Consumer Financial Services
LAW REPORT
Focusing on Significant Caselaw and Emerging Trends
Route to:
VOLUME 12, ISSUE 14 January 21, 2009

Requested *en banc* rehearing petition to 4th Circuit in *Palisades* could breathe new life into CAFA removal provision

By Anthony Rollo and Candy Burnette*

A three-judge panel of the 4th U.S. Circuit Court of Appeals recently held that the Class Action Fairness Act did not give removal rights to a newly added counter-defendant faced with class allegations in an action commenced by its co-counter-defendant in state court, in accord with the majority of courts to consider the issue to date. (*Palisades Collections LLC v. Shorts*, No. 08-2188 (4th Cir. 12/16/08).) However, the 4th Circuit could be poised for a rethink. A petition for rehearing *en banc* was recently filed, fueled by a lengthy dissent by Judge Paul V. Niemeyer.

A change in direction here by the influential 4th Circuit would have significant ramifications for the ability of consumer financial services organizations to file small collection actions in state court, without the fear of exposure to class action counterclaims that were virtually unremovable pre-CAFA. Unfortunately, some courts have been slow to recognize the new expansive tools created by CAFA to facilitate the removal of class actions in settings that previously did not allow removal.

State-court collection action

Palisades began as a simple action filed in West Virginia state court by Palisades Collection LLC to collect $794.87 from Charlene Shorts, a defaulting cellular telephone account holder. Shorts filed a counterclaim against Palisades alleging unfair trade practices under state law, and a year later amended her complaint to add as a counter-defendant AT&T Mobility LLC, the successor to the original wireless provider, AT&T Wireless Services Inc., along with class action claims against all counter-defendants.

Shorts then filed a motion to certify a class of roughly 160,000 similarly situated customers in West Virginia, seeking over $16 million in damages. Before the state court could rule on the motion, ATTM removed the case to the U.S. District Court, Northern District of West Virginia. The plaintiff moved to remand, asserting that ATTM was not a true "defendant" under 28 USCA § 1441. The district court agreed and remanded the case. ATTM appealed.

On the appeal, ATTM argued that Section 1453(b), a provision added under CAFA, provided an independent basis for removal by a counter-defendant, in addition to the general removal statute, Section 1441. It argued alternatively that if neither Section 1441 nor 1453(b) would permit removal with ATTM in the position of counter-defendant, the parties should be realigned to make ATTM a traditional defendant, thereby allowing for removal.

The majority's 'holistic' approach

In resolving those issues, the panel, led by Chief Judge Karen J. Williams, took a "holistic" approach in divining the meaning of the term "defendant" in both the general removal and CAFA removal provisions. The panel noted first that Section 1441 allows removal by "the defendant or the defendants." It then examined the new CAFA provisions, including Section 1332 (d)(2), which gives District Courts original jurisdiction of class actions where the matter in controversy exceeds $5 million and there is diversity between at least one class member and one defendant, and Section 1453(b), which provides that "a class action may be removed … by any defendant without the consent of all defendants."

The panel rejected ATTM's argument that Section 1441 standing alone provided a basis for removal by an additional counter-defendant who was not an original plaintiff, or any counter-defendant, relying on *Shamrock Oil & Gas Corp. v. Sheets*, 313 U.S. 100 (1941). In *Shamrock*, the Supreme Court held that under the predecessor to Section 1441, the original plaintiff could not remove a case to federal court on the basis that a counterclaim was filed against it.

The panel noted decisions from various jurisdictions applying *Shamrock* to preclude removal by a third-party defendant under Section 1441, and finding that only a "traditional" defendant has the right to remove — *i.e.*, "defendants against whom the original plaintiff asserts claims." The panel also looked to the fact that Congress has extended the right of removal to parties other than traditional defendants (such as in the bankruptcy context), but has always done so expressly.

'Any defendant'

The panel then turned to Section 1453(b), which ATTM argued would provide an independent right of removal based on its use of the phrase "any defendant" versus "the defendant or the defendants" in Section 1441, and based on the language in Section 1453(b) that "a class action may be removed …" The panel rejected the latter language as providing a basis for removal by all parties, finding that the provision when read as a whole only grants removal rights to defendants.

