

IN-HOUSE LITIGATOR

THE JOURNAL OF THE COMMITTEE ON CORPORATE COUNSEL

Walking the Advancement Tightrope: How to Protect Both the Corporation and the Directors

By Ross Bricker, Doug Rees, and Eamon Kelly

In this era of heightened scrutiny of corporate America, the conduct of senior business executives and directors is increasingly the target of internal reviews and audits, protracted criminal investigations, and civil litigation. The cost of paying for counsel and other professionals and funding a strong defense, whether to allegations or formal charges of wrongdoing, can be staggering. As a result, many corporations are adopting policies that commit the company to advance legal costs to defend officers and directors accused of wrongdoing related to their work for the company.

While laudable in theory, the application of advancement rules has proved to be more challenging in practice. Imagine having to explain to your company’s shareholders why you are paying tens of millions of dollars for the ongoing appeals (and criminal defense) of an officer convicted of mail fraud.¹ Imagine being ordered to advance defense costs to a former officer who has turned into a courtroom adversary accused of stealing your company’s trade secrets.² Imagine explaining that the company will have to pay for the defense of a breach of fiduciary duty suit brought against its former law firm.³ Still worse, imagine after learning that a company your corporation acquired under

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Update on CAFA’s Impact on Corporate Defendants

By Holly E. Loiseau, Jed P. Winer, and Jeremy T. Grabill

After many failed attempts and years of legislative debate, the Class Action Fairness Act (CAFA) was enacted by Congress in 2005 and heralded as a victory for corporate defendants who had long complained about abuses in class-action practice.¹ This article will provide an update on CAFA’s modifications and will highlight how the new legal landscape is causing corporate counsel to grapple with novel strategic decisions that were unheard of only four years ago in the pre-CAFA era. Although the increased access to a federal forum may be a welcome development for some class-action defendants, corporate counsel need to recognize that this access comes with associated costs, namely, increased judicial scrutiny of both the removal and settlement of class actions.

In general, the removal of a case filed in state court to federal court must satisfy two conditions. First, federal subject matter jurisdiction must exist such that the case could have been originally filed in federal court. Second, the defendant’s removal must be procedurally proper. CAFA relaxes both of these traditional conditions in the class-action context, thereby making it easier for defendants to remove class actions to federal court. CAFA also authorizes interlocutory appeals of remand orders, ensuring that appellate courts have an opportunity to intervene before a class action is remanded

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Message from the Cochairs

Weathering the Economic Storm: Are You Ready?

It was a sunny day in Scottsdale, Arizona, last year when a group of corporate counsel gathered for our annual Litigation Roundtable. One of the topics we discussed was controlling corporate legal spend when, as one corporate-counsel panelist lamented, some outside law firms seem more focused on increasing their AmLaw profit-per-partner rankings, billing rates, and associate salaries than reducing litigation cost. He speculated that “the current billing structure is not sustainable.” Little did we know how quickly this would be tested. Just a year later, these highly paid associates are being laid off en masse, prominent national law firms are shutting down, and virtually every firm’s profits are declining.

Corporate America is faced with its most challenging times ever. As we wait for the raging financial storm to pass, we are bracing for what is inevitable: a tsunami of regulation, enforcement, and consumer actions that are sure to hit corporations. To guard against the storm, corporate counsel must be valiant, strategic, and well-informed. But for corporate counsel faced with both aggressive cost reductions and less staffing, the biggest challenge is doing more with less and fearing the next round of layoffs. In this climate, reducing legal spend is no longer an option, and it is no longer just the concern of corporate counsel. It must be a top priority for every lawyer defending corporations, whether he or she is corporate counsel of an embattled auto company or a securities litigation partner of a white-shoe firm in New York.

So what strategies can we employ to weather the storm? How can we cut back without sacrificing quality? To find out, we took an informal survey of corporate counsel across the nation to hear their tips and strategies. Here is a sampling of what they had to say.

What Can Corporate Counsel Do to Control Legal Spend?

Bring work in-house. To justify current staffing levels, legal departments are looking to bring in-house some of the work they typically give to outside lawyers. For instance, many legal departments are now handling electronic discovery in-house, such as document collection, retention, custodian interviews, and first rounds of reviews. To do this successfully without mishap, corporate counsel are seeking input from outside counsel to develop a protocol that will stand up in court. Moreover, some are upgrading their technological resources to match the capabilities of outside firms and employing systems, such as the Concordance database system, for managing electronic documents. While bringing work in-house adds to the already heavy workload, as one legal manager comments, in these tough times, the entire staff appreciates the extra work. This spells job security.

Scrutinize outside counsel billing. For those matters that outside counsel continue to handle, corporate counsel are scrutinizing the bills more carefully. Indeed, outside lawyers must be more economical about their time and the seniority level of the attorney that does the work. It is tough to justify interviews, meetings, and court appearances that are overstaffed. One

corporate counsel recommends more use of junior partners and senior associates: “These are folks who can handle the day-to-day work at less cost and who ought to be developed to step into leadership roles on the account and within the firm.” These days, it is a rare client who will insist that a senior partner attend every deposition at \$800 an hour.

Cut internal costs. Layoffs are everywhere—not just at law firms. Regardless of uptick in litigation and regulation, corporations are aggressively trimming fat everywhere, including staffing in-house. Indeed, when your department is not a revenue generator, the only thing you earn is additional scrutiny for reducing budgets and downsizing. One in-house counsel of a Fortune 500 company reports that they may cut approximately 50 legal jobs before the year’s end. In addition, many legal departments are experiencing hiring and travel freezes. Even globe-trotting general counsel have learned to befriend videoconferencing to avoid expensive business trips.

Seek creative billing arrangements. Not surprisingly, to contain outside counsel costs, corporate counsel are asking their outside firms to offer discounts and creative billing arrangements. These include flat fees and no-flex case budgets. Some are looking for ways to interject competition into hiring outside counsel by requiring alternative billing arrangements or employing RFPs for major matters. Others are switching to firms in regions of the country where the billing structure is lower for work that can be done anywhere. One corporate counsel explains that firms that do not traditionally offer flexible billing arrangements must get flexible if they want to retain business.

Don’t cut out the important stuff. At the same time, it is important to resist the temptation to cut corners or costs in areas that deserve additional attention. If anything, corporations will face increased litigation, regulation, and enforcement. One corporate counsel explains, “There is a greater need than ever to anticipate new regulatory and legal risks and to address them proactively to prevent misses that could otherwise lead to major costs in terms of dollars and reputation.” He adds that across-the-board cuts might seem

appealing in the short-term, but they make little sense in the long run. Therefore, corporate counsel must carefully weigh what to cut and what to bolster as they prepare for the onslaught of litigation, regulation, and enforcement.

What Can Outside Counsel Do to Control Legal Spend?

In this climate, outside counsel are expected to share the pain. The challenge is not whether, but how, to distribute the pain “in a fair way” between legal departments and outside lawyers, notes one general counsel.

Think outside the box. This means outside counsel should understand the limited budgets companies have for legal fees and should get creative when negotiating rates. After all, it is in everyone’s best interests for companies to survive. Consider ways to give back. Provide free or nearly free services to assist the in-house counsel clients who are shouldering the work that might have been given to outside lawyers in more abundant times.

Follow instructions. It is more important than ever to adhere closely to and enforce the company’s case management and billing guidelines. For instance, if your client requires that you limit staffing levels to one partner, one associate, and one paralegal per case, you must stick to that. While clients may have been more flexible and forgiving in the past, they will now be less willing to pay for unapproved staffing or expenses.

Reformulate your litigation strategy. Corporate counsel are reprioritizing their litigation docket, so start a dialogue with your clients to determine how they wish to proceed. Do your clients still believe you should take the case to trial when there is an opportunity to settle? Probably not. Your clients are likely to view the case differently in this new economy and will appreciate your foresight in exploring alternative methods of resolving the matter. Go over the case budget with them to determine what projects you can eliminate or postpone. Ask if they expect

any changes to case management or billing protocol. In this climate, being in tune with your clients’ changed business priorities is just as important as winning a case.

Forecast risks. With an increased workload, corporate counsel who put out fires all day are unable to devote additional time in planning ahead. Therefore, corporate counsel appreciate outside lawyers who offer to help anticipate and mitigate new risks in their business. Thoughtful warnings and updates from outside counsel will be remembered.

Think long-term. Maintain relationships even when the work dries up, keeping in mind that it will eventually return. For in-house counsel who have lost their jobs, consider offering of-counsel relationships or job referrals. These attorneys will likely find their way back to in-house jobs when the economy strengthens again. In them, you may find the most loyal clients.

Accepting the New Reality

During these tough times, the focus is on finding ways to keep companies out of bankruptcy and preserving our jobs, not on current AmLaw firm rankings. The interesting part will be seeing how companies and law firms deal with the new reality and how long the reality continues in its present form, notes one general counsel. He predicts, “Unless things rebound quickly, all of us are going to make less money. Firms can bandage over that for a year or so, but if it lasts longer, the basic structure of firms is likely to change.”

As for our earlier mentioned panelist’s prophetic comment at the Litigation Roundtable, it is unclear whether the current law firm billing structure will continue in this economic downturn. What is clear, however, is that both outside lawyers and corporate counsel must accept the new reality and look for proactive and creative ways to avert risks and shed unnecessary costs. In the end, those who go the extra mile in helping their business clients weather the economic storm will garner loyalty—rain or shine. ■

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Whose Document Is It Anyway?

Best Practices for Avoiding Post-Production Chaos

By Michael Wyatt

Many consider production to be the final step in the electronic discovery process. However, once production is complete, lawyers are often left with large quantities of electronic data that have to be organized and reviewed. Lack of planning for those data once they have been produced can render your pre-production efforts worthless. The introduction of new federal discovery rules in recent years has shifted the focus to the gathering and production of electronic data at the expense of planning what you are going to do with the data once they have been produced. To get the most from your e-discovery dollars, which is now the largest non-lawyer litigation expense, it is essential that careful thought and planning go into what you want to do with the data post-production. How do you want to organize and manipulate the data? What level of data extraction should there be to enable you to get to the “hot” documents relevant to the case you want to build or the defense(s) you want to assert in an efficient manner? A strong understanding of how data are utilized on the ground is vital in delivering good results. Because of the increasing volume of data involved in litigation, the effort required to produce electronic data is an increasingly herculean one. Consequently, much of the planning and decision-making for the discovery process is being delegated to more junior members of corporate legal departments.

The act of producing data is only the beginning of the process and your obligation to your company’s interests in the litigation. What exactly has been produced? How are you going to get your arms around what you have turned over to the other side? Ask any young lawyer working on a piece of litigation and he or she will tell you a version of the same story; that is, being called into the general counsel’s office to be met with him or her waving a piece of paper

in the air and asking, “Has this been produced in the XYZ litigation and, if so, when and by whom?” How do you find out the answers to these questions if you don’t know off the top of your head? What tools are at your disposal to be able to figure it out quickly? This can be complicated if the data have not been handled and organized properly in advance.

