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July 2019

MOORE'S FEDERAL PRACTICE—TOP THREE HIGHLIGHTS

The following three summaries are this month's Editor's Top Picks from the dozens of decisions added to Moore's Federal Practice and Procedure.

CLAIM PRECLUSION

Accrual of Claim

Media Rights Techs., Inc. v. Microsoft Corp.

922 F.3d 1014, 2019 U.S. App. LEXIS 13239 (9th Cir. May 2, 2019)

The Ninth Circuit clarifies that for purposes of claim preclusion, a claim accrues when it becomes legally cognizable, that is, when it can be sued upon.

Jump to full summary

CLASS ACTIONS

Defendant Classes

Bell v. Brockett

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The Fourth Circuit has held that, while the district court failed to comply with Rule 23 in certifying a class without simultaneously appointing counsel for the class and without properly analyzing the adequacy of class counsel, the judgment should be affirmed because under the unique circumstances of this case the defendants had waived the error.

Jump to full summary

FRE 804(b)(1): FORMER TESTIMONY

"Same Party," "Opportunity and Similar-Motive" Analyses

United States v. Baker

923 F.3d 390, 2019 U.S. App. LEXIS 12597 (5th Cir. Apr. 26, 2019)

The Fifth Circuit upheld the trial court's decision to exclude an unavailable witness's deposition testimony from an SEC proceeding under the unavailability hearsay exception for former testimony; the SEC and the DOJ were not the same party for Rule 804(b) purposes, and they did not have sufficiently similar motives in developing the testimony.

Jump to full summary

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Brenna Clanton, Solutions Consultant

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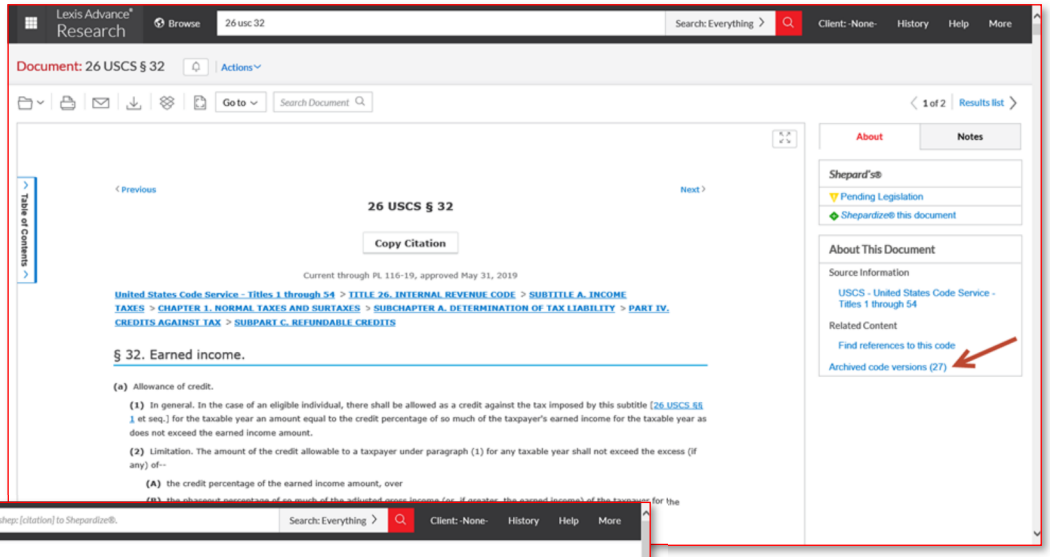

