Consumer Financial Services
LAW REPORT

Focusing on Significant Caselaw and Emerging Trends

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Class action

Claims of class reps-come-lately were moot before they started

The 5th U.S. Circuit Court of Appeals recently affirmed the dismissal of the claims of two proposed class representatives as moot before they sought addition as named plaintiffs through amendment, but after they had settled their claims against a defendant title company, prior to the resolution of the motion to amend. (*Murray v. Fidelity National Financial Inc., et al.*, No. 09-50157 (5th Cir. 01/15/10).)

"Not only were the [plaintiffs]' claims mooted before they ever became parties to the suit, the suit itself was moot from the day it was filed," wrote Circuit Judge Emilio M. Garza in penning the 5th Circuit panel's decision.

Wesley and Kelly R. Murray were not parties to the class action suit filed by Rosa M. Arevalo and Amy L. Rash, alleging that Ticor Title Insurance Co. had overcharged them to record documents related to their residential real estate closings. The original plaintiffs also alleged that other defendants — including Chicago Title Insurance Co. — were liable under theories of vicarious liability.

(See **MOOT** on page 6)

Preemption

HEA preempts borrowers' claims against student loan servicers

No matter which kind of federally-insured student loans are at issue, state law claims challenging the policies and procedures of student loan servicers are preempted by federal law. The 9th U.S. Circuit Court of Appeals upheld a District Court's grant of summary judgment to the loan servicer in a putative class action brought by student loan borrowers. The appeals court held that the servicer's methods of calculating interest, assessing late fees, and setting the repayment start date on their loans were governed exclusively by the Federal Family Education Loan Program administered by the U.S. Department of Education under the Higher Education Act. (*Chae v. SLM Corp.*, No. 08-56154 (9th Cir. 01/25/09).)

Ann Chae, William Coakley, Hoon Koo, and Carlos A. Pineda were student borrowers who took out FFELP Stafford, Supplemental and Consolidated Loans from various lenders between 1993 and 2006. Sallie Mae Inc. was the third-party servicer for each of the loans. The borrowers brought a putative class action, arguing that three of Sallie Mae's student loan-servicing policies variously violated California business, contract, and consumer protection laws:

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How to avoid reaping what you didn't sow: CAFA's solution for removal of counterclaim class actions

By Anthony Rollo and Candy Burnette*

You are a risk manager at XYZ Financial Services Inc., weighing your options with the defaulting Mr. Smith.

You will likely do what you ordinarily do: Sue Mr. Smith to collect on his delinquent account. But with just a few hundred or even a few thousand at stake, the federal court lacks jurisdiction, so you will need to sue him in state court. The risks are minimal, although there's a chance that Mr. Smith could file counterclaims against you. But he's only one customer, right?

Wrong!

You've forgotten to factor in the aggressive plaintiff's attorney who's been waiting for his chance to bring that big class action against you on behalf of customers all over the state, with claims that run the gamut. All he has to do is include class counterclaims in Mr. Smith's answer, and he has you trapped in an expensive and lengthy class action battle in an unfriendly state court.

The problem

This has become a growing problem for creditors. Even though class counterclaims like those brought by Mr. Smith were identical to those that could have been brought by class action plaintiffs in stand-alone actions, courts consistently have held that they could not be removed to federal court for the sole reason that they were brought as counterclaims to the original suit.

Under the rule announced by the Supreme Court almost 70 years ago in *Shamrock Oil & Gas Corp. v. Sheets*, 313 U.S. 100 (1941), a counterclaim defendant who was also the original plaintiff could not remove under the predecessor provision to 28 USC § 1441. Since then, until very recently, courts have held that only a "traditional" defendant — one against whom the original plaintiff asserts claims — can remove under Section 1441.

The solution

In 2005, Congress passed the Class Action Fairness Act, legislation designed to widen the doors to the federal courts for large-scale class actions of national importance, and to curb abuses by class action plaintiffs' attorneys and unfair treatment of foreign defendants by state court judges and juries. Under CAFA, federal courts have original jurisdiction over class actions brought on behalf of over 100 putative class members, with at least $5 million in controversy and minimal diversity. Removal under CAFA is accomplished primarily under Section 1453(b), which states that a class action may be removed by "any defendant."

By its terms, CAFA appears to solve your problem. But, notwithstanding the sweeping changes intended by Congress and the new removal provisions drafted to effectuate them, for the first four years after CAFA's enactment, courts continued to apply *Shamrock* to foreclose removal of qualifying class actions brought as counterclaims, by importing the *Shamrock* definition of "defendant" into the phrase "any defendant" in Section 1453(b).

However, in 2009, two important decisions paved the way for courts to rethink CAFA's effect on removal by counterclaim defendants in the class action context, with one expressly holding for the first time that CAFA now allows removal in these circumstances.

Palisades

The first of these groundbreaking opinions was in *Palisades Collections LLC v. Shorts*, 552 F.3d 327 (4th Cir. 2008). Although the majority held that counterclaim defendants could not remove under CAFA, the dissent by Judge Paul V. Niemeyer called that holding into serious doubt with an extensive analysis of the statute itself, Congressional intent, and the underpinnings of the *Shamrock* rule. (*For more, see the Jan. 21, 2009 issue, p. 3.*)

Palisades was a simple collection action brought in West Virginia state court to collect less than $800 from Charlene Shorts, a defaulting cellular telephone account holder. Shorts, however, filed a counterclaim against original plaintiff Palisades, the collection agency, and amended her counterclaim to add class claims against AT&T Mobility LLC on behalf of roughly 160,000 customers in West Virginia, seeking more than $16 million in damages. ATTM removed the case under CAFA's Section 1453(b), and Shorts moved to remand, arguing that ATTM was not a traditional "defendant" with authority to remove under Section 1441. The District Court remanded the case and ATTM appealed.