Planning

Planning is a critical component of the electronic discovery process, and it is essential to be able to anticipate the importance of efficiently and accurately determining a document’s origin and status in the litigation. At the planning stage, it is vital to think beyond simply where the relevant and/or responsive data and documents are. Thinking about how you will organize and review the data is just as important as locating it. Think about categories, or “families,” of documents within the data so that they can be grouped with similar or related documents. You could break the data down by causes of action, requests for production, or simple subject matter. Of course, one document can be in more than one family. Assigning data to a family or families while they are being reviewed can dramatically reduce time and money spent searching for the document(s) you are looking for later on. If you have not anticipated these questions and, subsequently, have not planned for them, the consequences can be a disaster. For example, consider the actual case where some form of coding and subjective review of a massive amount of data had been completed. The litigation was a dispute over three separate construction projects on the same site. The review had been set up to group the documents by the types of construction defects, but it did not allow for the documents to be grouped by construction project. Therefore, every time a search was performed

for a specific defect, the lawyers had to manually filter the documents by project. For the attorneys to build their case adequately (and efficiently), counsel had to rely first on text searching alone and later had to pay to have additional review and coding carried-out, thus causing a significant delay in the litigation. Conducting a discovery diagnosis can help your organization identify and document current discovery practices, evaluate recommended approaches based upon industry best practices, and project quantifiable benefits from implementing discovery management principles. In short, you will be able to determine what needs to be collected, processed, reviewed, and produced, and can then determine the most time- and cost-efficient method to accomplish a quality production.

Production Format: Should You Image Your Data?

One example of how planning helps to avoid post-production problems is production format. How you store and search your data can be affected by the format in which you produce the documents. There are pros and cons to images versus native formats. Making the data you produce text-searchable is important. It can help to locate documents with common terms or phrases. Images can be processed to be text-searchable. This can be done by either making the images text-searchable or by producing the data in its native format. Producing data in its native format has advantages and disadvantages. The advantages are that native formats generally require minimal processing, meaning a considerable reduction in processing costs. In addition, you are able to view the metadata, including tracked changes, comments, and calculations. It is important to remember that native files need the original application, which can create licensing issues. Therefore, further support for the applications may be necessary. The alternative is

reviewing native files with a universal viewer. Native files cannot have Bates label or other markings added at the page level. It is possible to identify a whole file with something similar to Bates numbers, but it cannot be redacted or annotated.

There are also advantages to imaging your data. Images can easily be viewed with common viewing tools, such as Adobe. Also, the appearance of the document is identical to the original as printed. Images cannot be altered, but they can still be text-searchable. Images can be Bates-labeled and endorsed with any other language, such as “confidential.” Imaging, however, also has its disadvantages. Most notably are the high costs and extensive time associated with converting large quantities of native files to images. On average, image files are five to ten times larger than the electronic document equivalent, which can create storage space issues. Metadata and any other hidden data are also lost in the imaging process.

Review

There are other examples of how good planning can make life after production easier and less stressful. Carefully planning the format and substance of a review can avert problems or costly do-overs later on. There are many different types of review, and selecting the right type for your particular case is essential. Legal review of documents is one of the largest litigation expenses, and it is only increasing as the volume of corporate data grows. Think about how many emails are sent and received in your company every day. (Your friendly IT person can probably provide this information.) Ideally, you want each document to be reviewed only one time. Formulating the review in such a way as to glean every piece of relevant data from each document will ensure that the process will not have to be repeated, thereby saving significant time and money. What type of review you choose should depend on several factors, including the volume and type of data to be reviewed, whether there are potentially privileged documents that need to be identified (and a subsequent privilege log created),

whether there are specific discovery requests, including Rule 26(a) disclosures, and the number of issues or causes of action involved in the litigation.

Hosting

Having a powerful and versatile hosting tool for your electronic data is essential. The ability to review, categorize, and organize data can have a significant impact for litigants and the outcome of litigation. Once the obligation of producing the data has been met, the data has to be utilized to build your case and/or defenses, prepare witness files for deposing and examining witnesses, and assembling exhibits for motions and trials. Possessing and utilizing a tool that can navigate you to the key documents—both positive and negative for your case—is vital.

Imagine a case where over one million documents have been produced. What methods are there for directing you to the key documents? Provided that you have selected the best method for reviewing and coding the data, problems such as determining whether a document had been produced or not becomes less of an ordeal. Without a good search tool and the appropriate planning, the chances of having an efficient way of verifying the status of documents grows slimmer.

Imagine you are in the middle of a deposition where an attempt is made to utilize a document as an exhibit and you need to know whether the document had been produced. The document has no Bates number associated with it. Because you have instant access to the repository via the Internet and powerful search capabilities, you are able to determine the origin and status of that document in seconds. Therefore, an appropriate objection to its use can be made in a timely fashion. Having the tools in place to be able to conduct such a search was a result of anticipating this scenario several months previously in the planning phase of the discovery process. Thinking in advance about how you will want to utilize electronic data post-production can make a significant difference in the time and money you spend managing and organizing it. Having a centralized hosting tool that can accommodate

electronic data across multiple matters will also dramatically decrease your litigation spending on electronic discovery management.

Cost Strategy and Settlement

Getting an early grasp on the expense involved in collection, processing, reviewing, and producing your electronic data is crucial. This is true not only for the purposes of preparing a budget, but also for making a determination whether it is financially prudent to continue with the litigation at all. If, for example, you have determined that you are going to incur \$100,000 in processing costs for

Search terms utilized to gather all potentially relevant electronic data are becoming increasingly important in avoiding problems post-production.

your production (and even more costs to review it) in a matter that the total claims by the plaintiff amount to just \$25,000, that fact will have a significant impact on how and if you proceed with the case or attempt to resolve the dispute before the total costs are incurred. Further, having your and the opposing party’s production hosted in a powerful search and organization tool will allow you to get to the most relevant documents in a more efficient way, thereby reducing your costs and leading you to a more informed and firmer footing when it comes to strategy and negotiating a settlement.

What Can Go Wrong? Examples from 2008

A review of some 2008 cases and opinions concerning electronic discovery provide good examples of some of the pitfalls that can be made by failing to plan adequately for production of electronic data as well as failing to get an early grasp of what data you have.

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WALKING THE ADVANCEMENT TIGHTROPE: HOW TO PROTECT BOTH THE CORPORATION AND THE DIRECTORS

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your watch had been cooking the books, having to explain that your corporation must pay lawyers to defend your lawsuit seeking to recover for the fraud.⁴

This article explores the ins and outs of advancement, describing when it is mandatory, permissive, or court-ordered, and how to avoid breach of duty or other charges in making advancement decisions. Our conclusion suggests a best practice, not widely deployed, to help company board members navigate the statutory and fiduciary standards and business imperatives: Corporations should provide mandatory advancement obligations but adopt rules that impose conditions on advancement—such as liability caps and exclusions for certain direct actions by the corporation—to better balance corporate interests.

Background

What Is Advancement?

Let's start at the very beginning with this concept: Indemnification and advancement are distinct legal rights. Indemnification generally means an obligation to make a person whole for a loss sustained. Advancement generally means a commitment to pay ongoing litigation expenses before any final ruling on the merits. It is usually coupled with a commitment by the party to repay the amounts advanced if it is later determined that the party was not entitled to advancement.

Corporate law permits, and sometimes requires, a corporation to indemnify its officers and directors when they are party to a civil—or criminal—action as a result of their service to the corporation. For example, most state business statutes require corporations to indemnify officers and directors who are successful in defending suits.⁵ It is improper, however, for a corporation to extend indemnification to an officer or director who loses his or her case if the board concludes that the officer or director acted in bad faith or should have known he or she was violating a criminal law.⁶

Because the right to ultimate indemnification hinges on the person's conduct

and the outcome of the case (which cannot be determined before the action is concluded), the law also allows corporations to advance to officers and directors their litigation expenses during the pendency of the case. In essence, advancement is a loan to a director or an officer, potentially subject to repayment if the officer is not ultimately entitled to indemnification.⁷ The principal rationale for advancement is that it allows corporations to “attract capable individuals into corporate services” by promising them “interim relief from any out-of-pocket financial burden if they incur legal expenses as a result of their service to the corporation.”⁸

Types of Advancement

Contractually Required Advancement.

There are three main types of advancement. The first and most common is contractual, or mandatory, advancement. Most states allow corporations to adopt provisions in bylaws or articles of incorporation, requiring the corporation to advance legal expenses, and many corporations do so. Mandatory advancement provisions provide corporate directors and officers the broadest protection possible and are strictly enforced by courts. The one caveat to be aware of is that the precise language of the bylaws matters. They must expressly state that advancement (or advance payment of litigation expenses) is required. A bylaw provision that merely provides for indemnification will not be read to include an obligation to pay legal expenses in advance.⁹

Permissive Advancement. The second type of advancement is permissive advancement. Even if a corporation's bylaws are silent, many state business statutes, including Delaware's, permit the corporation to approve advancement. Permissive advancement can be the most problematic form of advancement because it involves a decision to advance fees in a particular case and is subject to the board's duty of care.¹⁰ In this situation, the overriding goal of advancement—to attract good officers and directors—is not clearly implicated because the officer

or director seeking advancement agreed to serve without obtaining advancement rights. The decision to provide permissive advancement also raises concerns about director self-dealing when a corporate director is seeking advancement.

Discretionary Advancement. The third type of advancement is discretionary, or court-awarded, advancement. Some states allow officers and directors to seek a discretionary order from a court requiring a corporation to advance reasonable legal expenses. Although the standards that govern when a court will require advancement are not well-developed (in part because Delaware law does not provide for court-awarded advancement), this may be a powerful option available to officers and directors.

Mandatory Contractual Advancement

Corporations typically elect to provide their directors and officers with mandatory unconditional advancement, often by adopting bylaws that require advancement to the “extent permitted by law.”¹¹ Although mandatory contractual advancement can, in theory, be conditional,¹² a review of the reported cases indicates that it rarely is. While mandatory unconditional advancement is the most protective of officers and directors, corporations and their counsel may be surprised to learn how strictly courts will enforce these rights. For example, Delaware courts have held the following:

- Mandatory advancement must continue after a criminal conviction.¹³ Conrad Black, the former CEO and chairman of Hollinger International, was convicted on three counts of mail fraud for receiving illegal payments from the corporation and was found civilly liable for breaching his fiduciary duty. After his conviction, the corporation sought a declaratory judgment that it could stop advancing fees for his criminal appeal. The corporation had already incurred \$60 million in fees in the criminal case. The court, however, held that

the corporation must continue to advance legal expenses until there was a final, non-appealable decision.

