

Gaming Removal Under the Class Action Fairness Act: Can a Plaintiff Stipulate to Less than the Requisite Amount-in-Controversy to Evade Removal?

CASE AT A GLANCE

The Class Action Fairness Act of 2005 contains a provision enabling the removal of state class actions into federal courts; in order to qualify, the class action must involve damages in excess of \$5 million. The Court will decide whether a state class representative may stipulate to damages less than \$5 million in order to avoid removal into federal court.

Standard Fire Insurance Company v. Knowles Docket No. 11-1450

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From: The Eighth Circuit

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ISSUE

May a state court class representative in his complaint stipulate that he is seeking less than \$5 million in damages on behalf of himself and the class, in order to avoid removal of the state class action to federal court under the Class Action Fairness Act of 2005?

FACTS

On March 10, 2010, Greg Knowles's (Knowles) home in Miller County, Arkansas, was damaged in a hailstorm. Knowles filed a property damage claim under his homeowner's insurance policy with The Standard Fire Insurance Company (Standard Fire), a Connecticut corporation. Standard Fire reimbursed Knowles for the costs involved in repairing his house, but did not include any amount associated with Knowles's retaining a general contractor to supervise those repairs.

Generally, when a policyholder makes a claim under a homeowner's policy, the insurance adjuster makes an assessment of damage and determines whether the damage is sufficiently complex to require a general contractor's supervision and coordination. A general contractor typically adds a percentage to a repair contract—known as the “general contractors’ overhead and profit” (GCOP)—which typically is 20 percent of the estimated job.

Because Standard Fire did not pay Knowles for his contractor's GCOP fee, Knowles retained counsel and filed a class action against Standard Fire in Miller County Circuit Court on April 13, 2011. His state court complaint asserted a breach of contract claim on behalf of himself and all other Arkansas residents who received payments under a homeowner's insurance policy for damage to their dwellings, which did not include a payment for a general contractor's overhead and profit expense.

For Standard Fire's alleged breach of contract, Knowles asked for money damages for himself and class members equal to 20 percent of the amount paid by Standard Fire to repair the damaged properties. Knowles alleged that he and the plaintiff class stipulated to limit their recovery to less than \$5 million, and that this stipulation was binding for the purpose of establishing the amount in controversy. In addition, the “pray for relief” in the complaint expressly limited damages to these amounts and stated that all elements of damages, costs, and fees would not exceed \$75,000 for Knowles individually or any class member individually and/or \$5 million for the entire class combined. Knowles accompanied his complaint with a sworn and binding stipulation stating he would not at any time during the litigation seek damages for the class in excess of \$5 million in the aggregate (including costs and attorney fees).

In response, Standard Fire removed the case to the federal district court for the Western District of Arkansas based on the Class Action Fairness Act of 2005 (CAFA). See Pub. L. No. 109-2, 119 Stat. 4; 28 U.S.C. § 1453 (CAFA removal provision). Standard Fire contended that the class action satisfied all the prerequisites for federal court jurisdiction because the action involved citizens of different states, involved more than 100 claimants, and exceeded \$5 million amount-in-controversy requirement for diversity class actions. See 28 U.S.C. § 1332(d).

Knowles filed a petition for remand, asking the federal court to send the case back to the Miller County state court. At the remand hearing, Standard Fire offered proof that the amount-in-controversy of all class members' claims exceeded \$5 million, including amounts for interest and attorney fees. By Standard Fire's calculations, the court noted that the total expected damage award amounted to \$5,024,150, or \$24,150 in excess of the statutory minimum for state court jurisdiction. Knowles did not introduce evidence of his own

regarding the amount-in-controversy. The court agreed that Standard Fire therefore satisfied its burden to demonstrate that the amount-in-controversy exceeded \$5 million.

However, the court then shifted the burden to Knowles to prove to a legal certainty that his claims fell under the threshold of \$5 million (which would require a remand to state court). The court ruled that Knowles's stipulation was legally binding under state law and showed to a legal certainty that the aggregate damages on behalf of the class would not in good faith exceed \$5 million. In addition, the court rejected Standard Fire's argument that Knowles's allegation of damages was made in bad faith. Consequently, the court ordered a remand to state court.

Standard Fire petitioned the Eighth Circuit for permission to appeal the remand order pursuant to CAFA. See 28 U.S.C. § 1453(c)(1). On January 4, 2012, the Eighth Circuit summarily denied the petition. On March 1, 2012, the appellate court subsequently denied Standard Fire's petition for rehearing. The opinions of the district and appellate courts are unpublished.