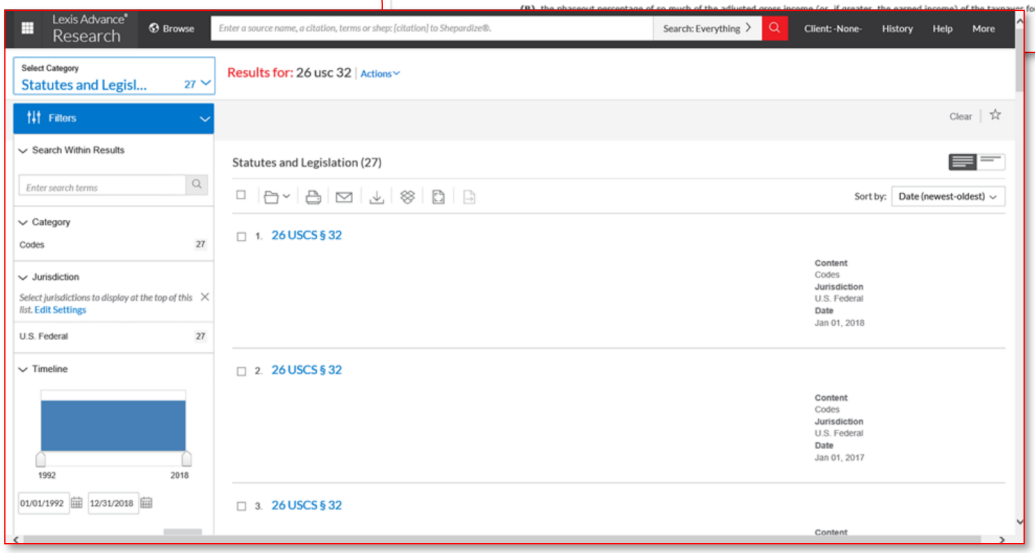

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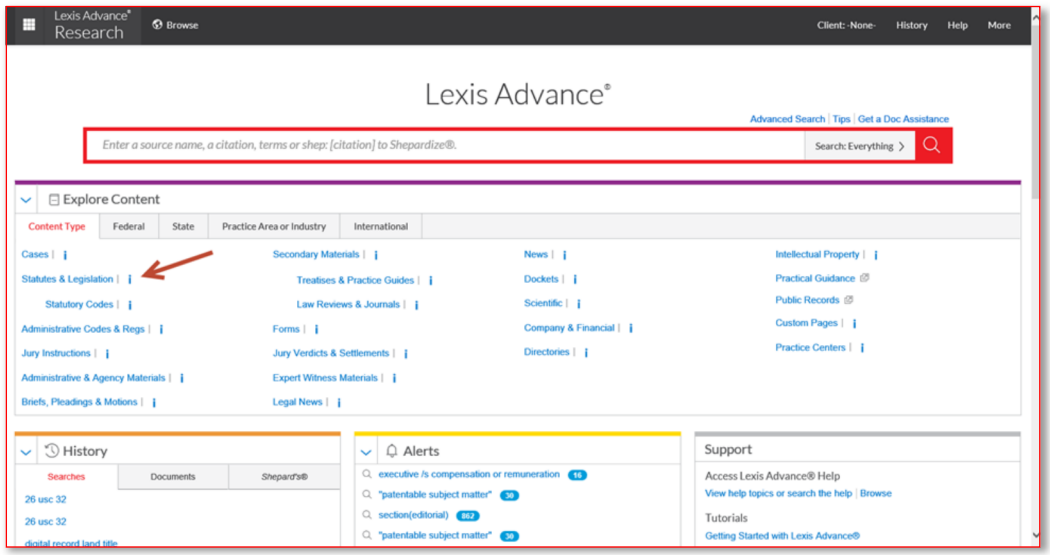

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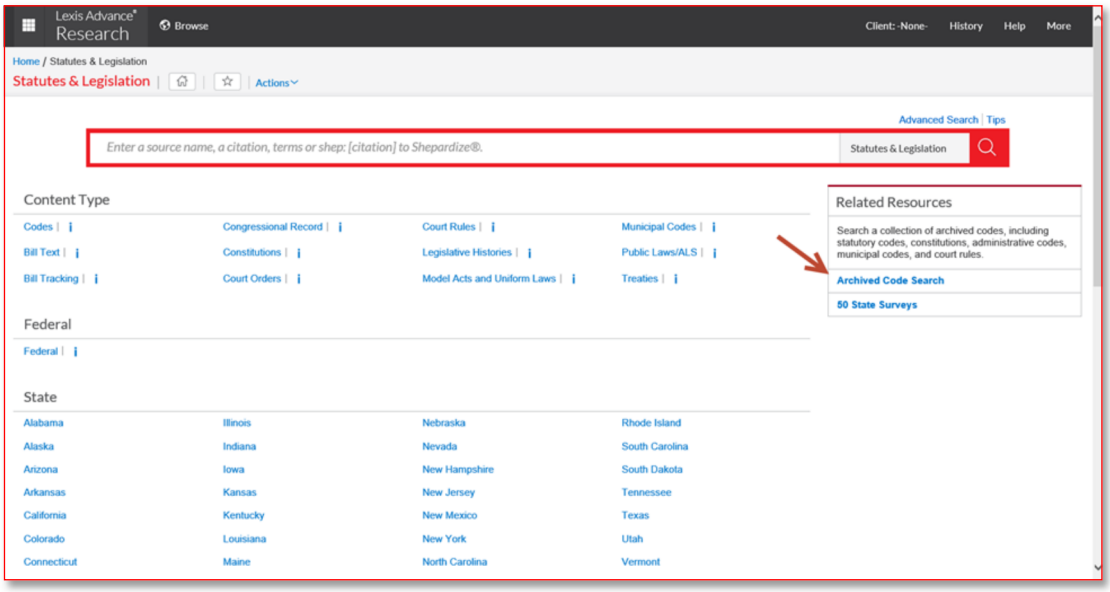

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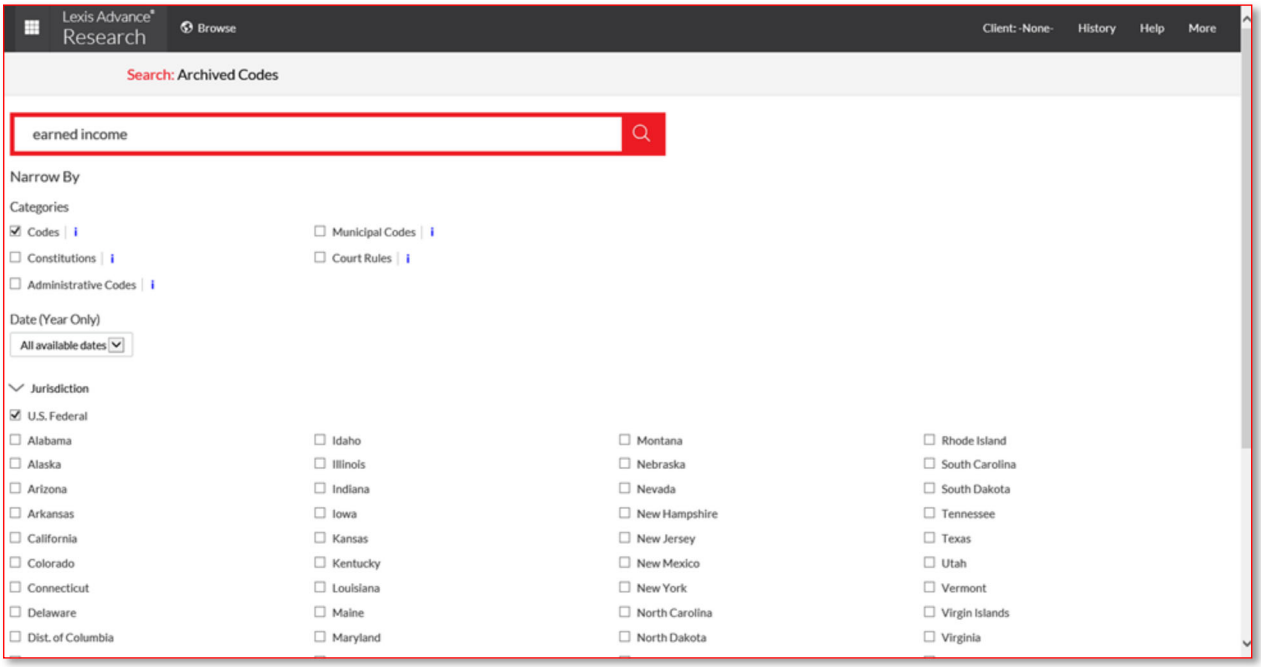

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Marie Kaddell, Solutions Consultant

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NEW FROM JIM WAGSTAFFE

REMOVAL AND REMAND MAGIC: SEVEN NEW TRICKS TO MAKE YOUR CASE DISAPPEAR FROM YOUR OPPONENT'S CHOICE OF FORUM

By: Jim Wagstaffe

When removing an action to federal court (or in opposition seeking a remand), there is a certain "magic" to mastering this remarkable change of judicial stagecraft. Since, as they say, magic can spell the difference between mediocrity and accomplishment, let me share with you seven magic tricks based on recent case law developments to achieve good fortune in your removal and remand practice.