- A corporation must pay to defend former officers against the corporation's suit for theft of confidential information.¹⁴ Wendell Brown resigned as director and officer of a company and started a competing business. The company accused him of stealing trade secrets. The court held that because there was a "nexus or causal connection" between the claim and Brown's service as officer and director of the corporation, the corporation was required to advance his expenses in defending the action.
- A corporation suing former directors of a subsidiary it purchased for fraud in the sale of the subsidiary must pay for the former directors' defense.¹⁵ After the acquiring company discovered misstatements by the company it acquired, it sued the former directors for securities fraud. The former directors sought advancement as they were exhausting the D&O policy limits. The

court held that the corporation was compelled to continue paying the former directors' legal expenses even though the company was accusing them of fraud.

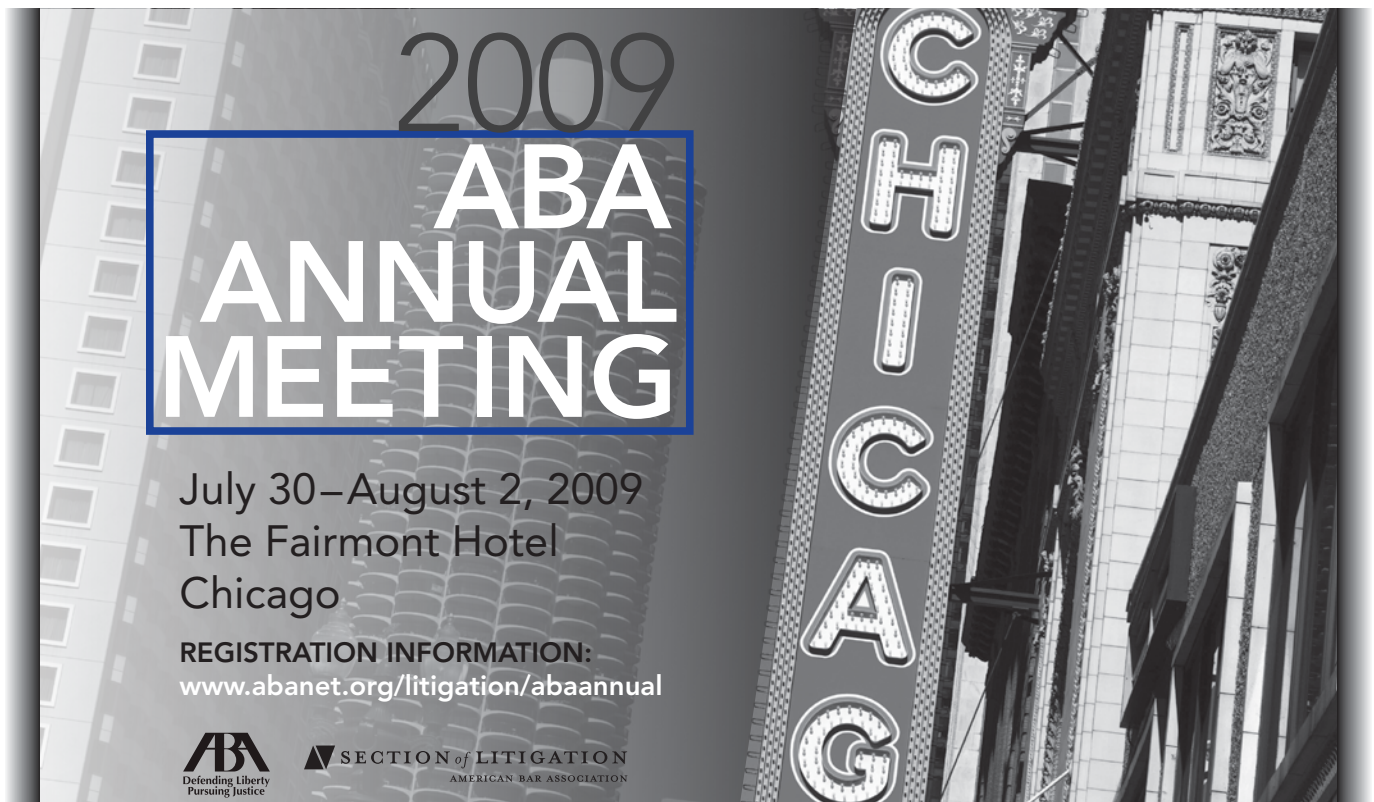
- A corporation is required to advance fees to a law firm sued for breach of fiduciary duty.¹⁶ A law firm represented a corporation in a dispute for control of the company. After the company was taken over, it refused to pay the law firm and amended a breach of fiduciary duty action to name the firm as a defendant. The corporation was forced to advance fees to the firm because the court held that the law firm was an agent within the meaning of the corporation's advancement bylaws.

Delaware courts have recognized only a handful of defenses to mandatory unconditional advancement, and these defenses have been narrowly tailored. For example, advancement is excused where the claim is not based on the director's or officer's work for the company, but courts require corporations seeking to advance this defense to show that the claim has no "nexus or causal connection"

to the director's or officer's service.¹⁷ Delaware's Supreme Court has also recognized a limited unclean hands defense to advancement, available if an officer attempts to shield assets to prevent recovery of the advancement.¹⁸ But, in *Homestore Inc. v. Tafien*, the Delaware Supreme Court ruled that an officer's "motivation" for engaging in the official conduct at issue in the underlying proceeding cannot serve as a basis for denying advancement—even if the conduct is motivated by "personal greed" as opposed to the corporate interest.¹⁹ Courts in other states have followed Delaware's lead.²⁰

Corporations that are tempted to challenge mandatory advancement should be cautious, because courts rarely accept such defenses and Delaware courts will grant the officer "fees on fees." It is therefore likely the corporation will end up paying the officer's or director's expenses incurred in securing advancement.²¹

Given the costs imposed by mandatory unconditional advancement, the alternative of permissive advancement appears to be appealing. But, as discussed below, delaying the advancement decision until an action is brought



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against a director or an officer triggers a host of statutory and fiduciary obligations that corporations must consider before granting advancement.

Approving Permissive Advancement

Almost all advancement statutes allow for permissive advancement in specific cases. But where the corporation has not previously adopted mandatory advancement, then in approving a permissive advancement to a director or an officer, the corporation must take care to comply with a mix of statutory standards and fiduciary obligations. If the corporation has not taken care to follow the statutory procedure or comply with its fiduciary obligations, the corporation leaves itself open to shareholder efforts to block advancement or impose liability for improper advancement.

Four models of permissive advancement statutes are discussed in this part. Almost all states require (1) the officer or director seeking advancement to provide a repayment undertaking; and (2) board action to approve advancement. But statutes vary in two important ways. First, advancement statutes vary in whether and, if so, how heightened approval requirements are imposed on advancements to directors. When advancement is made on behalf of a director, there is a split of authority on whether advancement must be approved by disinterested directors (or shareholders). Second, statutes vary in the extent to which the board is required to determine if the officer or director seeking advancement has met a standard of conduct. As discussed further below, even where boards are not strictly required to consider the officer's or director's conduct, the board should use its business judgment to consider such conduct.

Properly Approving Advancement

1. Delaware

Under Delaware law, a corporation's decision to grant or deny advancement is protected by the business judgment rule, but advancement to directors is treated as a self-interested transaction. Advancement to directors, therefore, must be approved by disinterested parties or the decision is subject to judicial review under the heightened entire fairness standard. In addition

to proper approval, Delaware General Corporation Law section 145(e) requires an undertaking to repay fees if the officer or director is ultimately found not to be entitled to indemnification.²²

As the Chancery Court explained in *Advanced Mining Systems, Inc. v. Fricke*, Delaware law "leaves to the business judgment of the board the task of determining whether the undertaking proffered in all of the circumstances, is sufficient to protect the corporation's interest in repayment and whether, ultimately, advancement of expenses would on balance be likely to promote the corporation's interests."²³ Thus, where advancements are sought by officers not serving as directors, corporations have broad authority to grant or deny advancement. Where, however, a board seeks to advance fees to a corporate director, *Havens v. Attar* holds that permissive advancement is a form of self-interested transaction. As a result, advancements to directors must be approved by disinterested directors or shareholders or be subject to the exacting "entire fairness" standard.²⁴

Whether the advancement is made to a director or an officer, *Advanced Mining Systems* indicates that the board (or a special committee considering requests for advancement) should address two issues: (1) the recipient's ability to repay; and (2) whether advancing expenses to the officer or director is in the corporation's interest.²⁵

When determining if the corporation should advance fees, the board can also consider imposing additional conditions. Delaware's advancement statute expressly allows the corporation to impose terms and conditions on its advancement: "expenses (including attorney fees) incurred by former directors and officers or other employees and agents may be so paid upon such terms and conditions, if any, as the corporation deems appropriate."²⁶

A corporation can impose any conditions that "comport with the implied covenant of good faith and fair dealing inherent in all contracts."²⁷ For example, in *Thompson v. Williams Cos., Inc.*, the Delaware chancery court approved of a board's decision to condition advancement to an employee indicted on federal criminal charges on receipt of dollar-for-dollar security and an affirmation that the

employee personally believed that he met the conduct standard for ultimate indemnification. The *Thompson* court concluded that, although the board "cannot condition . . . advancement on arbitrary terms not rationally related to a proper corporate interest, the board was well within its contractual discretion to require Thompson to establish his ability to repay the loan and to represent that his conduct as an employee was consistent with an ultimate right of indemnification."²⁸ Interestingly, the court approved the conditions imposed on Thompson even though the board granted unconditional advancement to other employees to induce these other employees to cooperate with an ongoing criminal investigation. *Thompson* confirms that, so long as it does not act in bad faith, a board has broad authority to condition advancement.²⁹

Second, a board should address and articulate why advancing expenses is in the corporation's best interests. The board is free to make a holistic determination considering the corporation's financial health, interest in encouraging the officer to cooperate with the corporation in its own defense of pending litigation,³⁰ or desire to assist the officer in defending against a case that the corporation believes is meritless. The corporation is not required to determine if the officer or director met the relevant standard of conduct for indemnification (in advance of a final determination),³¹ nor is the board required to consider the officer's likelihood of success on the merits.

