance Company, 536 F.3d 418 (5th Cir. 2008) (Stewart, J.).

2 Caldwell, 536 F.3d at 421-22. Attorney General Foti lost his bid for reelection before the Fifth Circuit issued its decision in the case.

3 La. R.S. 51:123, et seq.

4 *Id*. at 422.

5 *Id*.

6 *Id*. For a further discussion of McKinsey's strategy advice to various insurance companies, *see*, *Web-Extended Interview: Darrell Preston*, Week of August 17, 2007, *available at* http://www.pbs.org/now/shows/333/insurance-industry.html (last visited February 27, 2009); *In Tough Hands At Allstate*, BusinessWeek, May 1, 2006, *available at* http://www.businessweek.com/magazine/content/06_18/b3982072.htm (last visited February 27, 2009).

7 *Caldwell*, 536 F.3d at 422.

8 *Id*.

9 *Id*. at 422-23.

10 *Id*. at 423.

11 *Id*. at 421-22.

12 *Id*. at 423.

13 *Id*.

14 *Id*. at 423.

15 *Id*.

16 *Id*. at 423, 424.

17 *Id*. at 431.

18 *Id*.

19 *Id*.

20 *Id*.

21 Richard P. Ieyoub & Theodore Eisenberg*, State Attorney General Actions, The Tobacco Litigation, and The Doctrine of Parens Patriae*, 74 Tul. L. Rev. 1859 (2000).

22 Hawaii v. Standard Oil Co. of Ca., 405 U.S. 251, 257 (1982).

23 *Id*.

24 Ieyoub & Eisenberg, 74 Tul. L. Rev. at 1863-71.

25 *Id*. at 1865.

26 Alfred L. Snapp & Son, Inc. v. Puerto Rico, 458 U.S. 592, 600 (1982).

27 *Id*. at 601.

28 *Standard Oil*, 405 U.S. at 260-65.

29 Pub. L. No. 109-2, §2, 119 Stat. 4 (Feb. 18, 2005) (codified as amended in various sections of 28 U.S.C.).

30 Pub. L. No. 109-2 at §§ 2-4.

31 *See* 28 U.S.C. § 1332.

32 *See* 28 U.S.C. § 1715.

33 For a more in depth discussion of the purposes behind CAFA and case law interpreting it, *see* Julia B. Strickland, Lisa M. Simonetti & Stephen J. Newman, 2007 Overview of the Class Action Fairness Act, Litigation and Administrative Practice Course Handbook Series Litigation, PLI Order No. 11372 (July 12-13, 2007).

34 28 U.S.C. § 1332(d)(11)(A).

35 28 U.S.C. §1332(d)(11)(B)(i).

36 28 U.S.C. § 1332(d)(11)(B)(ii).

37 *Caldwell*, 536 F.3d at 428.

38 *Id*. at 425-27.

39 *Id*. at 429.

40 *Id*. at 429-30.

41 *Id*. at 428 (quoting Harvey v. Blockbuster, 384 F. Supp. 2d 749, 755 (D.N.J. 2005)).

42 Section 158 of the Louisiana Monopolies Act provides that "[a]ll suits for the enforcement of this Part shall be instituted in the district courts by the Attorney General, on his own motion or by direction of the governor, or by the district attorney, acting under instruction of the governor or Attorney General; but when the penalty of imprisonment is demanded, the prosecution shall be in accordance with the provisions regulating criminal procedure." La. R.S. 51:158. Further, section 128 of the Louisiana Monopolies Act provides that "[t]he district courts have jurisdiction to prevent and restrain violation of this Part, and the Attorney General or the district attorneys in their respective districts under the direction of the Attorney General or the governor, shall institute proceedings to prevent and restrain violations." La. R.S. 51:128.

43 *Caldwell*, 536 F.3d at 428 (citing La. R.S. 51:137) (emphasis added).

44 *Id.* at 429.

45 *Id*. (emphasis in original).

46 *Id*.

47 On remand, Louisiana did move to sever its claims; the district court, however, granted the defendants' motions to dismiss the case and therefore denied the State's motion to sever.

48 28 U.S.C. § 1332(d)(11)(B)(ii)(III).

49 *Caldwell*, 536 F.3d at 430.

50 *Id.*

51 *Id.* While likely satisfied as well, the Fifth Circuit failed to discuss whether at least one plaintiff's claim exceeded $75,000. *See Caldwell*, 536 F.3d at 430. Two other Circuits have held that in order for a "mass action" to be removable under CAFA, at least one plaintiff's claim must exceed $75,000. *See, e.g.,* Abrego Abrego v. Dow Chemical Co., 443 F.3d 676 (9th Cir. 2006); Lowery v. Alabama Power Co., 483 F.3d 1184 (11th Cir. 2007).

52 *Caldwell*, 536 F3d at 430.

53 *Id.* at 430-32.

54 The Fifth Circuit's *Road Home* decision is cited as Louisiana v. AAA Insurance Company, 524 F.3d 700 (5th Cir. 2008).

55 *Caldwell*, 536 F.3d at 431.

56 *Id.* at 431-32.

57 *Id.* at 434 (Southwick, J., dissenting).

58 *Id.* at 432-33.

59 *Id.* at 433.

60 *Id.*

61 *Id.* at 434.

62 *Id.* at 433-34.

63 *Id.*

64 *Id.* at 435.

65 *Id.* at 435-36.

66 *Id.*

67 *Id.* at 424 (quoting S. Rep. No. 109-14, at 35 (2005), U.S. Code Cong. & Admin. News 2005, 3).

Recent Wave of Case Law Rejects "Concealed Defect" Class Actions

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period has expired[, a] rule that would make failure of a part actionable based on such 'knowledge' would render meaningless time/mileage limitations in warranty coverage."[18]

Like some of the other concepts addressed earlier, the rule rejecting warranty-based claims based on allegations of "known defects" has long been recognized by U.S. courts.[19] But until recently, courts had been very reluctant to apply this rule to fraud-based concealed defect claims. Here, too, however, the tide has turned. For example, in *Duffy v. Samsung Electronics America, Inc.*, the plaintiff claimed a concealed defect in "membrane panels" of certain Samsung microwaves that created a fire hazard. Making a variant of the newer argument discussed above, counsel contended that the warranty's terms should be ignored because "this is not a case where the manufacturer failed to disclose the abstract proposition that products may wear out after the warranty expires, but one where it concealed a known safety hazard that could have been corrected during the warranty period."[20] *Duffy* rejected this distinction, and held the plaintiff to the expectation established by the warranty: "To recognize Plaintiff's claim would essentially extend the warranty period beyond that to which the parties agreed."[21]

Hoey v. Sony Electronics, Inc. reached a similar conclusion.[22] This case involved an alleged concealment of a soldering "defect" in certain VAIO notebook computers that purportedly caused the computers to fail prematurely at an inordinate rate. "Plaintiffs advance[d] the theory that Sony had a duty to disclose the defect because plaintiffs would have had the expectation that a notebook computer would operate defect-free for more than one year," the term of Sony's warranty.[23] The court rejected the notion of a duty to disclose based on such expectations, however, finding "no authority that provides that the mere sale of a consumer electronics product in California can create a duty to disclose any defect that may occur during the useful life of the product."[24] *Sanders v. Apple, Inc.*,[25] and *In re Ford Motor Co. Speed Control Deactivation Switch Control Products Liability Litigation*[26] are similar in conclusions and reasoning.

CONCLUSION

Concealed defect class actions will probably continue to appear. But the recent shift in case law suggests that a consensus might be growing around the Seventh Circuit's "no injury, no tort" concept, announced nearly seven years ago.[27] The new case law is explicit: where a defendant's "knowledge of 'unreasonable risk' to plaintiffs... [amounts to] the risk of 'serious potential damages' [comprised of] the cost of repairs in the event that the defect ever causes" the part at issue to fail, no duty of disclosure—and thus no fraud-based claim—arises.[28] If these recent cases constitute a conscious trend, such arguments may in fact be likely to proliferate.

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Endnotes

1 In re Bridgestone/Firestone, 288 F.3d 1012, 1017 (7th Cir. 2002). *Bridgestone/Firestone* was one of the first cases to invalidate fraud-based "concealed defect" theories as a matter of law. Unfortunately that did not stem the tide of these claims in most jurisdictions.

2 Shaw v. Toshiba America Info. Sys., 91 F. Supp. 2d 926 (E.D. Tex. 1999). In circular reasoning, the Court observed that the class could not be limited to current owners of allegedly defective laptops because, if it were, "Defendants could simply argue Plaintiffs lack standing…since they already know about the allegedly defective" product. *Id.* at 938. On the same page, however, the Court also held that, despite their "knowledge" of the alleged defect, plaintiffs themselves had standing to pursue concealed defect claims because they could "be future purchasers of other computers" with the alleged defect. *Id.* at 938 n.21.

3 Andy Pasztor, *Toshiba to Pay $2B Settlement on Laptops*, ZDNet News (Nov. 1, 1999), *available at* http://news.zdnet.com/2100-9595_22-10384.html.