CASE ANALYSIS

Congress enacted the Class Action Fairness Act in 2005, which accomplished two major changes in prevailing class action law. First, CAFA amended the existing federal diversity jurisdiction statute by adding a new special provision for diversity class actions. See 28 U.S.C. § 1332(d). Ordinary nonclass diversity actions may be brought in federal court if the parties come from different states and if the amount-in-controversy exceeds \$75,000. 28 U.S.C. § 1332(a). The new CAFA provision for diversity class actions specifies that a plaintiff may pursue a class action in federal court if (1) the parties to the litigation are from different states, (2) there are more than 100 class members, and (3) the amount-in-controversy exceeds \$5 million.

In addition to creating a new special jurisdictional provision for diversity-based class actions, CAFA also changed prevailing rules relating to satisfaction of the amount-in-controversy requirement for federal class actions. Prior to CAFA's enactment, prevailing jurisprudence did not allow class action plaintiffs to aggregate their individual damage claims to meet the \$75,000 requirement (known as the "non-aggregation" rule, from *Zahn v. Int'l. Paper Co.*, 414 U.S. 291 (1973)). Instead, class action precedents required that each class member individually satisfy the \$75,000 amount-in-controversy requirement. Because many class actions involved class members with individual claims less than \$75,000, courts refused to certify those class actions even though the litigation satisfied diversity-of-citizenship requirements.

To resolve this problem, CAFA explicitly changed the amount-in-controversy requirement for diversity class actions. The new provision makes no reference to the \$75,000 amount-in-controversy requirement for ordinary nonclass litigation. Instead, the CAFA provision requires that a court "shall" have jurisdiction over a proposed action "in which the matter in controversy exceeds the sum or value of \$5 million, excluding interest and costs ..." 28 U.S.C. § 1332(d)(2).

In addition, CAFA states that "the claims of individual class members shall be aggregated to determine whether the matter in

controversy exceeds the sum or value of \$5 million, exclusive of interests or costs." See 28 U.S.C. § 1332(d)(6). CAFA's legislative history and scholarly commentary indicate this provision was intended to override the prevailing *Zahn* nonaggregation rule.

Second, CAFA altered a defendant's ability to remove a state class action into federal court. See 28 U.S.C. § 1453. As is true for any case in which a defendant seeks to remove a case from state to federal court, a class action may be removed only if there is a good federal jurisdictional basis for the court accepting the removal. After the enactment of CAFA, a state class action removed under CAFA would have to satisfy the new diversity jurisdictional requirements for class actions.

For many jurists and commentators, the removal provision was central to the congressional legislative goal and intent in enacting CAFA. In this view—articulated in CAFA's extensive legislative history—the goal of CAFA was to deal with problems of rogue state judiciaries that enabled an array of abusive class action practices, including but not limited to relaxed class certifications, *in terrorem* blackmail pressure, worthless coupon settlements, and excessive attorney fees. The core purpose of CAFA's removal provision, then, was to provide an avenue of federal relief for out-of-state defendants sued in class actions in so-called hellhole state courts.

Against this backdrop, the *Standard Fire* appeal raises fundamental issues concerning how—and to what extent—the new CAFA provisions for diversity class actions have changed or modified principles relating to removal of state class actions into federal court. Thus, *Standard Fire* asks whether CAFA has altered principles relating to pleading and removal that apply in ordinary, nonclass diversity cases.

In ordinary, nonclass cases, a plaintiff who files an action in state court may evade a defendant's attempt to remove the case to federal court by pleading allegations that do not satisfy the requirements for diversity jurisdiction. Thus, a plaintiff may successfully defeat removal by naming a nondiverse defendant to the lawsuit, or by pleading damages below the \$75,000 threshold for federal jurisdiction. As long as a plaintiff has pleaded in good faith and has not fraudulently joined parties to defeat diversity jurisdiction, courts repeatedly have recognized that a plaintiff is "the master of his own complaint" and may allege parties, claims, or remedies to ensure that the litigation will remain in state court.

In addition, federal courts have developed doctrines to determine whether a plaintiff's damage allegations satisfy jurisdictional requirements in ordinary diversity actions. At the threshold, courts simply accept a plaintiff's damage allegation as made in good faith. If a defendant then challenges the plaintiff's damage claim, the defendant must prove "to a legal certainty" that a prevailing plaintiff could not, to a legal certainty, recover less than the jurisdictional amount of \$75,000. See *St. Paul Mercury Indem. Co. v. Red Cab Co.*, 303 U.S. 283 (1938).