2. New York

Although advancement actions are most frequently brought under Delaware law, the first indemnification statute was adopted in New York, which has a robust body of case law addressing advancement rights.³² The New York advancement statute, like the pre-1994 Revised Model Business Corporation Act discussed below, is emblematic of a number of statutes that do not specify how a corporation should authorize advancement. New York Business Corporations Law section 723(c) provides "[e]xpenses incurred in defending a civil or criminal action or proceeding may be paid by the corporation in advance of the final disposition of

such action or proceeding upon receipt of an undertaking.”³³

New York authorities, however, are in agreement that advancement should be approved by the board.³⁴ Further, New York law permits the board to approve advancement but does not require advancement.³⁵

Although there is authority indicating that advancement to a director must be approved by disinterested parties—as it must be in Delaware—the issue has not been definitively settled by New York courts.³⁶ On the one hand, several authorities suggest advancement must be approved by disinterested parties. For example, in *Pilipiak v. Keyes*, the New York Supreme Court upheld a shareholder vote to advance fees, noting that advancement, like indemnification, must be approved by disinterested directors or shareholders. In so doing, the court applied New York’s statutory indemnification approval requirements.³⁷ Although the appellate court ruled that the advancement of fees should have been enjoined because the officer being advanced fees had been convicted of a crime in the interim, the appellate court confirmed the lower court’s decision to apply indemnification standards to advancement: “Prior to judgment, the payment of legal fees or indemnification of the officer or director may be made so long as there is a finding, either by the shareholders or by a quorum of a disinterested board of directors, that the officer or director acted in good faith and for corporate purposes.”³⁸

There is also authority that an advance to a director is a self-interested transaction, and therefore, must presumptively be approved by disinterested parties (or be subject to the entire fairness standard).³⁹ Other cases, however, note only that board or shareholder approval is required.⁴⁰ The issue is not yet resolved; however, the weight of authority favors approval by disinterested parties.

No specific conduct standard is imposed by New York’s advancement statute. There is, however, New York authority that advancement is not appropriate where there is significant evidence that the director acted in bad faith to further his own interests.⁴¹ Likewise, directors run the risk of violating

their fiduciary duty if they approve or accept advancement and are later found (or admit) to have knowingly engaged in bad-faith, self-dealing, or criminal conduct that would preclude ultimate indemnification.⁴²

Where the board has denied advancement, it should be careful to justify a decision with more than allegations of misconduct.⁴³ If a board denies a request for advancement, a party may petition the court to authorize advancement as permitted by New York law.

3. Revised Model Business Corporation Act

Unlike New York’s advancement statute, the current version of the Revised Model Business Corporation Act (RMBCA), followed by 12 states, prescribes the same approval process for both advancement and indemnification.⁴⁴ The RMBCA requires any advancement to an officer to be approved by the board. If the advancement is sought by a director, it must be approved by the shareholders or a committee of disinterested directors, provided there are two or more disinterested directors. If there is only one disinterested director, the RMBCA would allow the full board to approve advancement.⁴⁵

Although the RMBCA imposes the same authorization process for indemnification and advancement, it does not require the board to make a specific finding regarding the officer’s or director’s

conduct. Instead the RMBCA requires the officer or director seeking advancement to affirm that he or she acted in a “good faith belief that he [or she] has met the relevant standard of conduct described in section 8.51 or that the proceeding involves conduct for which liability has been eliminated under a provision of the articles of incorporation.”⁴⁶ The RMBCA also requires the person seeking advancement to provide an undertaking to repay fees.

Thirteen states follow the pre-1994 version of the RMBCA, which requires the board to make a determination—based on the facts known to the corporation—that the officer’s or director’s conduct does not preclude the board from advancing fees.⁴⁷ The officer or director must also provide a repayment undertaking. Unlike the current RMBCA, however, the pre-1994 RMBCA does not specifically address whether the board should approve advancement to directors by a vote of disinterested directors or the full board.

4. Other Approaches

Courts in some states do not require disinterested parties to approve advancement and instead permit directors seeking advancement to vote on their own advancement.⁴⁸ A few other states have mandatory statutory advancement rules that require the corporation to advance expenses—provided the officer or director meets specific standards—and that

Practice Tip for Young In-House Lawyers

The in-house attorney wears many hats, often at the same time. Your value is as much in your knowledge of the business as it is in your legal expertise. Learn everything about the business, the industry, and the finances. Realize that the people you serve are knowledgeable and well-versed in the issues. What they need are answers to problems—not just legal advice. It is more important to listen and collaborate with your client than to tell your client what can or cannot be done.”

*By Mark Hooton, Associate General Counsel,
Blue Cross Blue Shield of Tennessee, Inc.*

allow courts to make an independent determination if the corporation refuses to grant advancement.⁴⁹

5. Undertaking Requirements

As noted above, most advancement statutes require the person receiving the advancement to provide an undertaking to repay all expenses advanced if it is ultimately determined after a final adjudication of the proceeding that the officer is not entitled to indemnification.⁵⁰ Although the corporation may condition permissive advancement on obtaining adequate security,⁵¹ statutes do not require that the undertaking be secured.⁵²

Blocking Permissive Advancements to Officers or Directors

Shareholders have successfully enjoined advancement based on a failure to observe approval requirements.⁵³ Likewise, courts will block advancement where no undertaking is provided.⁵⁴ Where the corporation has failed to follow proper approval requirements or satisfy statutory prerequisites for advancement, some courts have even held that the court should grant injunctive relief without applying the requirement of proving, in the traditional sense, irreparable harm or the balancing of the equities.⁵⁵

Some courts have enjoined permissive advancement on substantive grounds. For example, twin New York cases, *Estate of Purnell v. LH Radiologists, P.C.*⁵⁶ and *Donovan v. Rothman*,⁵⁷ discuss the circumstances under which it may be improper to advance legal expense. In *Purnell*, the president of a corporation secretly issued himself certificates that falsely indicated that he was the sole shareholder of the corporation and sought to block an audit of corporate records. The New York Court of Appeals concluded that the evidence of the officer's conduct amounted to bad faith and warranted an order enjoining the corporation from advancing legal expenses.⁵⁸ In *Donovan*, the court held that the misconduct at issue in *Purnell* precluded advancement, not only in the original proceeding (*Purnell*), but also in the derivative action (*Donovan*) premised on related but different conduct.⁵⁹ Although not expressly addressed by either court, a factor contributing to

the court's decision may have been the president's ability to award himself fees (because he misappropriated control of the corporation) without a meaningful review of his conduct. Other courts have similarly enjoined permissive advancement where there has been a finding that the officer or director at issue knowingly engaged in criminal activity.⁶⁰

Courts addressing the propriety of advancing expenses to an officer who has admitted to, or been convicted of, criminal conduct provide a useful illustration of the distinction between permissive advancement and mandatory advancement. Where there is a right to mandatory advancement, courts have held that the obligation to advance may continue on appeal or after the officer pleads guilty.⁶¹ In contrast, there is authority in at least one state (New York) that permissive advancement of such expenses would be a breach of the directors' fiduciary duties.⁶²

Because a decision to grant advancement is subject to the directors' fiduciary duty of care, an improper decision to advance legal expenses can be the basis for a derivative lawsuit alleging a director breached his or her fiduciary duties to the corporation.⁶³ If the advancement is made to a corporate director, the corporation may not benefit from the business judgment rule and may instead be required to show that the advancement was entirely fair to the corporation.⁶⁴

Considerations When Approving Advancement

Where a corporation seeks to exercise its business judgment to approve advancement, the board should consider at least the following factors: (1) whether, based on the information available to the board, the officer's or director's conduct is likely to preclude ultimate indemnification; (2) the corporation's financial condition; (3) the reasonableness of the fees incurred and the corporation's ability to recover advanced expenses; and (4) in light of these considerations, whether it is in the corporation's interest to impose any conditions or limitations on the advancement.

First, a corporation should review evidence available to the corporation regarding the officer's or director's conduct and evaluate whether the officer or director

will be entitled to advancement. Some statutes require that the corporation determine that the information available to it does not preclude advancement before deciding to advance fees.⁶⁵

But, even where such a conduct determination is not specifically required by statute, the board—in using its business judgment—can consider whether the director's or officer's conduct will ultimately preclude advancement.⁶⁶ In such circumstances, some courts have recognized that directors can be liable for a breach of their fiduciary duty if they approve advancement where the evidence available to them shows that the officer would not be eligible for ultimate indemnification because the officer acted in bad faith or knowingly committed a crime.⁶⁷ Where there is no prior obligation to advance expenses, advancement is no longer an abstract issue of attracting directors and executives. The corporation's interests in paying the expenses cannot be divorced from the facts and conduct at issue in the matter and the likelihood that the officer or director will be forced to repay the advance.

Although there is authority that conduct is irrelevant to determinations of whether advancement is appropriate, these authorities address the corporation's obligation to fulfill a previous commitment (in the bylaws or articles of corporation) to advance legal expenses if the officer or director incurs expenses as a result of his service. In such circumstances, it is usually unfair to allow the corporation to escape its bargain once it comes time to fulfill its obligation.⁶⁸

Second, the corporation should determine if it has sufficient financial resources to make advances.⁶⁹ Where a corporation does not have the funds to pay for legal expenses and has not previously committed to providing the advance, it may be imprudent to advance legal expenses.

Third, the corporation should consider its ability to secure repayment if the officer is ultimately found liable for repaying the legal expenses.⁷⁰ It may be appropriate in some circumstances for a corporation to limit its advancement unless the officer or director provides security for the undertaking.⁷¹

Finally, the corporation should determine if there are conditions it can impose to better protect the corporation's interests. For example, even where not required by law, the corporation might consider requiring the officer to submit an affirmation that the officer acted in good faith.

The corporation should be aware that in jurisdictions that allow court-awarded advancement, the officer can seek advancement from the court. In such cases, a decision to deny advancement should be made with particular care, because the board will likely face further litigation (and costs) if the officer or director seeks to convince the court to award advancement. It is important in such circumstances that the board can show that it made a reasonable, good-faith decision to deny advancement.

Court-Awarded Advancement

Even if a board denies a request for advancement, some states allow the officer or director to petition the court to require the company to provide advancement. Discretionary court-awarded advancement is an alternative means of obtaining advancement that is available in a minority of states.

Most states, including Delaware, limit a court's power to grant advancement to circumstances where the requesting party is contractually entitled to advancement.⁷² In these jurisdictions, the court's only task is to determine if the officer or director is entitled to advancement under the applicable contract, statute, bylaws, or articles of incorporation. An assessment by the court of the officer's conduct is only necessary in these actions where specifically required by the applicable documents and law.⁷³

A minority of states, however, follow the RMBCA approach, which grants a court the authority to order advancement based on its determination of what is "fair and reasonable."⁷⁴ Some statutes permit the court to award advancement but do not adopt the fair and reasonable standard.⁷⁵

Where the corporation is not contractually obligated to make advancements and the court is authorized to grant advancement, the decision to grant or deny advancement is left to the discretion of the court.⁷⁶ For example, New York law permits court-awarded advancement but

does not provide courts with guidelines for granting advancement.⁷⁷ The New York Supreme Court decision in *Vacco v. Diamadopoulos* shows that these orders are discretionary. The *Vacco* court refused to grant court-awarded advancement because of the misconduct of the party seeking advancement. In *Vacco*, former trustees of a not-for-profit university sought advancements to defend claims brought by the New York attorney general and the university that they breached their fiduciary duties by approving excessive compensation to the university's president and by authorizing advertising and insurance contracts between the university and two of the former trustees' firms. The *Vacco* court deferred to the board's decision, holding that advancement was not "warranted" because of "the scope of the findings of neglect of duty" by the New York Board of Regents.⁷⁸ The university's decision was also motivated, in part, by its precarious financial condition.⁷⁹

Although a court can consider a director's or an officer's conduct when determining (in its discretion) if advancement should be ordered, as a general rule, the court is not required to base its determination on whether the officer will ultimately be entitled to indemnification.⁸⁰ In some circumstances, however, the officer's misconduct and control of the corporation is such that it may be improper for a court to award advance legal expenses. For example, as discussed earlier in this article, the New York courts have enjoined permissive advancement where there is substantial evidence an officer engaged in bad faith or self-dealing.