4 Talalai v. Cooper Tire & Rubber Co., No. L-008830-00-MT (N.J. Sup. Ct.).

5 For more detail on this plaintiffs' argument, see, e.g., Eric H. Gibbs & Geoffrey A. Munroe, *Consumer Class Actions in the Wake of* Daugherty v. American Honda Motor Co., Forum (Jan./Feb. 2009), at 33-35.

6 Duquesne Light Co. v. Westinghouse Elec. Corp., 66 F.3d 604, 614 n.9 (3d Cir. 1995).

7 Seely v. White Motor Co., 63 Cal.2d 9, 18 (1965); East River S.S. Corp. v. TransAmerica DeLaval, Inc., 476 U.S. 858, 872 (1986).

8 2007 WL 2994812, at *2 (N.D. Cal. July 27, 2007).

9 *Id.* at *8.

10 *Id.*

11 144 Cal. App. 4th 824, 828 (2006).

12 *Id.* at 838.

13 2008 WL 818526 (N.D. Cal. Mar. 25, 2008).

14 544 F. Supp. 2d 964 (N.D.Cal. 2008).

15 160 Cal. App. 4th 981 (2008).

16 Muss v. Mercedes-Benz of N. Am., 734 S.W.2d 155, 158 (Tex. Ct. App. 1987); see, e.g., Ball v. Sony Elecs., Inc., 2005 WL 2406145, at *3 (W.D. Wis. Sept. 28, 2005) (barring consumer fraud claims because "Defendant's [promise in the warranty] to remedy defects in a product is not a representation that there are none, but an acknowledgment that there might be" defects"); Painter v. General Motors Corp., 974 P.2d 924, 926 (Wyo. 1999).

17 Amplification on this plaintiffs' theory can be found in, *e.g.*, Gibbs & Munroe, *supra* note 4.

18 Abraham v. Volkswagen of Am., 795 F.2d 238, 250 (2d Cir. 1986).

19 *See, e.g.,* Canal Elec. Co. v. Westinghouse Elec. Co., 973 F.2d 988, 993 (1st Cir. 1992) ("time-limited warranties do not protect buyers against hidden defects"); Walsh v. Ford Motor Co., 588 F.Supp. 1513 (D.D.C. 1984).

20 2007 WL 703197, at *7 (D.N.J. Mar. 2, 2007).

21 *Id.* at *8.

22 515 F. Supp. 2d 1099 (N.D. Cal. 2007).

23 *Id.* at 1104-05.

24 *Id.* at 1105.

25 2009 WL 150950 (N.D. Cal. Jan. 21, 2009).

26 2007 WL 2421480 (E.D. Mich. Aug. 24, 2007).

27 In re Bridgestone/Firestone, 288 F.3d 1012, 1017 (7th Cir. 2002).

28 Daugherty v. American Honda Motor Co., 144 Cal. App. 4th 824, 836 (2006).

The Third Circuit Joins the Majority with *In Re Hydrogen Peroxide*

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The Court, in evaluating this decision, noted that a hearing on the merits could lead to prejudice. Using language lower courts have since pondered and analyzed, Justice Powell stated that "nothing in either the language or history of Rule 23... gives a court any authority to conduct a preliminary inquiry into the merits of a suit in order to determine whether it may be maintained as a class action." [12]

Creating an almost immediate circuit split, lower courts interpreted *Eisen* in two disparate ways. Many took it to be a complete bar to any fact finding or weighing of facts or law pertaining even peripherally to the merits of the case.[13] A few, like the Fifth Circuit, interpreted *Eisen* as barring inquiry into the merits only to the extent that the inquiry does not pertain to class certification.[14] Four years later, the Court again spoke to the issue. Justice Stevens, writing for a unanimous Court in *Livesay*, stated that "[e]valuation of many of the questions entering into determination of class action questions is intimately involved with the merits of the claims."[15] But *Livesay* did not end the debate. Most lower courts continued to limit their class action inquiry to the pleadings, only occasionally considering extrinsic evidence, like expert reports.[16]

In 1982, the Court revisited the question in *Falcon*, Justice Stevens writing:

> [S]ometimes the issues are plain enough from the pleadings to determine whether the interests of the absent parties are fairly encompassed within the named plaintiff's claim, and sometimes it may be necessary for the court to probe behind the pleadings before coming to rest on the certification question.... [A]ctual, not presumed conformance with Rule 23(a) remains... indispensable.[17]

The Court made it clear that a class action "may only be certified if the trial court is satisfied, *after a rigorous analysis*, that the prerequisites of Rule 23(a) have been satisfied."[18] Although the *Falcon* decision was focused on Rule 23(a), lower courts are uniform in also applying it to Rule 23(b).[19]

For the past 25 years, courts have struggled to reconcile the apparently contradictory rulings in *Eisen*, *Livesay*, and *Falcon*. How can a court avoid a "preliminary inquiry" into the merits when class questions are often "intimately involved" with the merits of the claims? Along the same lines, how does a court conduct a "rigorous analysis" of class certification elements without looking to what are often identical issues bearing on the merits? Many courts, for fear of tripping *Eisen*, continued to take very conservative positions with respect to the scope of their inquiry and the burden of "proof" placed on plaintiffs moving to certify a class.[20] This cautious approach tended to favor certification.

Raising the Standards of Proof for Class Certification

The late 1990s saw renewed interest in tackling the standards for class certification. The Supreme Court in 1997 returned attention to the issue when it affirmed decertification of a class in *Amchem Products v. Windsor* and reminded courts to take a "close look" at the predominance and superiority factors in Rule 23(b)(3).[21] The Court noted that the Rules Enabling Act did not permit courts to use a procedural mechanism of economy, like class certification to "abridge", "enlarge," or "modify" the substantive rights of parties.[22] The Seventh Amendment guarantees that any civil claim with over twenty dollars in controversy follow procedures maintaining "the substance of the common-law right of trial by jury" and encompassing those parts of the jury trial process that "are regarded as fundamental, as inherent in and of the essence of the system."[23]

Amchem prompted most circuit courts to rethink their class certification standards and procedures in light of the due process implications on the parties—courts again began to recognize that class actions can "sound the death knell" of a party's case, as had been discussed in *Livesay*.[24] Many courts, reconsidering their class certification standards, began to conclude that the only way to harmonize the Supreme Court's conflicting rulings was to allow an inquiry into the merits to the extent necessary to make findings of fact and law necessary to satisfy the requirements of Rule 23. This trend picked up pace in 2003 after Rule 23's time requirement for ruling on class certification was changed from "as soon as is practicable" to "at an early practicable time." The Advisory Committee comments highlighted and endorsed this new nuanced approach to inquiring into the facts:

> Although an evaluation of the probable outcome on the merits is not properly part of the certification decision, discovery in aid of the certification decision often includes information required to identify the nature of the issues that actually will be presented at trial. *In this sense it is appropriate to conduct controlled discovery into the 'merits,' limited to those aspects relevant to making the certification decision on an informed basis.*[25]

The trend harmonizing Supreme Court doctrine on certification standards has produced over the last decade what observers consider a sea change, with most courts now firmly requiring a rigorous analysis of the Rule 23 factors, including to the extent necessary an inquiry into the merits.[26] The Second, Fourth, Fifth, and Seventh Circuits have begun to require district courts to make specific findings of fact for class certification.[27] The Ninth Circuit included a statement in *Dukes v. Wal-Mart* that "courts are not only 'at liberty to' but *must* 'consider evidence which goes to the requirements of Rule 23 [at the class certification stage] even [if] the evidence may also relate to the underlying merits of the case.'"[28] The First and Eighth Circuits do not demand findings of fact in every case, but have endorsed higher standards of review and now require lower courts to consider merits issues in cases with fact disputes, or novel or complex injury arguments.[29] Thus, for example, the First Circuit wrote that, "when a Rule 23 requirement relies on a novel or complex theory as to injury, as the predominance inquiry does in this case, the district court must engage in a searching inquiry into the viability of that theory and the existence of the facts necessary for the theory to succeed."[30]

Recent Evolutions in the Third Circuit Leading to *Hydrogen Peroxide*

While the majority of the federal courts of appeal over the past several years moved to clearly more rigorous analysis, requiring findings of fact and allowing a scope of inquiry broad enough to encompass the merits, a minority of circuits has toed the line in *Eisen* or trod an awkward middle ground. The Third Circuit, along with the District of Columbia and Sixth Circuits, falls within this group.[31] In fact, the Third Circuit for years was considered among the strictest in interpreting *Eisen*, and therefore the most plaintiff-friendly circuit in the nation.