Before we begin with the show, let's understand the appearance and disappearance nature of federal removal jurisdiction. The plaintiff makes the case appear initially in state court, presumably choosing that sovereignty as best suited for the client. In response and generally only if the action as filed could have been brought there originally, the defendant can unilaterally remove the action to federal court. And then if the removal was jurisdictionally or procedurally improper, the plaintiff can move to remand, causing the action to disappear from the federal stage teleported back to its original forum. See The Wagstaffe Group Practice Guide: Fed. Civ. Proc. Before Trial Ch. 8: Analyzing Removal Jurisdiction (LexisNexis 2019) (hereafter "TWG").

So, what magic wands can you wave per the very recent case law to insure that your client's case lands in the desired state or federal court? There are seven new and improved tricks to work your removal and remand magic.

1. Plaintiffs Can Prevent Removal By Sprinkling State Court Fairy Dust in Their Forum Selection Clauses

In recent years, the U.S. Supreme Court has strongly affirmed the right of parties contractually to plan the shape and location of anticipated litigation.[1] Specifically, the parties may contractually waive the right to remove a case by doing so in a valid forum selection clause limiting venue to state court.

For example, if the parties enter into a contract with a clause providing that all claims must be litigated exclusively in a described state court, this will constitute a waiver of the right to remove.[2] By the same token, if the forum selection clause designates a county in which there is no federal courthouse, this too constitutes a waiver of the right to remove.[3]

Significantly, if a served co-defendant (whose joinder ordinarily is required to remove) signed such a contractual removal waiver, it will also waive it for all removing parties. See *Autoridad de Energia Electrica v. Vitol S.A*, 859 F.3d 140 (1st Cir. 2017). The tips for plaintiffs seeking to thwart removal are (1) first name and serve the defendant(s) who are parties to the contractual waiver, and (2) make any motion to remand within 30 days of removal as this waiver itself can be waived. And for a removing defendant who was not a party to the waiver agreement, remove before service on the co-defendant.

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[1] See *Atl.Marine Constr. Co., Inc. v. United States. Dist. Court.*, 134 S.Ct. 568 (2013); see also TWG § 12-III[H].

[2] See *Medtronic Sofamor Danek, Inc. v. Gannon*, 913 F.3d 704 (8th Cir. 2019)—forum selection clause providing claims must be litigated in Minnesota state court precludes removal; *FindWhere Holdings, Inc. v. Systems Environment Optimization, LLC*, 626 F.3d 752 (4th Cir. 2013)—same; TWG §8-VII[A][2].

[3] See *Bartels v. Saber Healthcare Group, LLC*, 880 F.3d 668 (4th Cir. 2018)—forum selection clause limiting venue to county in which there is no federal court precludes removal; *Grand View v. Helix Electric*, 847 F.3d 255 (5th Cir. 2017)—same; *City of Albany v. CH2M Hill, Inc.*, 2019 U.S. App. LEXIS 15802 (9th Cir. May 29, 2019)—same.

2. Plaintiffs Can Keep the State Court Rabbit in the Hat: Avoid Pleading Federal Jurisdiction in Their State Court Complaints

The magic trick for plaintiffs seeking to avoid removal of their case to federal court is to plead only state claims (to avoid federal question removal) and sue at least one party from the same state (to avoid diversity removal). See TWG §8-II[B].

When it comes to keeping the state court complaint jurisdictionally pristine, it is important to keep the defendant from successfully trying to make it seem like there nevertheless is a federal rabbit in the hat. With rare exceptions, even if there is a federal issue in the case, if the complaint contains only state law claims, removal on federal question grounds is not available. See, e.g., *Burrell v. Bayer Corp.*, 918 F.3d 372 (4th Cir. 2019)—state law claim for damages caused by sterilization product not properly removed simply because device regulated by FDA; *Estate of Cornell v. Bayview Loan Servicing*, 908 F.3d 1008 (6th Cir. 2018)—no removal of state law claim barring due on sale clauses simply because federal issue referenced in complaint.[4]

By the same token, plaintiffs can keep the diversity jurisdiction rabbit in the hat by being sure to include a properly named party who is nondiverse. This includes a nondiverse member of any noncorporate entity. See, e.g., *Funding LLC v. Rapid Settlements*, 851 F.3d 530 (5th Cir. 2017)--any nondiverse member of LLC defeats removal; *Purchasing Power LLC v. Bluestem Brands, Inc.,* 851 F.3d 1218 (11th Cir. 2017)--same.

3. Putative Plaintiffs Can Use the Magic Sauce of *Home Depot v. Jackson* By Filing Their Affirmative CAFA or Federal Claims as Third-Party Complaints

The Supreme Court in *Home Depot U.S.A., Inc. v. Jackson*, 139 S. Ct. 1743 (May 28, 2019) has just confirmed that the right to remove actions to federal court is limited to defendants. In particular, the High Court ruled that even if there is a right to remove (say per CAFA, 28 U.S.C. § 1453), if the removing party was sued in a counterclaim or a third-party complaint, removal is not allowed. See also *Renegade Swish, L.L.C. v. Wright*, 857 F.3d 692 (5th Cir. 2017)—no removal based on federal counterclaim; TWG §8-V[C].

Thus, if a party wants to make the removal risk disappear, the brand new trick (called a "tactic" by the *Home Depot* dissenters) is to wait until one is sued (e.g. on a one-off collection case) and then include the otherwise removable CAFA or federal claim as a counterclaim or third party complaint. Tactical magic.

4. Defendants Can Use Procedural Sleights of Hand to Remove on Diversity Grounds

Plaintiffs often draft their complaints to include nondiverse co-defendants or include a forum-based opponent to thwart efforts to remove the action to federal court. In response, defendants desiring to remove can use two sleight-of-hand magic tricks to change the focus: (i) declare that the nondiverse parties are sham and can be ignored, or (ii) avoid the bar on local defendants by removing *before* service of process.