Other factors the court might consider include the corporation's financial resources, the officer's ability to fund a defense in the absence of advancement, and the reasonableness of the corporation's rationale for denying advancement.⁸¹

To say the decision is left to the discretion of the court, however, does not mean the court's discretion to grant advancement is totally unrestrained. For example, New York's statute requires that an officer raise a genuine issue of fact or law upon which to base his or her defense in the underlying matter. Likewise, the party seeking legal fees has the burden of demonstrating that those fees and expenses are

both reasonable and necessary in connection with his or her defense.⁸²

Best Practices: Independent Investigation and Approval

When a corporation is faced with a request to advance a potentially large defense bill and does not have a bylaw or written policy of providing advancement, the best practice is for the board to conduct an independent review to determine if advancement is in the corporation's best interest.

If a director is interested in the transaction, the corporation should designate a committee of disinterested directors to consider advancement. A number of courts, including the influential Delaware

An independent review may not be necessary in every case, particularly if the corporation takes other steps to protect its interests.

chancery court, have identified advancement of legal expenses as a self-interested transaction.⁸³ If the corporation has formed a special litigation committee, advancement may appropriately be considered by that committee. Further, depending on the nature and scope of the allegations against the officer, it may be prudent to hire independent counsel to provide a recommendation on the issue.

Although most advancement statutes allow the board to advance expenses without reaching a conclusion regarding the officer's or director's conduct, boards deciding whether to award permissive or discretionary advancement should consider the officer's conduct. If the wrongdoing is egregious and the corporation's investigation strongly suggests the officer or director will not be ultimately entitled to indemnification, the corporation may be better served by denying advancement.

Yet, even where the officer's conduct would apparently preclude ultimate

indemnification, a board might still find that advancement is in the corporation's best interest, for example, to encourage the officer or director to cooperate in an important investigation.⁸⁴ Other considerations that corporations should weigh include the corporation's financial resources and the officer's ability to repay advanced fees.⁸⁵ When the expenses to be incurred are unusually large, it may also be prudent to impose conditions or seek additional security.

Where the amount being sought is modest or implicates an officer—and not a director—an independent review may not be necessary in every case, particularly if the corporation takes other steps

Defining and specifying who is covered by its mandatory advancement obligation can ensure that the beneficiaries of such obligations track the corporation's intentions.

to protect its interests. For example, the corporation may require security for its advancement and an affirmation from the employee that he or she acted in good faith pursuant to the corporation's interest.⁸⁶ The corporation might also impose a reasonable cap on the advancement to ensure that the fees are reasonable. This approach can be more responsible and economical in some circumstances.

Where a board decides to deny advancement, care should be taken during its deliberations, particularly if the controlling statute allows the court to award discretionary advancement. In such circumstances, the court is free to independently review the officer's conduct to determine if advancement is "fair and reasonable." As a result, the board should take care to conduct and document an independent review, possibly by outside counsel.

Corporations should revisit their bylaws to ensure that they are serving the

best interests of the directors, officers, and corporation. Even in the best-case scenario, a request for permissive advancement can trigger a time-consuming and potentially expensive investigation. At the worst, the board's decision to grant advancement exposes the corporation to potential liability, particularly where an entire board is accused of wrongdoing. Thankfully for corporations, there is a better (but rarely utilized) option: conditional mandatory advancement.

A Better Practice: Conditional Mandatory Advancement

Conditional mandatory advancement is a better alternative to both mandatory unconditional advancement and permissive advancement. Even as the Delaware courts have strictly enforced unconditional advancement bylaws, the courts have openly invited corporations to begin to impose conditions on these obligations.⁸⁷ In reviewing and revising its bylaws, the corporation should make sure to balance its need to reassure its directors and officers while also protecting the corporation from advancing excessive legal expenses in unexpected situations. To achieve this balance, corporations should consider at least four possible conditions: (1) caps on advancement; (2) a careful definition of who is entitled to advancement; (3) excluding certain claims brought directly by the corporation from the right to advancement; and (4) strict disclosure requirements—such as an affirmation of good faith and financial disclosure—on officers and directors requesting advancement.

Caps on mandatory advancement obligations are not new to the corporate boardroom. All D&O insurance policies impose such limits. Insurance provides a way to fund defense bills while also imposing overall limits on coverage under the policy. Corporations should consider adopting similar limitations on their mandatory advancement obligations. Although a corporation could retain the ability to advance funds beyond such limits, this limitation would allow the corporation to protect against excessive advancement obligations.

Defining and specifying who is covered by its mandatory advancement

obligation is another way to ensure that the beneficiaries of such obligations track the corporation's intentions. For example, the corporation may want to reevaluate bylaw provisions that extend advances to agents of the corporation because of the potential scope of such obligations. Corporations also might decide to impose separate caps on advancements to non-officer and non-director employees and agents.

A corporation should also consider excluding certain types of claims from any mandatory advancement rights. For example, a corporation can exclude advancement when the corporation brings claims directly (not derivatively) against a director or an officer. To the extent that a corporation wants to reassure the current and prospective officers and directors, it could limit this carve-out to claims based on fraud, self-dealing, or misappropriation of corporate tangible or intangible property while continuing to cover direct claims based on the fiduciary duty of care and derivative actions.

To some extent, corporations have adopted similar limitations by limiting advancement for counterclaims brought against the corporation in response to decisions requiring the corporation to advance expenses in such circumstances.⁸⁸

The corporation may also wish to impose specific disclosure requirements for advancement. For example, it could require officers or directors applying for advancement to provide financial disclosures of their assets and liabilities and an affirmation that they expect that they will ultimately be entitled to indemnification. The corporation could also impose limitations on the officers' and directors' choice of counsel or require approval of certain expenses.

These potential limitations on advancement rights are not exhaustive, but they provide examples of how a corporation might condition advancement. Although conditional advancement exposes officers and directors to some added risk, such conditions protect the corporation from the spiraling cost of litigation and the real fear of being compelled to fund its opponent's legal bills. If properly crafted, these bylaw provisions would continue to provide strong

protection to the vast majority of corporate America's diligent and honest officers and directors.

Conclusion

Where an important officer or director has been sued, there may be an instinct to act quickly to approve advancement. Conversely, in some circumstances, corporations may reflexively want to deny advancement requests, particularly when the corporation brings suit against its officers or discovers its officers and directors may have engaged in criminal wrongdoing. If the corporation has already committed to advancement, it has little choice but to fulfill its obligation. But, if the corporation has not committed to advancement, it is important that the board ensure that the decision to advance fees is made only after careful consideration, if appropriate, by disinterested parties. In either case, a request for advancement is also an occasion for revisiting the corporation's bylaws to ensure that the bylaws reflect the corporation's interests going forward. ■