The court's reputation stemmed mainly from its 1977 decision *Bogosian v. Gulf Oil Corp*.[32] *Bogosian* reasoned that class members in an antitrust case alleging a market-wide conspiracy can prove injury simply by showing that prices "fluctuated within a range which, though different in different regions, was higher in all regions than the range which would have existed in all regions under competitive conditions."[33] Courts seized on this rationale as a "*Bogosian* short-cut" to presume that plaintiffs in conspiracy cases can prove impact and injury on a classwide basis.[34]

Third Circuit panel decisions over the past ten years evinced a slow and uneven shift from *Bogosian* to the majority approach. Some panels articulated a higher burden on plaintiffs and allowed an inquiry into the merits, while others refrained. For example, in the 2001 *Newton* decision, the Third Circuit wrote that a court must "delve beyond the pleadings to determine whether the requirements for class certification are satisfied."[35] Moreover, "[i]n reviewing a motion for class certification, a preliminary inquiry into the merits is sometimes necessary to determine whether the alleged claims can be properly resolved as a class action."[36] But less than two years after *Newton* another panel in *Linerboard* appeared to take a step back when it used a hybrid "belt and suspenders" approach to expert analysis, stating that, "in addition to relying on the *Bogosian* short cut, [the court] credited the testimony of plaintiffs' experts, opinions that were supported by charts, studies and articles from leading trade publications."[37]

These conflicting positions at the appellate level created uncertainty below, resulting in decisions like the 2007 *Behrend v. Comcast Corp.* ruling from the Eastern District of Pennsylvania. Granting certification, the judge wrote that the Third Circuit "has recognized the utility, and often the necessity, of looking beyond the pleadings at the class certification stage of litigation," but also that "in determining whether a class will be certified, the substantive allegations of the complaint must be taken as true," and "the interests of justice require that in a doubtful case... any error, if there is to be one, should be committed in favor of allowing a class action."[38]

Last year's unpublished decision, *American Seed Co. v. Monsanto Co.*, was another step to distinguish *Bogosian* and move to the majority. *American Seed* involved allegations that Monsanto had used a monopoly in certain corn seed markets to force exclusive-dealing obligations on licensees of its corn-seed traits and unfavorable "bundling" deals on its wholesale corn-seed customers. Plaintiffs moved to certify three classes of direct purchasers. The Third Circuit affirmed the denial of class certification, basing its decision mainly on the inadequacies of plaintiffs' expert evidence. The court gave additional meaning to the statement in *Linerboard* "that a putative class's presumption of impact under *Bogosian* be supported by some additional amount of empirical evidence": [39]

Plaintiffs have not provided any actual data for the court's review as to the "factual setting of the case," against which to evaluate these formulas. Dr. Kamien cites absolutely no factual authority in his declaration in support of his theory of common injury and damages… There is no indication that Dr. Kamien conducted at least a preliminary study of the market... Dr. Kamien's submissions are not supported by charts, studies, and articles from leading trade publications….[40]

The rigorous analysis in *American Seed*, in particular its focus on the use of actual data allowing for the court's review of the factual setting of the case, directly presaged the Third Circuit's recent ruling in *Hydrogen Peroxide.*[41]

Hydrogen Peroxide: The District Court Decision

In re Hydrogen Peroxide Antitrust Litigation involves the price-fixing claims of two putative classes of direct and indirect purchasers of hydrogen peroxide and related chemicals between September 1994 and January 2005.[42] The case was filed as a follow-up to criminal investigations of eighteen chemical manufacturers in the United States and the European Union.[43] Two of the manufacturers pled guilty in the United States.[44]

The plaintiffs alleged the manufacturers had fixed prices as to several different grades and types of hydrogen peroxide, used in a wide variety of products, including food, cosmetics, electronics, and textiles.[45] Direct purchaser plaintiffs moved for a nationwide class comprising "[a]ll persons or entities... who purchased hydrogen peroxide, sodium perborate, and sodium percarbonate."[46] Defendants did not "specifically contest" the plaintiffs' ability to meet the Rule 23(a) factors, but the Rule 23(b)(3) factors of "predominance" and "superiority" were "hotly contested."[47]

The district court certified the class under Rule 23(b)(3) noting "that questions of law or fact common to class members predominate" and that a class action was a superior method for adjudicating the issue.[48] Judge Dalzell made several pertinent observations and intermediate decisions on common proof of impact in reaching his ultimate holding:

• First, he observed the relatively lenient standards for certification in the Third Circuit, particularly as to antitrust matters, noting that "[i]t should come as no surprise that courts, both in this Circuit and elsewhere, have regularly certified as class actions suits alleging a horizontal price-fixing conspiracy."[49]

• Second, with respect to the scope of inquiry, he acknowledged that *Eisen* and *Livesay* are "seemingly difficult to reconcile."[50] Nonetheless, he went on to conclude in the Third Circuit: "[w]e read the jurisprudence... as obliging us to limit that inquiry to the minimum necessary at this juncture."[51] Therefore, "[i]t will not do here to make judgments about whether the plaintiffs have adduced enough evidence or whether their evidence is more or less credible than defendants'."[52] This led the court to a deferential standard of proof: "Plaintiffs need only make a threshold showing that the element of impact will predominantly involve generalized issues of proof, rather than questions which are particular to each member of the plaintiff class."[53]

• Third, Judge Dalzell reasoned that the market structure and plaintiffs' expert's opinion that the market had price structure were enough to warrant a *Bogosian* presumption of impact.[54] The court wrote:

> Because hydrogen peroxide is a fungible commodity available from a decidedly limited set of producers, this case is particularly suitable for treatment under *Bogosian*. Even in spite of the issues defendants raise, we find it reasonable that plaintiffs would be able to show antitrust impact on all purchasers merely by showing that defendants kept list prices that were artificially high because of their conspiracy.[55]

• Fourth, and finally, the Court did not find it a problem that Dr. Beyer had not yet completed his analysis for common proof of impact, reasoning that "it is improper to analyze the correctness or likely success of plaintiffs' proposed analytical model at the class certification stage."[56]

The district court acknowledged that its analysis may be in the minority: "The Second Circuit's decision in *Initial Pub. Offering* could be read to impose a higher burden than that in *Linerboard* or *Lumco*. We are, of course, bound to follow the still-binding guidance of our own Court of Appeals on this issue."[57] Defendants filed for interlocutory appeal, asserting that the district court had abused its discretion by: (1) "applying too lenient a standard of proof for class certification"; (2) "failing meaningfully to consider the views of defendants' expert while crediting plaintiffs' expert"; and (3) "erroneously applying presumption of antitrust impact" or individual injury.[58]

Hydrogen Peroxide: The Third Circuit Defines a More Rigorous Analysis

The Third Circuit accepted the appeal and focused its analysis on three specific issues: (1) the burden of proof required of a plaintiff to satisfy the requirements of Rule 23; (2) the degree to which a lower court can resolve factual and legal disputes relating to Rule 23 if those disputes overlap with the merits of the plaintiff's case; and (3) the role of expert testimony at class certification.[59]

The Third Circuit held that the district court failed to apply a high enough burden of proof.[60] While noting the dicta in *Amchem* that "'[p]redominance is a test readily met in certain cases alleging consumer or securities fraud or violations of the antitrust laws,'" the court embraced the notion that a certification merits a rigorous analysis.[61] Thus, a party's "assurance to the court that it intends or plans to meet the requirements is insufficient."[62] The "threshold showing" standard the district court had used was "an inadequate and improper standard" and that it "could signify, incorrectly, that the burden on the party seeking certification is a lenient one... or that the party seeking certification receives deference or a presumption in its favor."[63]

Turning to the scope of inquiry, the Third Circuit asserted that a court must look beyond the pleadings and make findings of fact and law grounded in a "'thorough examination of the factual and legal allegations.'"[64] The "[f]actual determinations necessary to make Rule 23 findings must be made by a preponderance of the evidence."[65] The court went on to write that "because each requirement of Rule 23 must be met, a district court errs as a matter of law when it fails to resolve a genuine legal or factual dispute relevant to determining the requirements."[66] This includes inquiries into the merits: "A contested requirement is not forfeited in favor of the party seeking certification merely because it is similar or even identical to one normally decided by a trier of fact."[67] Moreover, "[a]lthough the district court's findings for the purpose of class certification are conclusive on that topic, they do not bind the fact-finder on the merits."[68]

Finally, the Third Circuit held that the same rigorous standards now to be applied to factual and legal determinations should carry through to expert opinions.[69] "Expert opinions with respect to class certification, like any matter relevant to a Rule 23 requirement, calls for rigorous analysis."[70] The court went on to note that a judge should actively weigh expert testimony and decide which it found more persuasive, effectively ending the days when a "battle of the experts" would paralyze a district judge and draw a knee-jerk certification ruling: Weighing "conflicting expert testimony is not only permissible; it may be integral to the rigorous analysis Rule 23 demands."[71]

The court based its conclusions and the reversal of decades of relatively lenient class certification standards on the 2003 amendments to Rule 23. The change in timing, noted by other courts, "though subtle, reflects the need for a thorough evaluation of the Rule 23 factors-for this reason the rule does not 'require or encourage premature certification determinations.'"[72] In reaching this decision, the court severely limited any future applications of the type of presumptions that evolved from *Bogosian*.[73] It reasoned that to presume impact based on an "unadorned allegation of price-fixing would appear to conflict with the 2003 amendments to Rule 23, which emphasize the need for a careful, fact-based approach, informed, if necessary, by discovery."[74] While the court left it to the district court to decide on remand whether *Bogosian* could apply here, it seems unlikely that the "Bogosian short-cut" will be relevant to many future class certification analyses.