In light of these principles, Standard Fire contends that CAFA changed the amount-in-controversy rule for federal class actions, and that it satisfied its burden because as of the time of removal, the aggregated claims of the individual members of the putative class exceeded \$5 million. Standard Fire argues that the traditional

diversity provision instructs courts to assess the amount-in-controversy based on the “matter in controversy,” but CAFA’s diversity requirement explicitly directs that the claims of individual class members “shall be aggregated” to determine whether the \$5 million threshold is satisfied. In this context, Standard Fire asserts “claim” refers to each individual class member’s right to recovery under the operative facts in the complaint, and not the amount sought in recovery of that right.

Using this textual standard requiring the aggregation of individual claims, Standard Fire notes that it carried its burden of demonstrating that the aggregate amount-in-controversy exceeded \$5 million. Standard Fire further notes that the district court agreed that Standard Fire had carried its burden. In contrast, Standard Fire asserts, Knowles failed to counter Standard Fire’s estimates with any evidence of his own. Thus, the court’s determination that Standard Fire had satisfied the amount-in-controversy requirement is controlling, and a class representative cannot evade this calculation through stipulation, allegations, or any other means. A plaintiff’s stipulation cannot oust a court of federal jurisdiction, concludes Standard Fire.

In addition, Standard Fire contends that CAFA’s text does not authorize a plaintiff to use a stipulation to alter the aggregated total of individual class members claims and thereby circumvent the statutorily prescribed amount-in-controversy calculation. Moreover, the district court’s remand order conflicts with the CAFA’s purpose and legislative history, which was intended to prevent plaintiffs’ manipulation of the amount-in-controversy requirement to thwart federal court jurisdiction of class litigation.

Standard Fire and its numerous amici assert an array of policy arguments based on CAFA’s legislative history and congressional intent in providing for removal of state class actions from state “judicial hellholes.” In this view, CAFA’s purpose was to protect out-of-state defendants and absent class members from class action abuses in state courts such as Miller County, Arkansas.

Thus, in this case, the court’s remand order would force Standard Fire to litigate in a state court known for lax class certification standards inconsistent with Fed. R. Civ. P. 23 and for permitting lawyers to game procedural rules. Standard Fire points out that Knowles’s counsel previously filed dozens of class actions in Miller County, including against eight insurance companies, alleging the same GCOP claims asserted in this case. Standard Fire further notes that in contrast to Arkansas’s lax class certification standards, numerous federal courts have rejected class certification of proposed GCOP class actions.

Moreover, Standard Fire argues that a plaintiff cannot by stipulation bind absent class members to a recovery for less than \$5 million, because before a class is certified, a class representative cannot bind other proposed class members. A putative class representative has no power to diminish the claims of other individual class members before a class is certified. Furthermore, the ability to opt out of a class action is no substitute for Rule 23 or due process requirements.

Standard Fire also repudiates Knowles’s reliance on the “master of the complaint” doctrine to justify stipulated damages to avoid removal. Standard Fire contends that while this doctrine applies to

ordinary, nonclass diversity cases, it does not apply to CAFA class actions. Thus, the mere filing of a state class action does not make a plaintiff class representative the master of the claims or damages flowing from those allegations and belonging to other individual class members.

Thus, concludes Standard Fire, Knowles’s stipulation violates the due process rights of absent class members and exposes the class action to subsequent challenge or collateral attack. In addition, argues Standard Fire, under prevailing legal precedents, the stipulation still would not establish to a legal certainty that the amount in controversy was less than \$5 million.

In response, Knowles counters that Standard Fire’s interpretation of CAFA’s amount-in-controversy requirement in § 1332(d)(6) is incorrect because that provision simply displaced *Zahn*’s nonaggregation rule. Moreover, under Arkansas state law, a plaintiff may stipulate to damages. Where a plaintiff makes a stipulation of damages in good faith and the stipulation is enforceable under state law, it is controlling on the amount-in-controversy requirement. Knowles asserts that in enacting CAFA, Congress did not intend to preclude a federal court from considering a damage stipulation in assessing the amount-in-controversy requirement. Standard Fire and its amici, then, incorrectly accuse Knowles of attempting an end run around CAFA.

Furthermore, CAFA was not intended to override the traditional principle that a named plaintiff, as master of his own complaint, is capable to determine class members’ claims and whether those aggregate claims exceed CAFA’s jurisdictional amount. Thus, under well-settled precedents, a state court plaintiff may allege parties, claims, and damages in order to avoid federal removal, which has been the law for more than a century. Therefore, according to Knowles, the district court was correct to recognize the stipulation as binding and determinative of the amount-in-controversy for removal.