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Endnotes

1. *Sun-Times Media Group, Inc. v. Black*, 954 A.2d 380, 383 (Del. Ch. 2008) (holding that a provision providing legal expenses "shall be paid . . . in advance of the final disposition of such action" required the *Sun-Times* to continue to advance legal expenses on appeal).
2. *Brown v. Liveops, Inc.*, 903 A.2d 324, 327-30 (Del. Ch. 2006).
3. *Jackson Walker LLP v. Spira Footwear, Inc.*, No. 3150 (VCP), 2008 WL 2487256, at *6-8 (Del. Ch. 2008).
4. *Barrett v. Am. Country Holdings Inc.*, 951 A.2d 735, 743-46 (Del. Ch. 2008).
5. Even if the officer and director are found liable in a civil action, the corporation may still be committed to indemnify her if she acted in good faith in a manner she reasonably believed to be in the corporate interest. *See, e.g.*, Del. Gen. Corp. L. §145(a). Where the officer or director is adjudged liable to the corporation, she must seek a court ruling approving advancement. *See, e.g.*, Del. Gen. Corp. L. § 145(b).
6. *See, e.g.*, Del. Gen. Corp. L. § 145(a).
7. *Adelphia v. Rigas*, 323 B.R. 345, 375-76 (S.D.N.Y. 2005); *see Majkowski v. Am. Imagining Mgmt. Serv., LLC*, 913 A.2d 572, 589-90 (Del. Ch. 2006) ("[a]dvancement is a species of loan").
8. *Homestore, Inc. v. Tafeen*, 888 A.2d 204, 211 (Del. Sup. Ct. 2005); *see also Schmidt v. Magnetic Head Corp.*, 468 N.Y.S.2d 649, 656-57 (1st Dept. 1983) (indemnification and advancement provisions "were enacted to induce capable and responsible businessmen to accept positions in corporate management by protecting them from personal risk").
9. Delaware courts hold that a bylaw provision providing indemnification to the "extent" of the law, but not specifically referencing advance payment of legal expenses, cannot be interpreted as requiring advancement. *Advanced Mining Sys., Inc. v. Fricke*, 623 A.2d 82, 84 (Del. Ch. 1992); *Majkowski*, 913 A.2d at 589-90. In *Sodano v. AMEX*, No. 3417-VCS, 2008 WL 2738583, at *10-11 (Del. Ch. 2008), the court found that an employment release agreement between Sodano and the National Association of Securities Dealers adequately preserved indemnification rights under the association's organizational documents, which provided mandatory advancement rights. But a broad application of the decision is probably improper because of the unique facts in *Sodano*.
10. *See Havens v. Attar*, No. Civ. A. 15134, 1997 WL 695579, at *3 (Del. Ch. Nov. 5, 1997) (enjoining advancement of fees approved by self-interested directors); *Bansbach v. Zinn*, 1 N.Y.3d 1, 11-12 (2003) (holding a plaintiff was not required to make a demand before bringing a derivative action based on improper advancement and indemnification because the CEO was self-interested in the indemnification and advancement and the board was dominated by the CEO).
11. *See, e.g.*, *Barrett v. Am. Country Holdings, Inc.*, 921 A.2d 735, 739, 747 n.39 (Del. Ch. 2008). Other bylaws achieve the same result by requiring the corporation "shall" advance indemnifiable expenses with a commitment to indemnify directors and officers to the "extent permitted" by law. *See, e.g.*, *DeLucca v. KKAT Management, LLC*, No. Civ. A. 1384-N, 2006 WL 224058, at *7, *14 (Del. Ch. Jan. 23, 2006).
12. *Barrett*, 921 A.2d at 747 n.39.
13. *Sun-Times Media Group*, 954 A.2d at 383 (holding that a provision providing legal expenses "shall be paid . . . in advance of the final disposition of such action" required the *Sun-Times* to continue to advance legal expenses on appeal).
14. *Brown*, 903 A.2d 324, 327-30 (Del. Ch. 2006).
15. *Barrett*, 921 A.2d at 743-46. *Barrett* also rejected the corporation's attempt to condition advancement on an agreement to confess judgment so that the corporation could pursue D&O insurance proceeds.
16. *Jackson Walker*, 2008 WL 2487256, at *6-8.
17. *See Shearin v. E.F. Hutton Group*, 652 A.2d 578, 594-95 (Del. Ch. 1994) (wrongful discharge suit was not brought by reason of service as an officer); *but see Liveops*, 903 A.2d at 327-30.
18. *See Homestore*, 888 A.2d at 216-18 (requiring advancement but noting that a former officer's effort to shelter assets so that he would not be required to repay if not ultimately entitled to indemnification would be a basis for denying advancement); *see also Nakahara v. NS 1991 Am. Trust*, 739 A.2d 770, 791-92 (Del. Ch. 1998) (applying doctrine of unclean hands where trustees engaged in self-help during litigation over their right to advancement).
19. *Homestore*, 888 A.2d at 213-14.
20. *See, e.g.*, *Westar Energy, Inc. v. Lake*, —F.3d—, Nos. 07-3219, 07-3280, 2009 WL 12892, at *7-11 (10th Cir. 2009) (Kansas law); *cf. Happy Kids, Inc. v. Glasgow*, No. 01 Civ 6434 (GEL), 2002 WL 72937, at *4 (S.D.N.Y. Jan. 17, 2002) (finding that allegations of misconduct do not bar advancement of fees); *see also Barry v. Barry*, 824 F. Supp. 178, 183-85 (D. Minn. 1993) (Minnesota law).
21. *Barrett*, 921 A.2d at 743-46 (corporation's "stockholders will end up paying for this time and resource-wasting litigation").
22. Del. Gen. Corp. L. § 145(e).
23. *Advanced Mining Sys.*, 623 A.2d at 84.
24. *Havens*, 1997 WL 695579 at *3 (enjoining advancement of fees approved by self-interested directors); *Adelphia*, 323 B.R. at 385-87.
25. *Advanced Mining Sys.*, 623 A.2d at 84.
26. Del. Gen. Corp. L. § 145(e).
27. *Thompson v. Williams Cos., Inc.*, No. Civ. A. 2716-VCS, 2007 WL 221593, at *4, *11 (Del. Ch. July 31, 2007).
28. *Id.* at *2. In *Thompson*, the court was interpreting a bylaw provision that provided for advancement to employees (in addition to directors and officers) in language that closely tracks Delaware's advancement statute. *Id.*
29. *Barrett*, 951 A.2d at 737 (the corporation improperly conditioned advancement on the former directors' willingness to confess judgment in the underlying fraud action and assign any

coverage claim against their D&O insurance).

30. *Thompson*, 2007 WL 221593, at *6–7.

31. See *Homestore*, 888 A.2d at 211 (“The right to advancement is not dependent on the right to indemnification.”).

32. *Schmidt*, 468 N.Y.S.2d at 656.

33. New York B.C.L. § 723(c).

34. *Pilipiak v. Keyes*, 729 N.Y.S.2d 99, 99–100 (1st Dept. 2001); *Donovan v. Rothman*, 677 N.Y.S.2d 327, 329–30 (1st Dept. 1998).

35. The permissive (“may”) language of B.C.L. § 723(c) allows a corporation to grant advancement but does not require it. *Qantel Corp. v. Niemuller*, 771 F. Supp. 1372, 1374–75 (S.D.N.Y. 1991); see also *Vacco v. Diamandopoulos*, 715 N.Y.S.2d 269, 272–73 (Sup. Ct. 2000) (deferring to the not-for-profit corporation’s decision to deny advancement).

36. See *Pilipiak*, 729 N.Y.S.2d at 99–100.

37. *Pilipiak v. Keyes*, 185 Misc. 2d 636, 639–40 (N.Y. Sup. Ct., 2000), *rev’d on other grounds*, 729 N.Y.S.2d 99 (1st Dist. 2001) (denying a motion to enjoin a corporation from advancing legal expenses because a majority of the shareholders approved advancement).

38. *Pilipiak*, 729 N.Y.S.2d at 99–100. However, a 1986 amendment to the advancement statute, overlooked by the *Pilipiak* court, deleted a reference to the indemnification approval requirement, suggesting this may not be the proper standard. McKinney’s 1986 Session Laws of New York, ch. 513 § 1 (1987). Given this amendment, it is not clear if New York courts will ultimately adopt the rationale that advancement as a subset of indemnification must be approved pursuant to indemnification standards.

39. See *Bansbach*, 1 N.Y.3d at 11–12 (holding a plaintiff was not required to make a demand before bringing a derivative action based on improper advancement and indemnification because the CEO was self-interested in the special committee’s decision and dominated the board); New York B.C.L. § 713.

40. *Donovan*, 677 N.Y.S.2d at 329–30.

41. *Id.*; see also *Estate of Purnell v. LH Radiologists, P.C.*, 90 N.Y.2d 524, 527, 532 (1997).

42. *Bansbach*, 1 N.Y.3d at 11–14.

43. See *Booth Oil Site Admin. Group v. Safety-Kleen Corp.*, 137 F. Supp. 2d 228, 237 (W.D.N.Y. 2000) (relying on affidavits denying fraud allegations); *Sequa Corp. v. Gelmin*, 828 F. Supp. 203, 206 (S.D.N.Y. 1993).

44. Model Act Annotated § 8.53(c)(i) (2008); Conn. Gen. Stat. Ann. § 33-773; Ga. Code Ann. § 14-2-853; Haw. Rev. Stat. § 414-244; Idaho

Code § 30-1-853; Iowa Code Ann. § 490.853; Me. Rev. Stat. Ann., tit. 13-C, § 854; Mass.

Ann. Laws ch. 156D, § 8.53; Miss. Code Ann. § 79-4-8.53; Neb. Rev. Stat. § 21-20, 105; S.D. Codified Laws § 47-1A-853; W.Va. Code § 31D-8-853; Wyo. Stat. Ann. § 17-16-853; see also Vt. Stat. Ann., tit 11A, § 8.53(a); *Cox v. Fletcher Allen Health Care*, No 2: 05-CV-180, 2005 WL 2457632, at *4-8 (D. Vt. Oct. 5, 2005) (refusing to order advancement where the corporation denied advancement because evidence of the officer’s wrongdoing available to the corporation and presented to the court would preclude advancement).

45. Model Act Annotated §§ 8.53(c)(i) & (ii).

46. *Id.* § 8.53(a)(i).

47. See Ala. Code § 10-2B-8.53 (2008); Colo. Rev. Stat. § 7-109-104; Ind. Code Ann. § 23-1-37-10; Ky. Rev. Stat. Ann. § 271B.8-530; Mont. Code Ann. § 35-1-454; N.H. Rev. Stat. Ann. § 78.751; N.M. Stat. Ann. § 53-11-4.1; R.I. Gen. Laws § 7-1.2-814(E); S.C. Code Ann. § 33-8-530; Tenn. Code Ann. § 48-18-504; Utah Code Ann. § 16-10a-904; Vt. Stat. Ann. tit. 11A, § 8.53; Was. Rev. Code § 23B.08.530.

48. *Johnson v. Gene’s Supermarket*, 453 N.E.2d 83, 88–89 (Ill. Ct. App. 1983).

49. Minn. Stat. § 302A.521 (corporation must provide advancement “after a determination that facts then known to those making the determination would not preclude indemnification under this section”); Ohio Rev. Code § 1701.13(E)(5); see also *Ariz. Rev. Stat. § 10-852(b)* (requiring advancement to outside directors). Note, however, that Ohio and Minnesota corporations can modify the mandatory advancement provision in their bylaws or articles of incorporation. For a case applying Minn. Stat. § 302A.521, see *Barry v. Barry*, 824 F. Supp. 178, 183–85 (D. Minn. 1993).

50. See, e.g., Del. Gen. Corp. L. § 145 (e); N.Y. B.C.L. 723(c); Model Act Annotated § 8.53(c)(i) (2008); *Carlson v. Hallinan*, 925 A.2d 506, 540–42 (Del. Ch. 2006); *Donovan*, 677 N.Y.S.2d at 329–30.

51. See, e.g., *Thompson*, 2007 WL 221593, at *11.

52. *Spitzer v. Soundview Health Center*, 01/27/2005 NY.L.J. 18, (col. 3) (Sup. Ct. 2005) (applying New York law); *Sequa Corp.*, 828 F. Supp. at 207 (applying New York law); Model Act Annotated § 8.53(c)(i) (2008).

53. *Donovan*, 677 N.Y.S.2d at 329–30;

Havens, 1997 WL 695579, at *1.

54. *Donovan*, 677 N.Y.S.2d at 329–30; *Pilipiak*, 729 N.Y.S.2d at 100.

55. *Donovan*, 677 N.Y.S.2d at 329–30.

56. 90 N.Y.2d 524, 527, 532 (1997).

57. 677 N.Y.S.2d at 329–30.

58. *Purnell*, 90 N.Y.2d at 528–29, 532.

59. 677 N.Y.S.2d at 329–20.

60. See, e.g., *Pilipiak*, 729 N.Y.S.2d at 99–100.

61. *Sun-Times Media Group*, 954 A.2d at 407–08.

62. *Bansbach*, 1 N.Y.3d at 11–12 (finding that CEO breached his fiduciary duty by accepting permissive advancement after pleading guilty to federal crime); see also *Cox*, 2005 WL 2457632, at *4–8 (finding that it was improper under advancement statute to advance expense in a criminal proceeding where evidence available to the corporation showed that the officer engaged in deceptive, criminal conduct).

63. *Bansbach*, 1 N.Y.3d at 11–12 (holding that the lower court erred by granting defendant’s motion for summary judgment on shareholder derivative claims that the officer violated a fiduciary duty by improperly granting advancement and indemnification); *Petty v. Bank of N.M. Holding Co.*, 787 P.2d 443, 446–52 (N.M. 1990) (a shareholder stated a claim for breach of fiduciary duty, where it alleged that the corporation advanced fees to fund legal expenses arising out of the officers’ shareholding interests as opposed to their corporate role).