Practical Implications and Conclusion

The shift to a more rigorous analysis has several important implications for practitioners. First, the Third Circuit's new emphasis on findings of fact and law to support a decision based on a preponderance of the evidence means plaintiffs' counsel should carefully consider the timing of any class certification motions to allow additional time for creating a more robust record. Second, each party should focus its expert more on applying his or her theoretical models to the facts of the case, if only to a sample, permitting the court to test either parties' assertions about the practical viability of the proposed class. Third, defendants should consider more aggressively guiding courts in using the facts to make class certification decisions, particularly by relying on case law from other circuits where courts have been applying a rigorous analysis for years now.

The *Hydrogen Peroxide* decision resolves years of confusion and doctrinal tension in the Third Circuit. Hopefully this shift allows parties to fight over class certification on a level playing field, although whether this is true or the rigorous standards merely shift the strategic advantage from plaintiffs to defendants still remains to be seen.

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Endnotes

1 552 F.3d 305, 307 (3d Cir. 2008) (Scirica, C.J.) (*Hydrogen Peroxide II*) (vacating 240 F.R.D. 163, 166 (E.D. Pa. 2007) (*Hydrogen Peroxide I*)); *see also* Fed. R. Civ. P. 23(b) (2008) (providing "a class action may be maintained if… the court finds that the questions of law or fact common to class members predominate over any questions affecting only individual members.")

2 552 F.3d at 307.

3 *Id.*

4 *Cf.* Eisen v. Carlisle & Jacquelin, 417 U.S. 156 (1974) *with* Gen. Tel. Co. of the Sw. v. Falcon, 457 U.S. 147 (1982).

5 *Cf.* Windham v. Am. Brands, Inc., 565 F.2d 59 (4th Cir. 1977) (allowing an evidentiary inquiry) *and* Alabama v. Blue Bird Body Co., 573 F.2d 309, 326-28 (5th Cir. 1978) (same) *with* Bogosian v. Gulf Oil Corp., 561 F.2d 434, 455 (3d Cir. 1977).

6 *See, e.g.*, *Windham*, 565 F.2d 59; *Blue Bird Body*, 573 F.2d 309.

7 *See Bogosian*, 561 F.2d at 455.

8 259 F.3d 154, 168-69 (3d Cir. 2001).

9 *See, e.g.*, In re New Motor Vehicles Canadian Export Antitrust Litig., 522 F.3d 6 (1st Cir. 2008) (vacating certification order because district court did not apply rigorous analysis of plaintiffs' theory of the common impact); Cordes & Co. Fin. Servs. v. A.G. Edwards & Sons, Inc., 502 F.3d 91, 106-07 (2d Cir. 2007) (noting district courts should test experts' opinions when weighing those opinions for certification); In re Initial Public Offering Sec. Litig., 471 F.3d 24, 32-40 (2d Cir. 2006) (denying certification and disavowing earlier decisions using lenient standards to find expert reports that were not "fatally flawed" met a plaintiff's burden under Rule 23); Blades v. Monsanto Co., 400 F.3d 562 (8th Cir. 2005) (requiring district courts to consider the merits as necessary in determining certification).

10 Fed. R. Civ. P. 23(a), (b)(3).

11 Unger v. Amedisys Inc., 401 F.3d 316, 320 (5th Cir. 2005) ("The party seeking certification bears the burden of establishing that *all* requirements of Rule 23 have been satisfied."); *Hydrogen Peroxide II*, 552 F.3d 305, 315-16.

12 417 U.S. at 177.

13 *See, e.g.*, *Bogosian*, 561 F.2d at 455; Shelter Realty Corp. v. Allied Maint. Corp., 574 F.2d 656, 661 n.15 (2d Cir. 1978).

14 *Windham,* 565 F.2d 59 (permitting an evidentiary inquiry); and *Blue Bird Body Co.*, 573 F.2d at 326-28 (same).

15 437 U.S. 463, 469 n.12 (1978).

16 *See, e.g.*, *Shelter Realty*, 574 F.2d at 661 n.15; *cf. Windham*, 565 F.2d 59 *and Blue Bird Body*, 573 F.2d at 326-28; *with Bogosian*, 561 F.2d 434, 455.

17 457 U.S. at 160.

18 *Id.* at 161 (emphasis added).

19 *See, e.g.*, *Newton*, 259 F.3d at 167.

20 *See* infra section ___.

21 521 U.S. 591, 615 (1997).

22 *Id.* at 613.

23 Colgrove v. Battin, 413 U.S. 149, 156-57 & n.11 (1973) (quoting Balt. & Carolina Line, Inc. v. Redman, 295 U.S. 654, 657 (1935) and Austin W. Scott, *Trial by Jury and the Reform of Civil Procedure*, 31 Harv. L. Rev. 669, 671 (1918)).

24 437 U.S. at 469 (quotation marks omitted); *see also* In re Polymedica Corp. Sec. Litig., 432 F.3d 1, 5-7 (1st Cir. 2005); In re Initial Pub. Offerings Sec's. Litig., 471 F.3d 24, 32-40 (2d Cir. 2006); Szabo v. Bridgeport Machs, Inc., 249 F.3d 672, 674-76 (7th Cir. 2001); *Blades*, 400 F.3d at 562; Love v. Turlington, 733 F.2d 1562, 1564 (11th Cir. 1984) (adopting the pre-circuit split rule of the Fifth Circuit).

25 Fed. R. Civ. P. 23(c)(1)(A) advisory committee's note (2003 amendments).

26 *See, e.g.*, David S. Evans, *The New Consensus on Class Certification: What it Means for the Use of Economic and Statistical Evidence in Meeting the Requirements of Rule 23* (Jan. 2009), *available at* SSRN: http://ssrn.com/abstract=1330594.

27 *See, e.g.*, *New Motor Vehicles*, 522 F.3d at 24 (citing other decisions).

28 Dukes v. Wal-Mart, 509 F.3d 1168, 1177 n.2 (9th Cir. 2007) (alteration in original) (quoting Hanon v. Dataproducts Corp., 976 F.2d 497, 509 (9th Cir. 1992)).

29 *New Motor Vehicles*, 522 F.3d at 24; *Blades*, 400 F.3d at 566-67.

30 522 F.3d at 26.

31 *See, e.g.*, Meijer, Inc. v. Warner Chilcott Holdings Co. III, Ltd., 246 F.R.D. 293, 299 n.4 (D.D.C. 2007) ("The Court does not decide whether to adopt the standard for class certification motions operative in other circuits. Instead, the Court avoids any inquiry into the merits of Plaintiffs' claims that is not required to resolve the instant motion for class certification, and notes that that resolution does not involve significant factual disputes."); In re Nifedipine Antitrust Litig., 246 F.R.D. 365, 368 (D.D.C. 2007) (relying on In re Vitamins Antitrust Litigation, 209 F.R.D. 251, 256 (D.D.C. 2002), and In re Lorazepam Antitrust Litig., 202 F.R.D. 12, 21 (D.D.C. 2001) in disallowing inquiry into the merits); In re Scrap Metal Antitrust Litig., 527 F.3d 517, 535-36 (6th Cir. 2008) (allowing for relatively lenient inquiry for class certification).

32 561 F.2d at 455.

33 *Id.*; *see also* Nichols v. Mobile Bd. of Realtors, Inc., 675 F.2d 671, 676 (1982) (citing *Bogosian*, 561 F.2d at 455).

34 *See, e.g.*, In re Rubber Chems. Antitrust Litig., 232 F.R.D. 346, 352 (N.D. Cal. 2005); In re Carbon Black Antitrust Litig., 2005 WL 102966, at *15 & n.16 (D. Mass. Jan. 18, 2005); In re Wirebound Boxes Antitrust Litig., 128 F.R.D. 268, 272 (D. Minn. 1989); In re Alcoholic Beverages, 95 F.R.D. 321, 327 (E.D.N.Y. 1982).

35 Newton v. Merrill Lynch, Pierce, Fenner & Smith, Inc., 259 F.3d 154, 167 (3d Cir. 2001) (quoting James Wm. Moore et al., 5 Moore's Federal Practice § 23.61[5].

36 *Newton*, 259 F.3d at 168-69.

37 *Cf. Newton*, 259 F.3d 154 *and* Johnston v. HBO Film Mgmt., 265 F.3d 178, 188-89 (3d Cir. 2001) (same), *with* In re Linerboard Antitrust Litig., 305 F.3d 145, 152-53 (3d Cir. 2002) (affirming certification where the lower court had applied a "belt and suspenders rationale to support its conclusion").

38 Behrend v. Comcast Corp., 2007 WL 2972601, at *2 (E.D. Pa. Oct. 10, 2007) (quotation marks omitted) (certifying class of cable customers).