The first effort is to argue that the parties otherwise defeating complete diversity are sham parties who have been joined improperly because there is no basis for recovery. TWG §8-VI[D]. The sham joinder rule allows defendants to "press the delete key" on the nondiverse party only if there is no possible basis for recovery as ascertained on a summary basis. See *Grancare, LLC v. Thrower*, 889 F.3d 543 (9th Cir. 2018)–nursing facility administrator could be personally liable and hence was not a sham defendant.

In these extraordinary situations, the sham party's citizenship is ignored and the remaining defendant(s) "magically" can then remove the case to federal court. The examples of sham joinder, while fairly rare, find support in the recent case law.[5]

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[4] See also *Secretary of Veteran Affairs v. Smith*, 2018 U.S. Dist. LEXIS 48530—no removal of unlawful detainer action removed under federal Protecting Tenants at Foreclosure Act (S.D. Cal. 2018); *Jackson County Bank v. Dusablon*, 915 F.3d 422 (7th Cir. 2019)—no federal jurisdiction in trade secret violation suit by bank against former employee even if implicating federal securities law; *Mays v. City of Flint*, 871 F.3d 437 (6th Cir. 2017)—no substantial federal question over tainted drinking water case simply because state officers working with EPA.

[5] See *Couzens v. Donahue*, 854 F.3d 508 (8th Cir. 2017)--defendant not properly sued in individual capacity; *Alviar v. Lilllard*, 854 F.3d 286 (5th Cir. 2017)--no evidence of required willful intent for agent's individual liability for tortious interference; *Casias v. Wal-Mart Stores, Inc.*, 695 F.3d 428 (6th Cir. 2012)—joinder of nondiverse corporate manager a sham party in wrongful termination suit because he did not actively participate in termination decision; see also *Hoyt v. The Lane Construction Corp.*, F.3d (5th Cir. June 10, 2019)— removal permitted even if sham party "involuntarily" eliminated by summary judgment.

The second sleight-of-hand removal tactic serves to divert attention away from the general bar on diversity removal by local defendants. Even if there is complete diversity, the removal statute provides that if one of the defendants is from the forum state (a so-called "local" defendant), then removal cannot take place. 28 U.S.C. § 1441(b)(2); TWG §8-VI[E][4]. The rationale for this prohibition is that even if there is complete diversity (e.g. out-of-state plaintiffs), a local defendant does not "need" removal to avoid local prejudice. Id.

However, the sleight of hand flows from the statutory language limiting this removal prohibition to *served* local defendants. Therefore, courts have recently authorized what is known as "snap removal", i.e., removal by the local defendants *before* service.[6] The trick thus is for the local defendant to scan the filings through available litigation databases and voluntarily appear and file a notice of removal before being served.

5. Defendant's Houdini Escape Act from Late Removal: Seize Upon Ambiguity in Complaint to Explain Delayed Removal

The normal rule is that a defendant must remove a case within 30 days of proper service. 28 U.S.C. § 1446. And if the service is proper, ordinarily removal is unavailable if not accomplished within that 30-day window.[7]

So the Houdini escape act from this missed deadline is to seize upon a perceived ambiguity in the plaintiff's complaint as to federal jurisdiction (e.g. complaint doesn't identify parties' citizenship, no amount in controversy stated, ambiguous reference to origin of claim), generate a paper trail in the case (e.g. interrogatory response as to amount in controversy) and remove 30 days from receipt of that paper. See *Morgan v. Huntington Ingalls*, 879 F.3d 602 (5th Cir. 2018)—no need to remove until receipt of deposition transcript; TWG §8-X[D]. If the ambiguity is actual, the governing case law confirms that the defendant may wait to remove until receipt of the paper providing clarity.[8]

Importantly, this "seized upon the ambiguity" trick can be used even if the defendant subjectively knew or should have known of the basis for removal. *Harris v. Bankers Life & Cas. Co.*, 425 F.3d 689 (9th Cir. 2005); *Graiser v. Visionworks*, 819 F.3d 277 (6th Cir. 2016)--CAFA removal time not triggered until defendant receives sufficient information from plaintiff.

6. Defendants Can Wave a "Magic Federal Wand" to Transform Seeming State Law Claims into Federal Removal Jurisdiction

Ordinarily, removal on federal question grounds is allowed only if the "well-pleaded complaint" shows on its face that the action arises under federal law. However, there are several "exceptions" to this doctrine and removal can take place by defendants waving a magic federal wand to remove the action to their preferred forum. In four main circumstances, this happens when the state court claims are recharacterized as "federal" in defendant's notice of removal.

First, there may be limited situations in which a case is removable even though only state law claims are stated because they necessarily raise a substantial and disputed federal question.[9] Of course, such situations are rare and occur only when allowing removal would not disturb the federal-state balance approved by Congress. TWG §8-V[B][5][c].

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[6] *Gibbons v. Bristol-Myers Squibb Co.*, 919 F.3d 699 (2d Cir. 2019); *Encompass Insur. Co. v. Stone Mansion Rest. Inc.*, 902 F.3d 147 (3d Cir. 2018); contra *Gentile v. Biogen Idec, Inc.*, 934 F.Supp. 313 (D. Mass. 2013).

[7] Compare *Shakouri v. Davis*, 923 F.3d 407 (5th Cir. 2019)--defendant not properly served need not yet remove (although snap removal allowed); *Elliott v. American States Ins. Co.*, 883 F.3d 384 (4th Cir. 2018)—service on statutory agent does not start 30-day removal clock; *Anderson v. State Farm Mut. Auto Ins. Co.*, 917 F.3d 1126 (9th Cir. 2019)—same.

[8] See *Cutrone v. Mortgage Electronic Registration Systems, Inc.*, 749 F.3d 137 (2d Cir. 2014)--if plaintiff's pleading ambiguous, defendant may wait to remove until receipt of pleading or paper providing clarity; see also *Quinn v. Guerrero*, 863 F.3d 353 (5th Cir. 2017)--if state court complaint uncertain and does not clearly refer to a federal claim for relief removal need not take place until and if the claims are clarified by amendment or otherwise more certainly as arising under federal law.