64. See *Havens*, 1997 WL 695579, at *3.

65. See, e.g., *Cox*, 2005 WL 2457632, at *4–8 (refusing to order advancement where a corporation’s investigation concluded that senior managers engaged in deceptive conduct). Statutes requiring such a finding include Ala. Code § 10-2B-8.53 (2008); Colo. Rev. Stat. § 7-109-104; Ind. Code Ann. § 23-1-37-10; Ky. Rev. Stat. Ann. § 271B.8-530; Mont. Code Ann. § 35-1-454; N.H. Rev. Stat. Ann. § 78.751; N.M. Stat. Ann. § 53-11-4.1; R.I. Gen. Laws § 7-1.2-814(E); S.C. Code Ann. § 33-8-530; see also Minn. Stat. § 302A.521 (corporation must provide advancement “after a determination that facts then known to those making the determination would not preclude indemnification under this section”).

66. See, e.g., *Vacco*, 715 N.Y.S.2d at 273–74 (upholding board’s decision to deny fees in light of the officers’ conduct); *Advanced Mining Sys.*, 623 A.2d at 84 (refusing to order advancement where the corporation sued its former president for breach of fiduciary duty because the board of directors concluded advancement was not in the corporation’s best interest); see also *Pianka v. Washburn Doughty Assocs., Inc.*, No. Civ.

A. cv-00-371, 2000 WL 33675389, at *2 (Me. Super. 2000) (refusing to compel the board to consider former officer and director's request for advancement).

67. *Bansbach*, 1 N.Y.3d at 11-12 (lower court erred by granting defendants' motion for summary judgment on claims that the directors violated their fiduciary duty by improperly granting advancement and indemnification).

68. *Du Lucca*, 2006 WL 224058, at *2 ("In other words, this is yet another case in which defendants in an advancement case seek to escape the consequences of their own contractual freedom. Regretting the board grant of mandatory advancement they forged on a clear day, they seek to have the judiciary ignore the plain language of their contracts and generate an after-the-fact judicial contract that reflects their current preference.").

69. *Vacco*, 715 N.Y.S.2d at 273-74; *Adelphia*, 323 B.R. at 376 n.104; see also *Gill v. Brooklier*, 48 B.R. 204, 207-08 (C.D. Cal. 1985) (advancement of legal expenses to an employee was a fraudulent transfer under bankruptcy code because the debtor did not benefit from the transaction and the corporation was not under an obligation to advance expenses).

70. *Advanced Mining Sys.*, 623 A.2d at 84-85; see *Thompson*, 2007 WL 221593, at *2.

71. *Thompson*, 2007 WL 221593, at *2.

72. Court-ordered advancement is only available if the officer is entitled to advancement:

Va. Code § 13.1-700.1; Wash. Rev. Code Ann. § 23B.08.540; Del. Code. Ann. tit. 8, § 145; Minn. Stat. § 302A.521; N.D. Cent. Code § 10-19.1-91. No specific provision addressing court-ordered advancement: Alaska Stat. § 10.06.490; Ala. Code § 10-2B-8.54; Ark. Code Ann. § 4-27-850; Cal. Corp. Code § 317; Colo. Rev. Stat. § 7-109-105; 805 Ill. Comp. Stat. 5/8.75; Ind. Code Ann. § 23-1-37-11; Kan. Stat. Ann. § 17-6305; Ky. Rev. Stat. Ann. § 271B.8-540; La. Rev. Stat. Ann. § 12:83; Md. Code Ann. Corps. & Ass'ns § 2-418; Mich. Comp. Laws Ann. §§ 450.1563, 450.1564c; Mo. Rev. Stat. § 351.355; Mont. Code Ann. § 35-1-455; Nev. Rev. Stat. Ann. § 78.7502; N.H. Rev. Stat. Ann. § 293-A:8.54; N.M. Stat. Ann. § 53-11-4.1; N.C. Gen. Stat. § 55-8-54; Ohio Rev. Code Ann. § 1701.13; Okla. Stat. tit. 18, § 1031; Or. Rev. Stat. § 60.401; 15 Pa. Cons. Stat. Ann. § 1742; 14 P.R. Laws. Ann. § 2728; R.I. Gen. Laws § 7-1.2-814(D); S.C. Code. Ann. § 33-8-540; Tenn. Code Ann. § 48-18-505; Tex. Bus. Org. Code Ann. § 8.052; Utah Code Ann. § 16-10a-905; Vt. Stat. Ann. tit. 11A, § 8.54; and Wis. Stat. Ann. § 180.0854.

73. See, e.g., Vt. Stat. Ann. tit. 11A, § 8.53(a); *Cox*, 2005 WL 2457632, at *4-8 (refusing to order advancement where the corporation denied advancement because evidence of the officer's wrongdoing available to the corporation and presented to the court would preclude advancement).

74. Adopting Revised Model Act: Conn. Gen. Stat. Ann. § 33-774; Haw. Rev. Stat. § 414-245; Idaho Code § 30-1-854; Iowa Code Ann. § 490.854; Me. Rev. Stat. Ann. tit. 13-C, § 855; Mass. Gen. Laws Ann. ch. 156D, § 8.54; Miss. Code. Ann. § 79-4-8.54; Neb. Rev. Stat. § 2120, 106; S.D. Codified Laws 47-1A-854; W.Va. Code § 31D-8-854; and Wyo. Stat. § 17-16-854.

75. Adopting a similar approach: Ariz. Rev. Stat. Ann. § 10-854; Fla. Stat. Ann. § 607.0850; and Ga. Code Ann. § 14-2-854; see also N.Y. B.C.L. § 724; N.J. Stat. Ann. § 14A:3-5.

76. Model Business Corporation Act Annotated § 8.54 (official comment).

77. New York's statute only provides a minimum standard that the party raises a genuine issue of fact or law. N.Y. B.C.L. § 724(c). Although some courts grant advancement based on findings that a genuine issue as to liability in the underlying action has been raised, the authors are aware of no authority that the court must advance if a genuine issue is raised. *Booth Oil Site Admin. Group*, 137 F. Supp. 2d at 237 (relying on affidavits denying fraud allegations); *Sequa Corp.*, 828 F. Supp. at 206. And *Vacco*, 715 N.Y.S.2d at 273-74, discussed next, shows that courts can reject claims for advancement.

78. *Vacco*, 715 N.Y.S.2d at 271-73. The New York Board of Regents functions as a regulatory body over New York public and

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private universities and had recommended that the former trustees be replaced. *Id.* at 270–73.

79. *Id.* In addition, the court refused to dismiss a claim for breach of fiduciary duty based on improper advances, given the allegations that the trustees acted in bad faith by authorizing self-dealing transactions.

80. See *Booth Oil Site Admin. Group*, 137 F. Supp. 2d at 237 (relying on affidavits denying fraud allegations).

81. *Adelphia*, 323 B.R. at 375–76; *Vacco*,

715 N.Y.S.2d at 273–74.

82. N.Y. B.C.L. § 724; *Qantel Corp. v. Niemuller*, 771 F. Supp. 1372, 1374–75 (S.D.N.Y. 1991) (denying a motion that failed to “address these requirements”).

83. *Havens*, 1997 WL 695579, at *2–3; *Adelphia*, 323 B.R. at 385–92. *But see Johnson*, 453 N.E.2d at 88–89.

84. *Thompson*, 2007 WL 221593, at *6–7.

85. *Vacco*, 715 N.Y.S.2d at 273–74 (corporation’s resources); *Advanced Mining Sys.*, 623

A.2d at 84 (officer’s ability to repay).

86. *Id.* at *11.

87. *Homestore*, 888 A.2d at 212 (“corporations may specify by bylaw or contract the terms and conditions upon which present and former corporate officials may receive advancement”); *Barrett*, 921 A.2d at 747 n. 39.

88. *Gentile v. SinglePoint Fin., Inc.*, 788 A.2d 111, 113 (Del. 2001) (mandatory advancement limited to an officer who is a “named defendant or respondent”).

WHOSE DOCUMENT IS IT ANYWAY?

(Continued from page 5)

Failure to address the format of production adequately and the issue of metadata were common stumbling blocks for parties to litigation. In *Goodbys Creek v. Arch Ins. Co.*,¹ the defendants were ordered to reproduce all of their production in native format. The defendants had provided only images of their electronic data. The cost to reproduce an entire production would have been significant. Similarly, in *White v. Graceland Coll.*,² the court found that the production of electronically stored data in paper format did not comply with the rules and ordered the reproduction of certain electronic data in native format. It is crucial when producing data in any other format than native format that the metadata be preserved or saved. If that data is lost in converting the data to images, for example, the consequences down the road can be severe. Sanctions, adverse instructions to the jury, and even dismissal of the case in its entirety have all been remedies the courts have used for discovery penalties. The issue of spoliation has been raised frequently in opinions handed down in the last year. In one such case, a magistrate judge recommended a default judgment in favor of the plaintiffs and for defendants to pay “all reasonable costs” related to a spoliation discovery dispute.³ There are many other cases regarding spoliation as well, which emphasizes the profound importance of preserving any electronic data that could potentially be relevant, and therefore, discoverable.⁴ Failing to preserve electronic data can lead to severe adverse consequences for litigants.⁵

Another area where courts have been increasingly intervening in the discovery

process is the area of search terms. The search terms utilized to gather all potentially relevant electronic data are becoming increasingly important in avoiding problems post-production. Courts are ordering parties to litigation to come up with an agreed upon set of words and terms for the purpose of mining their data for relevant data. Depending on the size of the data set, processing electronic data can be an expensive and a time-consuming process. It is vital that your search terms strike the right balance of being comprehensive enough to hit every potential piece of relevant data, but also not so broad that a large amount of irrelevant data is captured. Remember, everything that is gathered and produced will have to be reviewed. Simply dumping large chunks of data on the adverse party is sure to raise the ire of a judge or discovery master. There are cases where parties have been ordered to conduct multiple searches across their whole data set to strike the right balance.⁶ Complaints by litigants of the excessive cost of searching large quantities of data often fall on deaf ears. In *Mikron v. Hurd Windows*,⁷ the court found that the defendants failed to live up to their meet-and-confer obligation and that they had also failed to demonstrate that plaintiff’s discovery requests were unduly burdensome and/or cumulative, or that the requested electronic data was “not necessarily accessible because of undue burden or cost.” Striking the right balance in the search terms and coming to a mutual agreement on what the terms should be makes the process more defensible to a challenge at a later date, which can lead to delay and additional cost.