39 *Am. Seed Co.*, 271 F. App'x 138, 141 (3d Cir. 2008) ("[U]nder our caselaw a putative class must, in accordance with *Linerboard*, support a presumption of impact with an analysis of the relevant data.").

40 *Id*.

41 *Am. Seed Co*., 271 F. App'x at 138; *see also* Teva Pharms. v. Abbott Labs., No. 03-cv-120, 2008 WL 3849696 (D. Del. 2008) (providing that court should look to whether the plaintiffs' submitted methodology can be used across the class and deciding that the plaintiffs' submission of economic articles, data and government studies was enough).

42 *Hydrogen Peroxide I*, 240 F.R.D. 163, 167 n.3 (E.D. Pa. 2007).

43 *Id.* at 166.

44 *Id.*

45 In re Hydrogen Peroxide Antitrust Litig., 401 F .Supp. 2d 451, 455-56 (E.D. Pa. 2005) (denying motion to dismiss).

46 *Hydrogen Peroxide I*, 240 F.R.D. at 167.

47 *Id.* at 168-69.

48 *Id.*

49 *Id.* at 167-68.

50 *Id.* at 169-70.

51 *Id.* at 170.

52 *Id.* at 174.

53 *Id.* (quotation marks omitted). Note that the Court applied this reasoning to the defendants' motion to strike the expert testimony of Dr. Beyer, plaintiffs' testifier. "We are not permitted, in addressing defendants' *Daubert* motion, to weigh the relative credibility of the parties' experts." *Id.* at 171.

54 *Id.* at 173-74.

55 *Id.* at 174.

56 *Id.* at 175.

57 *Id.* at 170 n.6.

58 *Id.*

59 *Hydrogen Peroxide II*, 552 F.3d at 307.

60 *Id.* at 307, 326-27.

61 *Id.* at 321-22 (quoting *Amchem*, 521 U.S. at 625).

62 *Id.* at 318.

63 *Id.* at 321.

64 *Id.* at 316-17 (citing *Newton*, 259 F.3d at 166).

65 *Id.* at 320.

66 *Id.*

67 *Id.* at 318.

68 *Id.*

69 *Id.* at 323-25.

70 *Id.* at 323.

71 *Id.*

72 *Id.* at 318 (quoting Weiss v. Regal Cellections, 385 F.3d 337, 347 (3d Cir. 2004)).

73 *Id.* at 325-27.

74 *Id.* at 326.

Mortgage-Backed Securities Litigation: Hedge Funds vs. Banks

Continued from cover

Countrywide-issued MBSs. The complaint alleges that the Pooling and Servicing Agreements ("PSA") governing the MBSs require Countrywide to repurchase every mortgage that it modifies by paying the current principal balance plus outstanding interest to the securitization Trust.

Countrywide removed the case to the U.S. District Court, Southern District of New York, where it is currently pending before Judge Richard Holwell.[5] As its basis for removal, Countrywide argues that the case is removable as a federal question[6] and, alternatively, as a minimally diverse class action.[7] The federal question is said to hinge upon interpreting 15 U.S.C. §1639a.

The Truth in Lending Act

Congress enacted §1639a as part of the Truth in Lending Act in 2008 to create a safe harbor for servicers of securitized mortgages to modify the loans "to maximize the net present value" of the MBSs. The statute reads, in part:

> (a) Except as may be established in any investment contract between a servicer of pooled residential mortgages and an investor, a servicer of pooled residential mortgages:
>
> ***
>
> (2) shall be deemed to act in the best interests of all such investors and parties if the servicer agrees to or implements a modification or workout plan, ... for a residential mortgage or a class of residential mortgages [provided that:]
>
> ***
>
> (C) The anticipated recovery on the principal outstanding obligation of the mortgage under the modification or workout plan exceeds, on a net present value basis, the anticipated recovery on the principal outstanding obligation of the mortgage through foreclosure.[8]

The *Greenwich* plaintiffs contend that §1639a does not apply to their case because the introductory language of the statute expressly excludes breach of contract claims. They argue that the PSAs are investment contracts that prevent Countrywide from modifying mortgages subject to the PSA unless those mortgages are repurchased. They also argue that §1639a does not create a right for the servicer to modify the underlying mortgages, but merely provides an objective standard by which to measure modifications that are permitted by other PSAs.

For its part, Countrywide argues that the PSA authorizes it to modify mortgages when prudent and when necessary to protect the interest of the Trust. Accordingly, Countrywide argues that §1639a shields it from liability to the MBS investors.

Congress may have the last word on the meaning of §1639a. Representative Barney Frank has introduced legislation to shield loan servicers from liability "notwithstanding any investment contract."[9] The legislation has received bipartisan support in the Finanical Services Committee. In fact, the Republicans on the committee are advocating for an amendment to include a provision requiring an investor whose suit is rebuffed by §1639a to pay the servicer's attorney fees.[10]

To avoid being barred by §1639a, the plaintiffs contend that whether Countrywide is permitted to modify mortgages under §1639a is immaterial to their case. They state that they take no position on whether the mortgages should be modified. Instead, they insist that their claims are focused upon the provision of the PSA which they claim requires Countrywide to repurchase any modified loan, and that these claims are not impacted by §1639a. Countrywide counters that that interpretation of the PSA should be informed by §1639a.

The primary issue in *Greenwich* is whether the PSA requires the risk of loss to shift to Countrywide when a non-performing loan is modified. Thus, unless H.B. 788 (or something similar) passes, this case will be won or lost based upon the language of the 160+ page PSA.

The Pooling and Servicing Agreement

The Greenwich plaintiffs argue that §3.12 of the PSA permits Countrywide to modify mortgages, but requires Countrywide to "purchase[] the Modified Mortgage Loan from the Trust Fund immediately following the modification as described below."[11] Notably, the PSA does not require Countrywide to repurchase the mortgage until after it is modified. Assuming for the moment that this section controls any loan modification, then the question becomes, "At what price?"

The answer will be reached through analyzing various defined terms in the PSA.[12] "Purchase Price" is defined for relevant purposes as the "Stated Principal Balance," which, in turn, is defined as the unpaid principal balance prior to any adjustments less any "Realized Loss." The term "Realized Loss" has two components. First, it means amounts unrecovered through a foreclosure sale or other liquidation. Alternatively, "Realized Loss" means the amount a court determined that the loan exceeds the value of the property combined with the amount to which the principal balance has been reduced below the reduced value of the house.

At first blush, the definition of "Realized Loss" appears to open the window for Countrywide to voluntarily modify the mortgages while maintaining the risk of loss with the MBS investors. This conclusion, however, is contradicted by the definition of "Deficient Valuation," which appears to require a court determination of the value of the property before a modification can be a "Realized Loss." Thus, §3.12 appears to require Countrywide to shoulder the loss of any modified mortgage.

This reading is supported by §3.12's requirement that "[f]or federal income tax purposes, the Trustee shall account for such purchases as a prepayment in full of the Modified Mortgage Loan." This statement appears to contemplate that the MBS investors will not suffer any loss as the result of Countrywide's voluntary mortgage modification. There is some room for argument that because the sentence reads that the Modified Mortgage Loan is paid in full, that the Trust should have realized the loss of the modification before the repurchase by Countrywide, and only the reduced amount is treated as paid in full.

Countrywide points to §3.01, which permits it to service and administer the loans in a prudent manner; the section provides that Countrywide's authority extends to cancelling and fully or partially releasing or discharging the loans, and unquestionably grants Countrywide the power to modify the mortgages, which Countrywide argues triggers the protections of §1639a.

PSA §3.01 also provides that Countrywide is responsible for any "shortfall in any collection ... is attributable to adjustments to Mortgage Rates, Scheduled Payments or Stated Principal Balances." This provision, however, might not be as restrictive as it appears. It holds Countrywide responsible for shortfalls *caused* by mortgage modifications. Countrywide will argue that collection shortfalls are inevitable for loans in default. The modifications are not causing the losses, but instead are designed to reduce losses. Moreover, §1639a requires the court to presume that the modifications reduce losses. Therefore, this provision is not activated.

In addition to the above provisions, PSA §3.05 will likely impact the disposition of *Greenwich*. That section expressly permits Countrywide to make certain specific adjustments to mortgages without triggering the §3.12 obligation to repurchase. The §3.05 adjustments are limited to waiving late fees, penalty interest, prepayment fees, and extending a loan for no more than 270 days. Importantly, §3.05 shifts the risk of loss to Countrywide by requiring Countrywide to advance payments to the Trust in accordance with the original amortization schedule in these instances.

Finally, §3.12 limits Countrywide to modifying no more than 5% of the mortgages underlying any tranch. The agreement, however, does not necessarily impose any liability upon Countrywide for exceeding this threshold, but merely permits the Trust to declare a default and remove Countrywide as servicer. This will not necessarily solve the Trust's problems because it will have to either service the loans itself, or negotiate a servicing agreement with a new servicer, who will not be likely to accept any risk of loss.