Regarding the phrase "any defendant," the panel found no reason to believe that the term "defendant" should not have the same settled meaning in Section 1453(b) as in Section 1441 (thus importing the *Shamrock* rule that the defendant is a "traditional" defendant), or that use of the term "any" somehow broadened the meaning of "defendant." Rather, the panel interpreted the intent of the modifier "any" to mean that "any defendant" could remove without the consent of all defendants, a clear change to the general rules of removal effected by CAFA.

"Put simply, there is no indication in the language of Section 1453(b) (or in the limited legislative history) that Congress intended to alter the traditional rule that only an original defendant may remove and to somehow transform an additional counter-defendant like ATTM into a 'defendant' with the power to remove," the 4th Circuit said.

Other arguments

The panel did acknowledge the policy considerations present in leaving such a potentially large category of class actions in state court, but discussed with approval the recent decision of the 9th Circuit in *Progressive W. Ins. Co. v. Preciado*, 479 F.3d 1014 (9th Cir. 2007), which determined (*in dicta*) that in enacting CAFA, Congress did not create an express exception to the rule in *Shamrock*; nor should an exception be implied for policy reasons.

Addressing ATTM's alternative argument that the parties should be realigned to make ATTM a traditional defendant, the panel looked to the "principal purpose" test for determining the "primary and controlling matter in dispute," and applied the rule that a counterclaim may not be considered; therefore, as the "principal purpose" of the suit was to collect a debt, realignment was inappropriate.

Dissent argues *Shamrock* inapplicable

In his dissent, Judge Niemeyer posited that Section 1453(b) does provide an independent basis for removal, and that a plain reading of the phrase "any defendant" includes counter-defendants, arguing that the term "any" is broad and inclusive, and a counter-defendant is a "kind of" defendant.

Similarly, Judge Niemeyer argued that the *Shamrock* rule, which dealt with the predecessor to Section 1441, is inapplicable in the CAFA context, and is in any event limited to counter-defendants who were original plaintiffs. The dissent also examines the legislative intent behind CAFA, arguing for a liberal interpretation of its removal provisions to effectuate its intended grant of broad federal jurisdiction over class actions.

Although Judge Niemeyer cites to no case law, the notion that additional counter-defendants may remove, even if counter-defendants who are also plaintiffs may not, is not unheard of. The 5th Circuit held 10 years ago in *State of Texas v. Walker* (142 F.3d 813 (5th Cir. 1998), that whereas removal by plaintiff/counter-defendants would "fly in the face of the well-pleaded complaint rule," removal by a counter-defendant who was not an original plaintiff was permissible.

This distinction, which was considered insignificant by the 4th Circuit panel in *Palisades*, could be critical to consumer financial services organizations who rely on other entities to collect debt.

Petition treats congressional intent

The petition for rehearing *en banc* filed by ATTM on Dec. 28, 2008, may provide additional support for reconsideration by the full panel. The petition offers an in-depth treatment of the congressional intent behind CAFA, arguing that the panel's decision permits exactly the sort of abuses which CAFA was intended to curb — namely that lawyers might "game the procedural rules" by "manipulating their pleadings" to keep class actions in state court. ATTM borrowed from a leading commentator who has observed that the counterclaim class actions brought since CAFA's enactment are "just the tip of an approaching iceberg."

In addition to espousing the same arguments as Judge Niemeyer regarding the language of Section 1453(b), ATTM also makes the argument the dissent did not address — that the parties should have been realigned to determine who was a defendant with authority to remove, relying on authorities purportedly holding that the counterclaim may be considered in conducting the realignment analysis.

Conclusion

A holding by the 4th Circuit that a counter-defendant can in fact remove an action under CAFA in these circumstances would be a departure from the status quo, but would tie up what many have viewed as an unintended loose end — a loophole that allows plaintiffs' attorneys to file large scale class actions with millions at stake in state court, simply by waiting for a target defendant to file a small collection action in the desired forum and then filing a counterclaim with class allegations.

Even a narrowing of the panel's holding, that allows removal by an additional, but not an original counter-defendant, would be significant for the industry, and confirm the intent of Congress to facilitate removal of class actions under CAFA.

However, it is yet to be seen whether the grounds provided in the dissent and the petition for rehearing *en banc* are sufficient to convince the 4th Circuit to take another look at its holding in *Palisades*. ❑