[9] See *Hornish Joint Living Trust v. King County,* 899 F.3d 680 (9th Cir. 2018)--state claims to declare property rights in railway corridor raised substantial federal question under National Trails System Act due to federal interest to preserve shrinking rail trackage; *Bd. of Comm'rs v. Tenn. Gas Pipeline Co.* 850 F.3d 714 (5th Cir. 2017)–suit by local flood protection authority alleging oil companies' activities damaged coastal lands raises substantial federal question since federal law provides standard of care; *Turbeville v. Financial Industry Regulatory Authority*, 874 F.3d 1268 (11th Cir. 2017)—removal jurisdiction existed over case against FINRA for defamation based on its federally regulated disclosure and investigation.

Second, there are also limited areas where federal law completely preempts the artfully pled state law claims and replaces them with the necessary federal claim. This occurs primarily in the areas of LMRA, ERISA and copyright law. TWG §8-V[E].[10]

Third, removal jurisdiction is allowed as to claims involving federally chartered corporations if they have a charter that provides that the entity may "sue and be sued" in federal court. *Federal Home Loan Bank of Boston*, 821 F.3d 102 (1st Cir. 2016); but see *Lightfoot v. Cendant Mortgage Corp*, 137 S.Ct. 553 (2017)--Fannie Mae's charter providing for jurisdiction in "any court of competent jurisdiction" does *not* provide for federal jurisdiction since it contemplates court in which there is an otherwise existing source of subject matter jurisdiction; see also TWG §8-VII[A][1].

Finally, the federal officer removal statute, 28 U.S.C. § 1442, allows removal if the federal officer raises a colorable federal defense and establishes that the suit is for an act under color of office. *Jefferson County v.* Acker, 527 U.S. 423 (1999). The statute also authorizes removal to federal court by persons acting under an officer or agency of the United States who are sued for acts "for or relating to any act under color of such office." This also includes such persons raising colorable federal defenses. See TWG §8-VIII[B][2]. Thus, even private persons or corporate entities who acted under the direction of a federal officer or agency can remove actions to federal court having a causal nexus to their actions under color of federal office.[11]

7. Plaintiff's Post-Removal Fortune Telling Efforts to Change the Future Course of the Action

If the defendant indeed has properly removed the action, the plaintiff may still perform a sovereign-changing remand magic trick by seeking to amend the complaint post-removal. The fortune telling change effort occurs when the plaintiff files an amendment (i) to dismiss the federal claim, or (ii) to add a nondiverse party—using either to alter the future course of the action with a follow-up remand motion.

Section 1447(e) of Title 28 clearly authorizes the Court to consider a plaintiff's post-removal changes to the case and remand the case to state court if appropriate (e.g. by the destruction of diversity with the joinder of a nondiverse party). However, since removal jurisdiction is measured at the time of removal, the Court has discretion to deny the requested changes—especially if the plaintiff's motives are transparently unjustified. See TWG §8-XI[B][H].

If the plaintiffs succeed in achieving a remand, they may move for attorney's fees and costs if there was no objectively reasonable basis for the defendant to have removed the action. *Martin v. Franklin Capital Corp.*, 546 U.S. 132 (2005); TWG §8-XI[G]. However, plaintiffs may well decide not to seek such relief as there often is no magic in sanctions because—unlike the remand decision itself—an award of sanctions is subject to an appeal. Such an appeal almost certainly will cost more than what is at stake.

Conclusion

It was Yeats who said that "the world is full of magic things patiently waiting for our senses to grow sharper." When it comes to the magic of removal and remand, we can all use a little help in growing our senses by keeping up on the most recent case law and using the helpful resources like our federal practice guide and its weekly Current Awareness feature.

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[10] See, e.g. LMRA Complete Preemption Removal-- *Cavallaro v. UMass Mem'l Healthcare, Inc.*, 678 F.3d 1 1st Cir. 2012)--claims for money had and received, unjust enrichment and conversion brought by union employee essentially were ones for unpaid wages, hinging on an interpretation of the CBA and hence removal proper on complete preemption doctrine; but see *Dent v. NFL*, 902 F.3d 1109 (9th Cir. 2018)—state negligent hiring claim not completely preempted.

[11] See *Butler v. Coast Electric Power Ass'n*, F.3d (5th Cir. June 7, 2019)—federal officer removal allowed to cooperatives raising federal preemption defense arising from federal loan agreements; *Zeringue v. Crane Co.*, 846 F.3d 785 (5th Cir. 2017)— federal officer removal over asbestos claim against government contractor supplying product to Navy and lawfully assisting federal officer in performance of officer's duties; *Sawyer v. Foster Wheeler LLC*, 860 F.3d 249 (4th Cir. 2017)—same; *Hammer v. U.S. Dept. of Health and Human Services*, 905 F.3d 517 (7th Cir. 2019)—federal officer removal of "civil actions" includes motions for declaratory relief; but see *Mays v. City of Flint*, 871 F.3d 437 (6th Cir. 2017)--rejecting federal officer removal when state officials not acting under supervision of federal agency; *Fidelitad, Inc. v. Insitu, Inc.*, 904 F.3d 1095 (9th Cir. 2018)—no federal officer removal if not acting at federal officer's direction; TWG §8-VII[B][2][d].

CLAIM PRECLUSION

Accrual of Claim

Media Rights Techs., Inc. v. Microsoft Corp.

922 F.3d 1014, 2019 U.S. App. LEXIS 13239 (9th Cir. May 2, 2019)

The Ninth Circuit clarifies that for purposes of claim preclusion, a claim accrues when it becomes legally cognizable, that is, when it can be sued upon.

Legal Background. The doctrines of claim preclusion and issue preclusion prevent parties from contesting matters that they have had a full and fair opportunity to litigate, thus protecting against the expense and vexation attending multiple lawsuits, conserving judicial resources, and fostering reliance on judicial action by minimizing the possibility of inconsistent decisions [Taylor v. Sturgell, 553 U.S. 880, 892, 128 S. Ct. 2161, 76 L. Ed. 2d 155 (2008]. Claim preclusion bars a party in successive litigation from pursuing claims that were raised or could have been raised in a prior action if the later action (1) involves the same claim as the first action, (2) reached a final judgment on the merits, and (3) involved identical parties or their privies [Mpoyo v. Litton Electro-Optical Sys., 430 F.3d 985, 987 (9th Cir. 2005); Owens v. Kaiser Found. Health Plan, Inc., 244 F.3d 708, 713 (9th Cir. 2001)].