In addition, according to Knowles, CAFA struck a balance between federal and state jurisdiction of class litigation. While a primary purpose of CAFA was to locate large multistate class actions of national importance in federal court, other CAFA provisions were intended to retain state court jurisdiction for small damages, intra-state class actions. CAFA did not create diversity jurisdiction over all class actions, but appropriately left certain intra-state class actions in state court.

Thus, Knowles argues, Standard Fire’s arguments on appeal are misplaced because this action involves precisely the type of local, small-damage class action that CAFA intended to remain in state court. Knowles also contends that a significant portion of Standard Fire’s (and its amici’s) arguments are devoted to unfair and unjustified ad hominem attacks on the Arkansas judiciary. The defendant and its amici, Knowles suggests, would use this case as a referendum on the legitimacy of the Miller County and Arkansas state courts.

Furthermore, Knowles argues that CAFA’s legislative history specifically articulates the need for streamlined jurisdictional inquiries and specified that a class representative could enter into jurisdictional stipulations to assist a court in making jurisdictional

determinations at the outset of a lawsuit. In contrast, Standard Fire’s position presents an unworkable and burdensome prospect for federal courts in CAFA removal cases. Thus, district courts would be subjected to an unworkable jurisdictional regime, forcing courts to grapple with intensive merits inquiries regarding damages at the outset of litigation in order to determine threshold jurisdiction.

Finally, following the settled jurisdictional rules relating to good faith pleading of damages for nearly 75 years does not violate the due process rights over absent class members, concludes Knowles. Considering a damage limitation at the jurisdictional stage is consistent with due process because that limitation cannot have a binding effect on the merits of absent class members unless and until the class is certified.

SIGNIFICANCE

In recent years, the Court has manifested an increasing interest in federal class action litigation, and *Standard Fire* is the fourth class action appeal on the Court’s docket this term. *Standard Fire* is significant because it presents the Court with its first opportunity to interpret several statutory provisions of CAFA since its enactment in 2005. In addition to the narrow CAFA statutory construction problems, *Standard Fire* also deals with larger issues of the allocation of class litigation between state and federal courts, and the underlying purposes of CAFA to address class action litigation abuse.

Beginning in the mid-1990s, many federal courts began articulating progressively more stringent requirements for class litigation, including more rigorous analysis of class certification requirements and settlements. In response, many class action attorneys abandoned federal courts for more congenial state court forums. Thus, for more than a decade, class litigation shifted to favorable state court jurisdictions, where corporate defendants often found themselves subject to more lax state class action rules, standards, and judicial orders. As a consequence, corporate defendants often capitulated to so-called settlement blackmail, by settling class litigation rather than be subjected to a jury trial on class claims. In light of egregious class action abuses, corporate defendants compiled lists of notorious plaintiff-favoring state “judicial hellholes.”

This shift, accompanied with the perceived and real abuses of class litigation in selected forums, inspired efforts by the defense and corporate bars to redress the balance between federal and state adjudication of class litigation. To this end, Congress enacted the Class Action Fairness Act in 2005—after eight years of legislative initiatives—intended to address various problems inspired by abusive state class litigation. The major CAFA reforms created a special diversity jurisdiction for federal class actions, loosened requirements for establishing federal court jurisdiction, and enacted a special removal provision for state class actions into federal courts. However, CAFA also carved out certain limited exceptions to federal court jurisdiction for purely local state controversies.

This case essentially presents the Court with a narrow statutory construction problem fraught with significant policy concerns. It asks the Court to determine whether a state court plaintiff may defeat removal of a state class action by simply stipulating to an amount-in-controversy below the federal jurisdictional amount. In an ordinary nonclass lawsuit, a plaintiff may do this, provided the

allegation of damages below the jurisdictional threshold is not made in bad faith. The question before the Court is whether CAFA has changed this rule for CAFA class actions.

If the Court upholds the district court’s remand order, then state court class action plaintiffs will have an approved mechanism by which to defeat removal of their class actions to federal court. Standard Fire and its amici contend that this result will undermine the central purpose of CAFA, which was to provide a federal forum for defendants sued in state court forums especially renowned for various class action abuses.

The appeal presents an interesting ideological dilemma for certain members of the Court. The Court’s conservative wing—consistent with an alignment with corporate interests—has manifested sensitivity to potential class action abuse. Justices so disposed are most likely to sympathize with CAFA’s legislative purposes. On the other hand, these same conservative and dedicated textualists are the justices also most likely to resist reliance on legislative history to illuminate statutory interpretations.

Therefore, it will be interesting to see the extent to which the Court resolves *Standard Fire* based purely on a textual construction of CAFA’s amount-in-controversy requirement, and shorn of any reference to CAFA’s legislative history.

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