Once the procedural wrangling over the proper forum for the litigation, and whether the plaintiffs have standing to assert claims under the PSA are resolved, the litigation will focus upon interpreting PSA provisions discussed above.

Public Policy Arguments

Notably, the claims asserted by the Greenwich plaintiffs have been limited to declaratory judgment claims regarding the respective rights and obligations under the PSA. The complaint does not allege any fraud, bad faith or malfeasance on the part of Countrywide in originating or securitizing the underlying mortgages. The absence of these claims is noteworthy. The plaintiffs have apparently elected to avoid public policy arguments over the propriety of the mortgages. There are no allegations that Countrywide knew that that mortgages could not perform or were overvalued at the time of securitization. As of this time, there have been no public policy arguments that Countrywide, as the originator of these "toxic assets," should shoulder the losses. The litigation does not appear designed to smear Countrywide. The litigation is poised purely as a contract case.

This, of course, does not mean that public policy arguments will not ultimately be raised. The plaintiffs will likely make these arguments in some form. The plaintiffs can certainly argue that the TARP funds Bank of America has received should be used to modify the mortgages.

For its part, Countrywide could argue that the entire purpose of an MBS is to transfer both the potential for profit and the risk of loss to the investors. The typical investor in MBSs are hedge funds, mutual funds, pension plans, and other institutional investors that understood the risk that they were assuming. The investors were willing to accept that risk to achieve returns that they thought would be slightly higher than investing in bonds. Moreover, the Trust hedged against this risk by participating in interest rate swaps with entities such as Swiss Reinsurance Co.[13] When the investors purchased the MBSs, they accepted the down-side risk along with the up-side returns.

The plaintiffs' argument regarding the correct interpretation of the PSA potentially creates a prisoner's dilemma, by punishing cooperation. If one ignores the question of why the loans are underperforming and who is to blame, this dilemma becomes clear.

Assume a loan has entered default. For whatever reason, the borrower is not in a position to continue servicing the loan at the contracted rate. The borrower's options are to either walk away or work with the lender to arrange a payment plan that the borrower can service. In most scenarios, the borrower would prefer to work something out to stay in the house. In the current market, the lender should have an equal incentive to return the loan to a performing status. The losses associated with a foreclosure will far outpace the losses associated with a successful modification. Thus there is an incentive for both parties to cooperate.

The mutual cooperation incentive disappears, however, when the risk of loan losses in a foreclosure are not borne by the same party that bears the risk of loss in a modification. If the MBS investor can receive the full return on its investment if the mortgages are modified, but lose up to 50% of the overall return in foreclosure, the MBS investor will obviously prefer modification. Countywide, however, will have the exact opposite incentive. If a loan is in default, Countrywide, as the servicer, can chose to either foreclose at little risk to itself, or to modify the mortgage and bear the cost of the modification and of repurchasing the note. Countrywide will have every incentive to minimize its risk by foreclosing on the mortgage. Overall, this will create a less than optimal result by maximizing losses for the mortgagor and for the MBS investor.

Of course, these public policy arguments are best left on the courthouse step. The systemic questions of how to address the subprime mortgage crisis, as well as the troubles of the broader financial world, are better answered by Congress, regulators, the states, and the financial industry than by a loan judge.

CONCLUSION

The PSA involved in *Greenwich* was the result of arms-length negotiations between sophisticated parties. Despite what those of us not involved in the transactions think the PSA should have provided, it reads the way the parties chose. The plaintiffs' reading of the PSA is certainly plausible, even though it may not conform with the risk-shifting that one would think should occur through securitization. So long as the court determines that the plaintiffs have overcome the procedural obstacles the PSA places in front of them, including making a demand upon the Trustee, and obtaining the support of 25% of the investors in certain circumstances, then the court should reach the merits of the matter. The language of the PSA should decide whether the hedge fund plaintiffs and other investors must accept the losses associated with their investments, or whether Countrywide is contractually bound to pay full value for any loan it agrees to modify.

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Endnotes

1 http://www.thetruthaboutmortgage.com/countrywide-finishes-top-in-loan-originations/.

2 *Id.*

3 http://query.nytimes.com/gst/fullpage.html?res=9E06EFDA1F3DF935A1575BC0A9619C8B63&sec=&spon=&pagewanted=2.

4 The states involved in the settlement were Arizona, California, Connecticut, Florida, Iowa, Michigan, North Carolina, Ohio, Texas, and Washington.

5 Case No 1:08-cv-11343-RJH.

6 28 U.S.C. § 1331.

7 28 U.S.C. § 1332(d).

8 15 U.S.C 1639a(a) (emphasis added).

9 111 H.B. 788.

10 http://republicans.financialservices.house.gov/index.php?option=com_content&task=view&id=360.

11 PSA, §3.12(A).

12 PSA, §1.01.

13 PSA, §3.21.

After *Bridge*: RICO Class Actions at a Crossing

Continued from page 5

through agents or employees. The plaintiffs claimed RICO violations predicated upon mail fraud, alleging the defendants had used mail transmissions in submitting fraudulent affidavits that falsely attested that the bids in issue were submitted solely in their own names. According to the plaintiffs, this "scheme to defraud" allowed the defendants to obtain a greater number of liens than if they had submitted the bids individually, thus cheating the plaintiffs out of a number of liens and violating RICO in the process.[11]

The defendants argued that plaintiffs' RICO claims failed because they could not prove the predicate acts of mail fraud. Specifically, the defendants asserted that even if the plaintiffs' allegations were true, they had alleged only that defendants made misrepresentations to the county in submitting false affidavits, and had not made any misrepresentations to the plaintiffs themselves. The defendants argued that as a result, the plaintiffs could not have relied upon any alleged misrepresentations by the defendants, even if the county did so rely. According to the defendants, in the absence of any such first-party reliance, the plaintiffs could not establish the predicate RICO violation of mail fraud.[12] After the case worked its way through the lower courts, the Supreme Court granted certiorari to resolve "the substantial question" of "whether first party reliance is an element of a civil RICO claim predicated on mail fraud."[13]

The Court answered that question in the negative. It held that "a plaintiff asserting a RICO claim predicated on mail fraud need not show, either as an element of its claim or as a prerequisite to establishing proximate causation, that it relied on the defendant's alleged misrepresentations."[14] The Court reached this result largely on the basis of a textual analysis, finding nothing in the language of the mail fraud statute or in RICO's civil action provision that would require a finding of reliance: "Nothing on the face of the relevant statutory provisions imposes such a requirement. Using the mail to execute or attempt to execute a scheme to defraud is indictable as mail fraud, and hence a predicate act of racketeering under RICO, even if no one relied on any misrepresentation."[15] Based on the absence of any reliance requirement in the statute, *Bridge* concludes that a plaintiff need not establish reliance as a substantive element of a RICO claim predicated on mail fraud.

However, *Bridge* does not dispense with RICO's proximate cause requirement. Notwithstanding that RICO plaintiffs need not show reliance to prove predicate acts of mail fraud, they still must show the defendants' fraudulent statements were both the "but for" cause and the proximate cause of their injuries.[16] That is, RICO plaintiffs still must prove a "sufficiently direct relationship between the defendant's wrongful conduct and the plaintiff's injury" to satisfy the proximate cause requirements articulated in the Court's earlier RICO decisions.[17] That point is significant because, as *Bridge* recognizes, a RICO plaintiff generally will prove proximate cause by showing reliance.[18]

RICO provides a private right of action to "any person" injured "by reason of" a RICO violation. But in its prior RICO opinions, the Court had recognized that RICO's provision of a private right of action to "any person injured… by reason of" a RICO violation does not in fact allow "any" injured person to sue, irrespective of how tenuous the connection between that person's injury and the defendant's conduct.[19] Instead, the Court determined that RICO's "by reason of" language imposes a proximate cause requirement upon RICO plaintiffs, with proximate cause characterized as a "generic[] label" for "the judicial tools used to limit a person's responsibility for the consequences of that person's own acts."[20]

The point is illustrated by *Holmes v. Securities Investor Protection Corporation*.[21] There, the Court considered RICO claims brought by SIPC, a private corporation obligated to reimburse customers of securities brokers who had become unable to meet their financial obligations. SIPC alleged that the defendants manipulated various stock prices, causing the stocks' value to plummet and, consequently, certain brokers to go out of business. As a result, SIPC was required to make millions of dollars in reimbursement payments to the customers of the now-defunct brokers. The Court concluded that SIPC could not maintain RICO claims against the alleged stock manipulators, because its injury was too remote from the defendants' alleged wrongdoing. SIPC's RICO claims thus failed for a lack of proximate cause.[22]

The Court reached a similar result in *Anza v. Ideal Steel Supply Corporation*.[23] *Anza* arose out of a steel supplier's allegations that its principal competitor fraudulently failed to charge sales tax, thus enabling the competitor to charge lower prices and improperly obtain a larger percentage of the market share. The *Anza* plaintiff asserted RICO claims based on this allegedly fraudulent scheme, but again the Court determined that the RICO claims failed for a lack of proximate cause.