In *Howard v. City of Coos Bay*, the Ninth Circuit held that for purposes of federal common law, claim preclusion does not apply to claims that accrue after the filing of the complaint in the previous action [Howard v. City of Coos Bay, 871 F.3d 1032, 1039–1040 (9th Cir. 2017)].

In the present case, the Ninth Circuit considered whether a dismissal with prejudice of a patent-infringement suit had claim-preclusive effect on a subsequent suit by the same plaintiff against the same defendant for copyright infringement, violation of the Digital Millennium Copyright Act (DMCA), and breach of contract.

The court of appeals held that claim preclusion barred the second suit's claims that had accrued when the first suit commenced. Those claims were based on the same events as the first suit. As described by the Ninth Circuit panel, the later suit "merely offer[ed] different legal theories for why [the defendant's] alleged misconduct was wrongful."

However, applying *Howard*, the court of appeals held that claim preclusion would not bar the plaintiff's claims that accrued after it filed the first suit. Although *Howard* did not explain or define "accrue," the appellate panel in the present case read *Howard* to mean "come into existence" or "arise." The court explained its understanding that *Howard* held that claim preclusion does not apply to claims that were not in existence and could not have been sued upon—that is, were not legally cognizable—when the previous action was initiated.

Applying this understanding of *Howard*, the court of appeals looked at the claims asserted in this case for copyright infringement, DMCA violations, and breach of contract.

Copyright infringement claims must be commenced within three years after the claim accrued [17 U.S.C. § 507(b)]. Under the "discovery rule," a copyright infringement claim accrues—and the statute of limitations begins to run—when a party discovers, or reasonably should have discovered, the alleged infringement. In addition, the "separate-accrual rule" in copyright law provides that when a defendant commits successive violations of the Copyright Act, the statute of limitations runs separately from each violation. Therefore, under the discovery and separate-accrual rules, claim preclusion did not apply to the plaintiff's copyright infringement claims for any separate sales of allegedly infringing products that the defendant made after the plaintiff filed the first suit.

The court of appeals next concluded that the DMCA claim, which was based on the same alleged copying of plaintiff's software that was the basis for the first suit, was barred by claim preclusion. The court explained that the statute of limitations began to run when the plaintiff learned, or reasonably should have learned, of the violation. And significantly, there is no separate-accrual rule applicable to DMCA claims.

Finally, the court of appeals found that under applicable state law, the plaintiff's breach-of-contract claim did not accrue until the plaintiff discovered, or had reason to discover, the cause of action. Since the second suit's contract claims were based on the same events as the first suit, the court of appeals concluded that they were barred by claim preclusion.

CLASS ACTIONS

Defendant Classes

Bell v. Brockett

922 F.3d 502, 2019 U.S. App. LEXIS 12411 (4th Cir. Apr. 25, 2019)

The Fourth Circuit has held that, while the district court failed to comply with Rule 23 in certifying a class without simultaneously appointing counsel for the class and without properly analyzing the adequacy of class counsel, the judgment should be affirmed because under the unique circumstances of this case the defendants had waived the error.

Background. This case, the Fourth Circuit noted, involved one of the rarest types of complex litigation, the defendant class action. The case involved an alleged Ponzi scheme. "Affiliates" were given the opportunity to share in the revenues of an online auction business. Because the online auction generated minimal revenue, funds for distribution depended on signing on new affiliates. The result was that nearly 90 percent of affiliates were net losers, losing approximately $822.9 million dollars. Nearly 8 percent were net winners, receiving approximately $282.1 million in profits. Of the net winners, about 14,700 individuals received at least $1,000 more in payments than they paid in. Some received over $1,000,000.

After the SEC shut down the operation, the district court appointed a receiver, who filed a defendant class action against the net winners. He asserted that the net winnings of the class were improper gains from a Ponzi scheme and that the gains should be recovered and returned to the net losers. In moving to certify the class, the receiver argued that the proposed class representatives (the named defendants) and their counsel would provide fair and adequate representation of the defendant class's interests under Rule 23(a)(4). Some of the named defendants opposed class certification. They argued that they could not afford to fairly represent the class, and catalogued the extensive costs imposed on the proposed class representatives and class counsel. However, the named defendants did not address the due process concerns related to defendant class actions, including whether the court could properly assert personal jurisdiction over the absent class members or whether absent class members should have notice or opt out rights.

The district court certified the defendant class under Rule 23(b)(1). The district court determined that the class representatives and their counsel would adequately represent the class. However, the district court did not appoint class counsel at that time. Instead, it held that counsel for the named defendants were fully capable of protecting the interests of their clients and consequently the class. It likewise did not address personal jurisdiction or opt out issues. The district court approved a notice of class certification, although not required under Rule 23(b)(1). The notice described the certification decision and notified class members of their membership in the class. No class member objected to the district court's failure to appoint class counsel. Finally, the district court entered a consent order appointing the lawyer representing the named plaintiffs as class counsel. The order provided that any members of the class that objected to the order must file objections within 30 days of the entry of the order. No objections were filed. The receiver eventually moved for summary judgment, which the district court granted, concluding that the transfers to the class members were fraudulent.

The district court then entered an order governing the damages phase of the case. Under this order, the receiver would send notice to individual class members of the calculations of their net winnings which would be the amount of the judgment against them. Class members could object to these calculations and provide evidence supporting an alternative calculation. The order provided that individual class members could hire counsel at their own expense to represent them with respect to these proceedings. Class counsel's only continuing obligation was to provide a collective notice of the process for determining the net winnings of individual class members. Class counsel did not object to this order, nor did any class member. The receiver also negotiated voluntary settlements with some of the class members.