The 4th Circuit majority affirmed, holding that *Shamrock* precludes removal by a counterclaim defendant under Section 1453(b). However, Judge Niemeyer observed that a natural reading of the phrase "any defendant" in Section 1453(b) plainly includes any and all types of defendants, not just the traditional defendant who could remove before CAFA under Section 1441. He also argued that Congress affirmatively chose to depart from the *Shamrock* rule when

(See **COUNTERCLAIM** on page 4)

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COUNTERCLAIM (continued from page 3)

enacting CAFA, as well as the canons of strict construction of the removal statute established in *Shamrock*, which are inapplicable in the CAFA context based on its intended expansion of federal court jurisdiction. For these reasons, argued Judge Niemeyer, there is no reason to import the *Shamrock* rule and artificially limit "any defendant" under CAFA to the original defendant.

Weickert

Taking his cue from Judge Niemeyer's dissent, federal District Judge Jack Zouhary became the first to uphold removal by a counterclaim defendant under CAFA in *Deutsche Bank Nat. Trust Co. v. Weickert*, 638 F.Supp.2d 826 (N.D. Ohio 2009).

Weickert, similar to *Palisades*, began as a simple foreclosure action in Ohio state court brought by trustee Deutsche Bank National Trust Co. against defendant borrowers, the Weickerts. In response, the Weickerts filed a class action counterclaim against original plaintiff Deutsche, and added as counter-defendants Home Loan Services, and Lerner, Sampson & Rothfuss, the servicer and foreclosure attorneys, respectively, alleging claims based on their servicing and collection practices.

HLS and LSR removed the case to federal court under Section 1453(b) of CAFA. The Weickerts moved to remand the case to state court, arguing that as "cross-claim" or "third-party defendants," HLS and LSR did not have the right to remove.

The *Weickert* court disagreed, finding that Section 1453(b) was intended to extend removal power to all parties who may become "defendants" to a class action, and not just to the original defendants to the suit.

"Concluding that a lawsuit that otherwise qualifies under CAFA is not of national importance merely because the class action plaintiffs brought the claim via counterclaims rather than an original complaint, contravenes clear congressional intent," Judge Zouhary explained.

"By enacting CAFA, Congress intended to open the federal courts to qualifying class actions; this clear intent eliminates the federalism concerns which animated the rule of construction that removal statutes be read narrowly," the judge concluded.

Judge Zouhary certified his opinion for interlocutory appeal to the 6th Circuit, citing a contrary ruling from an Ohio District Court in *Wells Fargo Bank v. Gilleland*, 621 F.Supp.2d 545 (N.D. Ohio 2009), as grounds supporting review, and the 6th Circuit granted that appeal under 28 USC § 1292(b).

The appeal is now pending.

Unearned consequences

Consumer creditors often sell defaulted accounts and/or rely on others to bring suit to collect from defaulting customers. In the case of *Palisades*, for example, ATTM was not a plaintiff to the original suit, but was brought in by Shorts as an additional counterclaim defendant. Similarly, the class claims in *Weickert* were removed by "additional" counterclaim defendants who were not original plaintiffs. Properly interpreted, CAFA should extend removal authority to *all* class counterclaim defendants, including the original plaintiff.

Judge Niemeyer correctly recognized in his *Palisades* dissent that *Shamrock* only dealt with a counterclaim defendant who *also* was the original plaintiff in the state court action. In fact, the U.S. Supreme Court framed the question raised in *Shamrock* as "whether the suit in which the counterclaim is filed, is one removable *by the plaintiff* to the federal District Court on grounds of diversity of citizenship." The Court then cited to a prior holding that "the plaintiff, having submitted himself to the jurisdiction of the state court, was not entitled to avail himself of a right of removal conferred only on a defendant who has not submitted himself to the jurisdiction."

Based on the stated rationale of *Shamrock*, it cannot apply to "additional" counterclaim defendants who did not choose the state court forum, and therefore cannot be bound to a choice they never made.

Judge Zouhary recognized this point in distinguishing the only other appellate decision to address the CAFA counterclaim removal issue, *Progressive West Ins. Co. v. Preciado*, 479 F.3d 1014 (9th Cir. 2007). In *Preciado*, there were no "additional" counterclaim defendants involved, and the court held that CAFA did not abrogate the *Shamrock* rule that original "plaintiff/cross-defendants" may not remove.

The logic of *Weickert* and the dissent in *Palisades* in interpreting CAFA and its stated legislative purpose should similarly apply to enable an original plaintiff who becomes a defendant in a class action counterclaim to remove to the same extent as an "additional" counterclaim defendant may remove.

Stay tuned

The *Weickert* decision can be expected to be joined by others holding that counterclaim defendants may remove to federal court under CAFA. As a result, financial services organizations should be able to pursue small claims in state court with less fear of the absurd consequence of having to defend large, unremovable class action counterclaims there. ❑

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