The plaintiff's injury was too far removed in the chain of causation from the defendant's alleged wrongdoing.[24]

In both *Anza* and *Holmes*, the plaintiffs' RICO claims failed because an intervening factor between the alleged misrepresentation and the injury precluded the plaintiffs from showing reliance on the misrepresentations, and in turn from satisfying RICO's proximate cause element. In *Holmes*, even when SIPC was subrogated to the rights of the brokers' customers, its injury remained "contingent on the harm suffered by the broker dealers" and whether the brokers' harm was the result of stock manipulation. Because the brokers could have gone out of business as a result of a variety of factors unrelated to the defendants' stock manipulation, SIPC could not show the brokers' reliance upon the misrepresentations at issue was the proximate cause of its (SIPC's) injuries. Therefore, "the link is too remote between the stock manipulation alleged and the customers' harm."[25]

The link between the decrease in the *Anza* plaintiff's market share and the defendant's alleged misrepresentations to state taxing authorities likewise was too attenuated. The decline in the *Anza* plaintiff's market share could have been attributable to any number of factors not related to the defendant's conduct; the plaintiffs thus could not show that anyone's reliance on the alleged misrepresentation caused it to lose market share.[26] In view of these intervening events between the defendant's alleged wrongdoing and the plaintiff's injury, the *Holmes* and *Anza* plaintiffs' RICO claims failed due to a lack of proximate cause.[27]

After considering these precedents, *Bridge* reached the opposite result. It determined that the plaintiff lien purchasers had shown their injuries were proximately caused by the defendants' fraudulent affidavits to the county, even if the plaintiffs themselves had not relied upon the defendants' misrepresentations. The Court reasoned that the plaintiffs' injuries (the loss of certain liens) could not have been caused by anything other than the defendants' false affidavits, and that the plaintiffs were the only parties likely to sue considering that they were the only ones that had suffered an injury. Accordingly, the *Bridge* plaintiffs had shown an injury sufficiently related to the defendants' conduct to satisfy the proximate cause requirement of RICO's "by reason of" language.[28]

In reaching this conclusion, *Bridge* makes plain that reliance is *not* a substantive element of a RICO claim predicated upon mail fraud, but proximate cause is. Therefore, proximate cause still must be shown, but it can be established in the absence of reliance. And while reliance often is used as a *method* of proving proximate causation, it is not the exclusive means of doing so. Under *Bridge*, reliance thus becomes a mode of proof of the substantive element of proximate causation, but is not, in and of itself, a substantive element of a RICO claim.[29]

However, despite what appears to have been the elimination of a substantial hurdle to making out a RICO claim, *Bridge* has not created an influx of new RICO class action matters being filed. Arguably, this result is attributable in large part to the continuing requirement that RICO plaintiffs prove proximate causation. In many (if not most) cases, the only available method for making that showing will be to prove reliance. The cases described below illustrate the point, demonstrating that reliance will not be absent from RICO jurisprudence notwithstanding *Bridge*.

Prevailing Defendants in Putative RICO Class Litigation

In an early case employing *Bridge*, Judge Conway in the Middle District of Florida tackled the issue of whether "third-party reliance is sufficient to establish proximate cause" under RICO.[30] Specifically, in *Ironworkers Local Union No. 68 v. Astrazeneca Pharmaceuticals L.P.*, the plaintiffs alleged that defendants promoted a drug for a number of uses, including off-label uses through misrepresentations. They further alleged that, as a result of these misrepresentations, "they were duped into paying hundreds of millions of dollars for [the drug,] both to treat conditions for which the drug was not approved and where less expensive, and equally safe and effective, alternative treatments existed."[31] The defendants filed a motion to dismiss, arguing that the plaintiffs' claims failed because they could not satisfy RICO's proximate cause requirement. In response, the plaintiffs argued that the physicians' reliance on the misrepresentations in prescribing the drug satisfied the requirement of proximate cause.[32]

The court rejected the plaintiffs' argument. It found that the prescribing physicians used "their independent medical judgment to decide… the best treatment for a given patient."[33] And, although the court was not addressing the class certification question, it went on to note that questions of fact would exist as to the reasons why each individual physician prescribed the drug, requiring an "individualized inquiry."[34] Tying that back to the proximate cause analysis, the court reasoned that the introduction of such evidence rendered the causal nexus between the defendants' alleged misrepresentations and the plaintiffs' alleged injury too attenuated to satisfy the demands of proximate cause.[35]

The Eastern District of New York reached a similar conclusion in *Calabrese v. CSC Holdings, Inc.*[36] *Calabrese* denied class certification based on a lack of numerosity. The lack of a sufficient number of class members followed from the court's conclusion that a portion of the putative class could not satisfy RICO's proximate cause requirement because its members could not demonstrate reliance.[37]

Calabrese arose out of a cable television provider's efforts to prevent the use of "pirate" decoder devices to gain access to cable television programming that otherwise would have resulted in a fee to the viewer. The *Calabrese* plaintiffs alleged that CSC violated RICO by threatening frivolous litigation over the possession or use of the devices as a means of exacting settlement payments.[38] The plaintiffs claimed they were injured when they made such payments in an effort to avoid litigation. They brought suit on behalf of themselves and every other person who had made settlement payments to CSC.

In considering the plaintiffs' class certification motion, the court began by confronting the issue of whether the plaintiffs would be required to show reliance in order to establish proximate cause. It determined that they would, because the only misrepresentations alleged to have been made were those purportedly made to the plaintiffs. Unlike *Bridge*, the *Calabrese* plaintiffs did not claim that the defendants had made representations to any third party. Therefore, "[u]nder the circumstances of this case, where the only misrepresentations at issue are those the defendants made directly to each victim of the alleged scheme, a putative plaintiff cannot establish that his injury was proximately caused by the RICO violation if he cannot allege and prove that he personally relied on the misrepresentations."[39] And if the plaintiffs were required to prove reliance, they also would be required to show that their reliance was reasonable.[40]

Based on that premise, *Calabrese* concluded the plaintiffs' claims were not suitable for class treatment. It assumed without deciding that CSC had made false representations to the plaintiffs about the legality of possession or use of the decoder devices.[41] The court then divided the plaintiffs into two groups: (1) those who relied only upon CSC's allegedly false representation that mere possession of the device was illegal; and (2) those who relied upon CSC's allegedly false representation that use of the device was illegal, while at the same time asserting in affidavits filed in support of the class certification motion that they had not used the device.

The court concluded the second group could not be members of the class because they could not reasonably have relied on CSC's alleged misrepresentations. As the court saw matters, it was unreasonable for the members of this group of plaintiffs to rely upon CSC's allegedly false claim that they would suffer adverse legal consequences as the result of their use of the decoder device at the same time that they swore they had never used the device.[42]

Because any reliance by these putative class members' upon CSC's alleged misrepresentations could not be considered reasonable, this group could not establish RICO's proximate cause element. And without this portion of the putative class, the named plaintiffs could not satisfy Rule 23's numerosity requirement. Accordingly, *Calabrese* denied the plaintiffs' class certification motion.[43]

Calabrese, *CSC*, and *Ironworkers Local* thus demonstrate that other than the first-party reliance requirement, *Bridge* does not disturb any of the substantive requirements RICO plaintiffs must meet to make out a RICO claim. The same can be said of procedural and pleading requirements. The point was illustrated most recently in *In re Managed Care Litigation*.[44] In that case, a putative class of physicians alleged that the defendant health insurance providers violated RICO by conspiring to inflate profits through the delay, denial, or reduction of claims payments. The plaintiffs argued that *Bridge* eliminated the heightened pleading standard of Federal Rule of Civil Procedure 9(b) for claims of mail fraud as a predicate RICO violation. The court rejected that contention, concluding that elimination of the reliance requirement did not do away with the obligation to plead fraud with particularity. "Nowhere in [*Bridge*] did the Court hold, or even imply, that allegations of RICO mail and wire fraud do not need to comply with the 'who, what, when, where, and how' requirements mandated by Rule 9(b)."[45] Because the plaintiffs had failed to plead any predicate acts of fraud with the requisite particularity, the court dismissed their complaint.

A district court in the Third Circuit likewise has rejected a putative class plaintiff's attempt to use *Bridge* as a way to avoid the Third Circuit's "direct purchaser" rule. The direct purchaser rule is a standing doctrine. It limits those persons or entities permitted to sue a manufacturer for charging inflated prices to the person or entity that purchased the goods directly from the manufacturer. Purchasers farther down the chain of distribution do not have standing. This rule is designed in part to prevent manufacturers from being subjected to multiple suits for the same alleged wrongdoing, one brought by every purchaser in the chain of distribution. Originally developed in the antitrust context, the Third Circuit recognizes that the direct purchaser rule also should be applied to RICO claims.[46]

In *Hale v. Stryker Orthopaedics*, the District of New Jersey rejected plaintiffs' attempt to use *Bridge* as a means to avoid application of the direct purchaser rule in a RICO case.[47] The *Stryker* plaintiffs alleged that the manufacturers of replacement surgical joints charged inflated prices to the physicians who implanted them in the plaintiff patients. The plaintiff patients claimed they ultimately bore the artificially inflated costs of the joints in the form of increased insurance premiums. They alleged RICO violations and various state law claims.