Over two years after the district court certified the class and almost two years after the appointment of class counsel, the first objection from an unnamed class member was raised. This class member challenged the adequacy of class counsel and sought decertification, arguing that (1) counsel had conflicting interests as class counsel; (2) counsel failed to obtain an independent expert evaluation of the business and conceded the existence of a Ponzi scheme; and (3) since counsel represented the class only through the liability phase of the action, there was no adequate representation of class members during the damages phase. Other class members also moved to intervene and decertify the class or alter or vacate the final judgment. The district court denied these motions.

District Court Erred by Failing to Follow Rule 23 Procedures for Appointment of Class Counsel. Defendant class actions, like plaintiff class actions, must comply with all the requirements of Rule 23. A class action is appropriate only when both class representatives and class counsel adequately protect the interests of the class. Rule 23(g) and Rule 23(c)(1)(B) require a court that certifies a class to appoint class counsel at the time of certification. Rule 23(g) requires courts to consider four enumerated factors in appointing class counsel: (1) the work counsel has done in

identifying or investigating potential claims in the action; (2) counsel's experience in handling class actions, other complex litigation, and the types of claims asserted in the action; (3) counsel's knowledge of the applicable law; and (4) the resources that counsel will commit to representing the class, as well as any other matter pertinent to counsel's ability to fairly and adequately represent the interests of the class. These requirements provide critical safeguards of the due process concerns inherent in class actions, and are especially important for defendant class actions in which due process risks are magnified. In defendant class actions, an unnamed class member can be brought into a case, required to engage in discovery, and even be subjected to a judgment compelling the payment of money or other relief without ever being individually served with a lawsuit.

The district court here abused its discretion by failing to appoint class counsel at the time of certification. Class counsel was not appointed until seven months later, and during this time the liability phase of the case continued. The district court had found that, during this time, the rights of the unnamed class members were protected by the alignment of interests between the class and the class representatives. Nevertheless, while events impacting the liability and potential damages of the unnamed class members took place, the class had no attorney owing duties and responsibilities to the class.

The district court also erred by failing to apply the Rule 23(g) factors in appointing class counsel. Neither the certification order nor the consent order referenced Rule 23(g) factors.

Reversal Was Not Required. Failure to comply with the requirements of Rule 23 in the vast majority of cases renders certification fatally defective. However, the unique circumstances of the present case compelled the court of appeals to affirm. First, a careful review of the class members' objections in the proceedings below indicated these issues had not been raised. The class members received notice of the class certification, but none objected to the absence of class counsel at that time. Nor did any class member object on timeliness grounds when class counsel was appointed some seven months later. Likewise, class members did not raise the district court's failure to apply the Rule 23(g) factors prior to or in their decertification motions. Appellants may not raise arguments on appeal that were not first presented below to the district court. Accordingly, the court concluded that the class members had waived the arguments regarding the untimely appointment of class counsel and the failure of the court to consider the Rule 23(g) factors.

Second, due at least in part to the failure of any class member to object to issues surrounding the appointment of class counsel, the litigation had progressed to an extent that it would be difficult if not impossible to remedy the errors. For example, over 2,500 class members had resolved the claims against them. These settlements involved payment of funds by defendant class members and the distribution of funds to net losers. At this stage of the litigation, it would have been impossible to rewind the case.

Because of the circumstances of this particular case, the Fourth Circuit rejected the argument that the district court's errors regarding adequacy of class counsel warranted reversal. This decision, the court said, "should not be construed to diminish the importance of compliance with Rule 23 for all class actions and for defendant class actions in particular. The circumstances that compel us to affirm the district court here are exceedingly narrow if not unique."

FRE 804(b)(1): FORMER TESTIMONY

"Same Party," "Opportunity and Similar-Motive" Analyses

United States v. Baker

923 F.3d 390, 2019 U.S. App. LEXIS 12597 (5th Cir. Apr. 26, 2019)

The Fifth Circuit upheld the trial court's decision to exclude an unavailable witness's deposition testimony from an SEC proceeding under the unavailability hearsay exception for former testimony; the SEC and the DOJ were not the same party for Rule 804(b) purposes, and they did not have sufficiently similar motives in developing the testimony.

Background. Defendant/appellant was Chief Executive Officer of ArthroCare, a publicly traded medical-device company. He was convicted on charges of wire fraud, securities fraud, making false statements to the SEC, and conspiracy to commit wire fraud and securities fraud. His conviction stemmed from a scheme that fraudulently inflated ArthroCare's quarterly earnings by selling millions of dollars in products to co-conspirator DiscoCare, which later returned the devices at a time when it would not hurt ArthroCare's chances of meeting Wall Street projections. This was defendant's second trial. The Fifth Circuit had vacated defendant's earlier conviction, along with the conviction of Michael Gluk, ArthroCare's Chief Financial Officer, based on erroneous evidentiary rulings.

On appeal in this case, defendant asserted that the district court should have admitted the SEC deposition testimony of Brian Simmons, ArthroCare's former controller who invoked the Fifth Amendment and did not testify at defendant's trial.

In 2010, the SEC deposed Brian Simmons, ArthroCare's former controller, in its civil investigation of the company. At the first trial, defendant sought to subpoena Simmons, but Simmons refused to testify, asserting his Fifth Amendment right against self-incrimination. Defendant and his co-defendant, Michael Gluk, sought to admit Simmons's SEC deposition testimony under Rule 804(b)(1). In a written order, the district court excluded the testimony.

At the second trial, after three former ArthroCare senior executives (including Gluk) testified that Simmons had participated in the fraud, defendant again subpoenaed Simmons. Simmons refused to testify on Fifth Amendment grounds, and defendant again sought to admit excerpts of Simmons's SEC deposition testimony in which Simmons (1) denied wrongdoing and awareness of improper activities at ArthroCare and (2) stated that ArthroCare's audit committee and outside auditor, PricewaterhouseCoopers, were aware of a "bill-and-hold" practice for ArthroCare's sales to DiscoCare. The district court, referencing its order in the first trial, again excluded the testimony.

Rule 804(b)(1). Rule 804(b)(1) provides exceptions to the rule against hearsay for "former testimony" of witnesses who are unavailable. The exception provides as follows:

> **(1)** *Former Testimony*. Testimony that:
>
> > **(A)** was given as a witness at a trial, hearing, or lawful deposition, whether given during the current proceeding or a different one; and
> >
> > **(B)** is now offered against a party who had—or, in a civil case, whose predecessor in interest had—an opportunity and similar motive to develop it by direct, cross-, or redirect examination.

Simmons's deposition testimony contained hearsay and his invocation of the Fifth Amendment made him unavailable. The issues, therefore, were (1) whether the DOJ and the SEC were the "same party" or "predecessors in interest," and (2) if so, whether the SEC, in its civil investigation of ArthroCare, had both the opportunity and a similar motive to the DOJ in developing Simmons's testimony.

"Same-Party" Analysis. <D>The Fifth Circuit had not previously decided whether the SEC and the DOJ are the same party for 804(b) purposes. The case law on this issue is limited, and no court has expressly held that the SEC and the DOJ are the same party. Courts sometimes proceed directly to the "similar motive" inquiry.

Defendant contended that the two agencies were the same party because they are both Executive Branch agencies. He relied primarily on *United States v. Sklena*, which held that the Commodity Futures Trading Commission (CFTC) and the DOJ were the same party for 804(b) purposes [United States v. Sklena, 692 F.3d 725 (7th Cir. 2012)]. He also relied on *Boone v. Kurtz*, in which the Fifth Circuit held that different government agencies were the same party for res judicata purposes [Boone v. Kurtz, 617 F.2d 435 (5th Cir. 1980)].

In response, the government cited *United States v. Martoma*, in which the district court considered whether an unavailable co-conspirator's prior SEC deposition was admissible at a later criminal trial. The *Martoma* court held that the SEC and DOJ were not the same party for 804(b) purposes [United States v. Martoma, 2014 U.S. Dist. LEXIS 152926 (S.D.N.Y. Jan. 8, 2014)].

In *Sklena*, the Seventh Circuit relied on the significant control that the DOJ exercised over the CFTC, including the CFTC's statutory mandate to report to the DOJ. The court of appeals reasoned that the "statutory control mechanism suggests to us that, had the Department wished, it could have ensured that the CFTC lawyers included questions of interest to the United States when they deposed [the non-testifying codefendant]." The court's holding also relied on the agencies' "closely coordinated roles on behalf of the United States in the overall enforcement of a single statutory scheme." The *Sklena* court concluded that "[f]unctionally, the United States is acting in the present case through both its attorneys in the Department and one of its agencies, and we find this to be enough to satisfy the 'same party' requirement of Rule 804(b)(1)."

Here, the district court determined that the SEC and the DOJ were not the same party because the SEC conducted an independent investigation of ArthroCare and its employees and independently pursued its own criminal and civil actions. On appeal, defendant disagreed with that conclusion, pointing to several emails between prosecutors and SEC investigators describing telephone calls, meetings, and "working together." According to defendant, these demonstrated that the SEC "was functionally working as part of the prosecution team."

In response, the government pointed out that (1) the SEC did not participate in any interviews conducted by the DOJ, (2) the DOJ was not present at any of the SEC's depositions, (3) an SEC attorney was not cross-designated or assigned to the prosecution team, and (4) the DOJ did not provide the SEC with materials from its investigation. In an order denying the designation of the SEC as part of the prosecution team at the first trial, the district court concluded that "[w]hile the SEC provided some material to the Government—which the Government, in turn, has provided to Defendants—the SEC's investigation pre-dated and was independent from the Government's investiga-

tion, and there was no overlap of personnel or direction." The government also noted that when the DOJ formally requested information from the SEC, the SEC faced restrictions responding to that request and limited the information it provided to the DOJ.

Although there was some cooperation between the two agencies, it was not extensive enough for the SEC and the DOJ to be deemed the same party. Defendant's contention that the SEC and the DOJ coordinated closely was undermined by (1) the fact that the telephone calls and meetings defendant cited occurred after Simmons's February 2010 deposition, and (2) the district court's specific findings that the SEC had been uncooperative and limited the information it provided to the DOJ.

Sklena did not mandate a different result. Unlike the CFTC, the SEC is not statutorily required to report to the DOJ, nor must the two agencies cooperate to enforce the same statutory scheme. The Fifth Circuit concluded that the SEC is an independent agency with its own litigating authority.

"Opportunity and Similar Motive" Analysis. <D>Even if the SEC and the DOJ were deemed to be the same party, they did not share a sufficiently similar motive in developing Simmons's testimony. When, as here, testimony in a prior civil proceeding is being offered against the government in a subsequent criminal proceeding, the Fifth Circuit considers "(1) the type of proceeding in which the testimony is given, (2) trial strategy, (3) the potential penalties or financial stakes, and (4) the number of issues and parties."

At the first trial, the district court excluded the testimony, ruling that the SEC and the DOJ did not have sufficiently similar motives. At the second trial, the district court referenced its previous order and again excluded Simmons's testimony. The court added that there was "no question" that Simmons was "involved in a conspiracy if there was a conspiracy," and that he would have had "to be deaf, blind and dumb in his position not to see it." The court concluded that (1) "the SEC ha[d] been totally noncooperative in this criminal case from the beginning, declined to share any information to the Department of Justice [or] counsel in this case for the defense" and would not "provide its investigators to cooperate in any way"; (2) the SEC's civil investigation of ArthroCare was "totally different from a criminal trial"; and (3) the court's review of the SEC deposition testimony showed no "basis for any cross-examination."

Even if the court of appeals assumed that the SEC and the DOJ were the same party, the agencies did not have sufficiently similar motives. First, the stakes and burdens of proof were different: The SEC was in the discovery phase in relation to potential civil enforcement actions, whereas the DOJ was trying to prove criminal involvement after a grand jury indictment. Second, the focuses and motivations of the investigations were different: The SEC likely was developing a factual background regarding wrongdoing at the company generally, whereas the DOJ would have been gathering evidence to convict specific individuals. Third, the lack of cross-examination showed the agencies' different trial strategies: The SEC deposition excerpts showed no sign of cross-examination or additional follow-up questions after Simmons denied his involvement and that he had any conversations with Baker. In contrast, the agencies were not coordinating their activity to a degree that would have led the SEC lawyer to cross-examine Simmons like a criminal prosecutor would have.

Accordingly, the district court did not abuse its discretion in excluding Simmons's deposition testimony.

Outcome. The judgment was affirmed.