The defendant joint manufacturers sought dismissal of the RICO claims based on the direct purchaser rule, arguing that the plaintiffs were not the direct purchasers of the replacement joints. The plaintiffs responded by claiming *Bridge* foreclosed that assertion, on grounds that the direct purchaser rule effectively placed a reliance requirement upon them that *Bridge* had eliminated.[48]

The court rejected the plaintiffs' argument. It held that *Bridge* has no bearing on the direct purchaser rule. As indirect purchasers, the *Stryker* plaintiffs' reliance upon the defendants' alleged misstatements was not at issue, and thus *Bridge* was inapplicable. Accordingly, the court granted the defendants' motions to dismiss.[49]

These decisions demonstrate that in many of the putative class cases considered after *Bridge*, the lack of a reliance requirement has not necessarily translated into a lowering of the barriers to class certification. However, *Bridge* has played a part in decisions to certify a class in other matters, as shown in the cases discussed below.

A Few Wins for Plaintiffs

In *Spencer v. Hartford Fin. Services Group*, the plaintiffs alleged that defendants engaged in the fraudulent practice of systematically retaining "a portion of an amount subject to a structured settlement, leaving the plaintiff with less than what they bargained for."[50] The plaintiffs sought class certification, and the defendants predictably attacked the proposed class on grounds of predominance. However, defendants' efforts were unsuccessful.[51]

Defendants opposed plaintiffs' class certification motion by arguing, in part, that common issues did not predominate. Plaintiffs rebutted the defendants' position, arguing that *Bridge* made clear that individualized personal reliance was unnecessary. The court agreed, explaining:

> A material misrepresentation still must be made, however, in order to establish a "scheme to defraud," and there must be proof that the material misrepresentation was made *in the case of* each class member, in order to make that person a part of the class.[52]

Indeed, the court determined that plaintiffs had to allege and prove that defendants made "standardized misrepresentations."[53]

Spencer nevertheless concluded the plaintiffs had met that burden. It found that there was some evidence that the defendants had made standardized misrepresentations to the plaintiffs, and noted that the plaintiffs limited their proposed class definition to those persons who had received the allegedly misleading representation. Accordingly, the court concluded the plaintiffs would be able to show that the injury allegedly suffered was capable of class-wide proof on the issue of proximate cause. Based on those findings, the court certified the class (but recognized that defendants ultimately might succeed at trial on the merits).[54]

The District of Maryland reached a similar result in *Robinson v. Fountainhead Title Group*.[55] There, the plaintiff alleged that he and the other putative class members were charged fees for sham title work in connection with home purchases. The plaintiffs claimed that putative class members each received a mailing containing a title policy and cover letter, and that these mailings were a critical component of the defendant's overall fraudulent scheme. The defendants argued that plaintiffs' claims failed because plaintiffs had not alleged any misrepresentations in the mailing itself. The court rejected defendants' argument as "irrelevant." Specifically, it noted that "[i]n *Bridge*, the predicate act mailings directed to non-parties took place after fraudulent scheme was implemented and even after the injury occurred, but the Supreme Court still found them sufficient to satisfy the mailing predicate act requirement of a RICO claim based on mail fraud."[56] The court thus granted the plaintiffs' request for reconsideration of their class certification motion, based on its conclusion that even if the mailing itself did not contain a fraudulent statement, it was nonetheless an essential part of the overall scheme to defraud.[57]

CONCLUSION

An argument certainly can be made that *Bridge* worked a substantial change in RICO jurisprudence by eliminating the requirement that plaintiffs plead and prove first-party reliance in making RICO claims predicated on acts of mail fraud. However, *Bridge* may not necessarily cause the tide of RICO class litigation to rise significantly. Although there are a handful of cases that have allowed class certification at least in part as a result of *Bridge*, RICO plaintiffs still must overcome a number of hurdles before they can prosecute a RICO claim on behalf of a class. In addition to the heightened pleading and other procedural requirements that remain intact, RICO plaintiffs still must prove proximate cause as a substantive element of their case. In many if not most instances, making that showing will continue to require proof of reliance. Thus, while reliance may no longer be an absolute requirement, it will continue to play a significant role in class action RICO litigation.

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Endnotes

1 Bridge v. Phoenix Bond & Indemnity Co., 553 U.S. ___, 128 S. Ct. 2131 (2008).

2 *Id*.

3 Fed. R. Civ. P. 23(b)(3) (prerequisite to damages class action is finding that "the questions of law or fact common to the class members predominate over any questions affecting only individual members").

4 1 Joseph J. McLaughlin, McLaughlin on Class Actions § 5:74 (5th ed. 2008).

5 18 U.S.C. § 1964(c).

6 Anza v. Ideal Steel Supply Corp., 547 U.S. 451, 457–58, 126 S. Ct. 1991, 1996–97 (2006); Holmes v. Securities Investor Protection Corp., 503 U.S. 258, 265–66, 112 S. Ct. 1311, 1316–17 (1992).

7 *Bridge*, 553 U.S. ____, 128 S. Ct. 2131, 2135 (2008).

8 *Id*.

9 *Id*.

10 *Id*.

11 *Id*. at 2136–37.

12 *Id*. at 1237.

13 *Id*.

14 *Id*. at 2145.

15 *Id*. at 2138 (citing Neder v. United States, 527 U.S. 1, 24–25, 119 S. Ct. 1827 1839 (1999) ("The common-law requiremen[t] of 'justificable reliance'… plainly ha[s] no place in the [mail, wire, or bank] fraud statutes.")).

16 *Id*. at 2144–45.

17 *Id*. at 2144.

18 *Id*. ("In most cases, the plaintiff will not be able to establish even but-for causation if no one relied on the misrepresentation…. Accordingly, it may well be that a RICO plaintiff alleging injury by reason of a pattern of mail fraud must establish at least third-party reliance in order to prove causation.").

19 Holmes v. Securities Investor Protection Corp., 503 U.S. 258, 265–66, 112 S. Ct. 1311, 1316–17 (1992).

20 *Id*. at 268, 112 S. Ct. at 1318.

21 503 U.S. 258, 265–66, 112 S. Ct. 1311, 1316–17 (1992).

22 *Id*. at 266, 112 S. Ct. at 1311.

23 547 U.S. 451, 457–58, 126 S. Ct. 1991, 1996–97 (2006).

24 Anza v. Ideal Steel Supply Corp., 547 U.S. 451, 457–58, 126 S. Ct. 1991, 1996–97 (2006).

25 *Holmes*, 503 U.S. at 271, 112 S. Ct. at 1311.

26 *Anza*, 547 U.S. at 457, 126 S. Ct. at 1996.

27 *Id*. at 458–59, 126 S. Ct. at 1997.

28 *Bridge*, 553 U.S. at ____, 128 S. Ct. at 2144.

29 *Id*., 128 S. Ct. at 2144 ("[T]he fact that proof of reliance is often used to prove an element of the plaintiff's cause of action, such as the element of causation, does not transform reliance itself into an element of the cause of action…. Nor does it transform first-party reliance into an indispensable requisite of proximate causation." (citation and internal quotation marks omitted)).

30 Ironworkers Local Union No. 68 v. Astrazeneca Pharmaceuticals L.P., 585 F. Supp. 2d 1339, 1341–42 (M.D. Fla. 2008).

31 *Id*. at 1342.

32 *Id*.

33 *Id*. at 1344.

34 *Id*.

35 *Id*.

36 No. 02-CV-5171 (DLI) (JO), 2009 WL 425879 (E.D.N.Y. Feb. 19, 2009) (order adopting Magistrate Judge's Report & Recommendation).

37 *Id*. at *13–14.

38 *Id*. at *1.

39 *Id*. at *12.

40 *Id*. at *12.

41 *Id*. at *13.

42 *Id*. at *13–14.

43 *Id*. at *1.

44 Nos. 00-1334-MD and 03-21296-CIV, 2009 WL 812257 (S.D. Fla. Mar. 26, 2009) (order adopting Magistrate Judge's Report & Recommendation).

45 *Id*. at * 8.

46 McCarthy v. Recordex Servs. Inc., 80 F.3d 842, 855 (3d Cir. 1996).

47 No. 08-3367 (WJM), 2009 WL 321579 (D. N.J. Feb. 9, 2009).

48 *Id*. at *4.

49 *Id*.

50 Spencer v. Hartford Fin. Servs. Group, No. 3:05-CV-1681(JCH), 2009 WL 637676, at *1 (D. Conn. Mar. 10, 2009).

51 *Id*.

52 *Id*. at *12.

53 *Id*.

54 *Id*. at *13.

55 No. WMN-03-3106, 2009 WL 539882 (D. Md. Mar. 3, 2009).

56 *Id*. at *2.

57 *Id*.

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