In summary, the benefits of planning for the management of your electronic data include the significant savings in overall costs; making the processes you utilize more defensible in a discovery dispute; allowing you to efficiently leverage the best possible outcome for those you represent; eliminating redundant data collection and processing efforts; and perhaps most importantly, giving you more control over the process. Looking beyond the effort required to gather and produce electronic data to how you can effectively manage and utilize it post-production will go a long way to avoiding the many post-production problems that litigants continue to experience. ■

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Endnotes

1. 2008 WL 4279693 (M.D. Fla. Sept. 15, 2008).
2. 2008 WL 3271924 (D. Kan. Aug. 7, 2008).
3. See *Gutman v. Klein*, 2008 WL 4682208 (E.D.N.Y. Oct. 15, 2008).
4. *Almarri v. Gates*, 2008 WL 4449858 (D.S.C. Oct. 2, 2008); *Arteria v. Universal*, 2008 WL 4513696 (D.N.J. Oct. 1, 2008); *Atlantic Recording v. Howell*, WL 4080008 (D. Ariz. Aug. 2009, 2008); and *Gippetti v. UPS*, 2008 WL 3264483 (N.D. Cal. Aug. 6, 2008).
5. *Keithly v. Homestore.com*, 2008 WL 3833384 (N.D. Cal. Aug. 12, 2008).
6. *Ross v. Abercrombie & Fitch*, 2008 WL 4758678 (S.D. Ohio Oct. 27, 2008).
7. 2008 WL 1805727 (W.D. Wash. Apr. 21, 2008).

UPDATE ON CAFA'S IMPACT ON CORPORATE DEFENDANTS

(Continued from page 1)

to state court. However, before removing a case to federal court under CAFA, corporate counsel must be aware of a new risk of jurisdictional discovery that could involve considerable time and expense. This risk arises from several highly factual exceptions to CAFA's expanded federal jurisdiction that plaintiffs may attempt to invoke following removal.

Similarly, class-action settlements in federal court must satisfy multiple conditions and ultimately be approved by the court. CAFA imposes added requirements on class-action settlements to combat questionable settlement practices. Of particular relevance to corporate counsel, CAFA increases judicial scrutiny of coupon settlements and disproportionate settlements. In addition, CAFA also requires that notice of a class-action settlement be given to federal and state regulators to provide the government an opportunity to object to proposed settlements. Counsel must be aware that these modifications may make it more difficult or expensive to secure federal court approval of certain settlements. While this new reality should initially be considered in deciding whether to remove a class action to federal court, ultimately counsel must ensure that these provisions be vigilantly adhered to when crafting class-action settlements.

This all leads to the question "Has CAFA been the panacea that corporate defendants expected?" Based on the Federal Judicial Center's (FJC) interim reports on the impact of CAFA on federal court dockets, it is clear that the legislation is achieving its purpose of shifting class actions into federal court, though perhaps not in the way most would have expected.² Interestingly, the FJC finds that although "class action removals increased in the immediate post-CAFA period," removals began "trending downward" shortly thereafter and are now "at levels similar to those in the pre-CAFA period."³ However, there has been "a dramatic increase in the number of diversity class actions filed as original proceedings in the federal courts in the post-CAFA

period."⁴ Thus, for those defendants that prefer to litigate class actions in federal court, notwithstanding potentially faster discovery and trial schedules, CAFA's impact has clearly been positive. But this positive impact could be offset to some degree by CAFA's settlement provisions, which complicate the process of securing approval for class-action settlements. Ultimately, though CAFA may not be a panacea, on-balance defendants should be pleased with its impact.

Federal Jurisdiction under CAFA: Expansion and Exceptions

Traditionally, diversity of citizenship jurisdiction existed over class actions only when there was complete diversity between the plaintiff class representatives and the defendants (i.e., no plaintiff class representatives could be a citizen of the same state as any defendant).⁵ Additionally, the U.S. Supreme Court recently clarified that traditional diversity jurisdiction required that at least one class representative satisfy the amount-in-controversy requirement (i.e., one representative's claims must exceed \$75,000).⁶

CAFA expands federal diversity jurisdiction over class actions by supplementing the complete diversity requirement with a more relaxed standard of minimal diversity. That is, diversity jurisdiction now exists for most class actions in which at least one class member and one defendant are citizens of different states.⁷ It should be noted, however, that this relaxed concept of minimal diversity does not apply in a number of circumstances, including when the putative plaintiff class consists of less than 100 members; when the aggregate amount in controversy is less than \$5 million (exclusive of interest and costs); when the primary defendants are states, state officials, or other governmental entities against whom a federal court may be foreclosed from ordering relief; or when the plaintiffs' claims relate to certain securities or corporate governance activities.⁸

In addition to this broad expansion of federal diversity jurisdiction over class actions, CAFA also sets forth three carve-out provisions defining circumstances under which truly local class actions may be remanded to state court.⁹ As will be discussed below, courts have assigned to the plaintiffs seeking remand the burden of proving that these exceptions apply. Moreover, some federal courts have allowed plaintiffs to engage in jurisdictional discovery to develop a factual

In addition to expanding federal diversity jurisdiction, CAFA also relaxes several features of traditional removal procedure.

record prior to resolving remand motions. Therefore, before removing a class action under CAFA, counsel should evaluate whether any of the following exceptions may apply and consider the risk of getting bogged down in jurisdictional discovery upon arrival in federal court.

First, the local controversy and home-state controversy provisions, located at 28 U.S.C. § 1332(d)(4)(A) and (B), require federal courts to decline jurisdiction over distinctly local class actions. Courts have no discretion in applying these two provisions—if plaintiffs can demonstrate that either of these provisions applies, the court must remand the class action to state court. Second, the discretionary provision, located at 28 U.S.C. § 1332(d)(3), allows but does not require federal courts to decline jurisdiction over local class actions in the interest of justice based on a review of multiple factors. As will be seen, all three provisions share a common feature: They all require federal courts to determine the percentage of putative class members that are citizens of the state in which the case was originally filed.

Home-State Controversy Exception

The home-state controversy exception provides that a federal district court “shall decline to exercise jurisdiction” over a class action in which “two-thirds or more of the members of all proposed plaintiff classes in the aggregate, and the primary defendants, are citizens of the State in which the action was originally filed.”¹⁰ Although the term “primary defendants” is not defined in CAFA, the legislative history instructs federal courts to interpret the term “to reach those defendants who are the real ‘targets’ of the lawsuit—i.e., the defendants that would be expected to incur most of the loss if liability is found.”¹¹ Indeed, a recent decision collecting the various approaches that have been used by the courts reveals that “a primary defendant is one (1) who has the greater liability exposure; (2) is most able to satisfy a potential judgment; (3) is sued directly, as opposed to vicariously, or for indemnification or contribution; (4) is the subject of a significant portion of the claims asserted by plaintiffs; or (5) is the only defendant named in one particular cause of action.”¹²

Local Controversy Exception

The local controversy exception provides that a federal district court “shall decline to exercise jurisdiction” over a class action when “greater than two-thirds of the members of all proposed plaintiff classes in the aggregate are citizens of the state in which the action was originally filed,” provided that all of the following elements are also satisfied:

- at least one defendant is a defendant from whom significant relief is sought by members of the plaintiff class; whose alleged conduct forms a significant basis for the claims asserted by the proposed plaintiff class; and who is a citizen of the state in which the action was originally filed
- principal injuries resulting from the alleged conduct or any related conduct of each defendant were incurred in the state in which the action was originally filed
- during the three-year period preceding the filing of the class action, no

other class action has been filed asserting the same or similar factual allegations against any of the defendants on behalf of the same or other persons¹³

A decision examining a putative class action that was removed from a Louisiana state court shortly after Hurricane Katrina addressed a number of these new statutory requirements under the local controversy exception.¹⁴ The named plaintiff representatives in the *Caruso* case were six property owners who suffered substantial damage to their properties during the storm. The plaintiffs sued various insurance providers to collect additional amounts under their homeowners’ insurance policies and sought to represent a class of similarly situated individuals. The defendants removed the putative class action to federal court under CAFA and the plaintiffs then moved to remand under the local controversy exception. The federal district court refused to remand the case, noting that several of the defendants had been named in similar cases within the past three years. But perhaps more importantly, the court also discussed the requirement that “significant relief” be sought against a local defendant and concluded that “a significant defendant is of less importance than a primary defendant” but is “obviously one who is something more than ‘insignificant,’ which is defined as ‘having little or no importance,’ or ‘trivial.’”¹⁵ Thus, the *Caruso* court drew a clear distinction between the home-state controversy and local controversy exceptions by ascribing different meanings to the use of the terms “primary” and “significant” in these provisions.

Discretionary Exception

The discretionary exception provides that a federal district court “may, in the interests of justice and looking at the totality of the circumstances, decline to exercise jurisdiction” over a class action in which “greater than one-third but less than two-thirds of the members of all proposed plaintiff classes in the aggregate and the primary defendants are citizens of the state in which the action was originally filed.”¹⁶ In making this determination, CAFA instructs courts to consider the following six factors:

- whether the claims asserted involve matters of national or interstate interest

- whether the claims asserted will be governed by laws of the state in which the action was originally filed or by the laws of other states
- whether the class action has been pleaded in a manner that seeks to avoid federal jurisdiction
- whether the action was brought in a forum with a distinct nexus with the class members, the alleged harm, or the defendants
- whether the number of citizens of the state in which the action was originally filed in all proposed plaintiff classes in the aggregate is substantially larger than the number of citizens from any other state, and the citizenship of the other members of the proposed class is dispersed among a substantial number of states
- whether, during the three-year period preceding the filing of that class action, one or more other class actions asserting the same or similar claims on behalf of the same or other persons have been filed¹⁷

CAFA’s Relaxation of Removal Procedures

In addition to expanding federal diversity jurisdiction, CAFA also relaxes several features of traditional removal procedure, thereby making it easier for defendants to remove class actions to federal court. In the class-action context, the following questions now have new answers in light of CAFA: (1) Who can remove a class action? (2) Must the removing defendant obtain the consent of all defendants prior to removing a class action? (3) What is the deadline for removing a class action? Corporate counsel should be aware of these changes when considering whether to remove class actions from state court.

Who can remove a class action?

Prior to CAFA, a defendant that was a citizen of the forum state could not remove a case on the basis of diversity jurisdiction.¹⁸ This limitation on removal no longer applies to class actions under CAFA. Any defendant, including defendants who are citizens of the forum state, can now remove class actions to federal court.¹⁹

Must the removing defendant obtain the consent of all defendants prior to removing a class action?

Prior to CAFA, the removal statute had been interpreted to require all defendants to consent to the removal of a case from state court.²⁰ This limitation on removal no longer applies to class actions under CAFA. A class action may now be removed by any defendant without the consent of the remaining defendants.²¹

What is the deadline for removing a class action? Prior to CAFA, defendants were required to remove cases within 30 days of receiving a pleading, motion, order, or other paper that demonstrated that the case was removable, but in no instance could defendants remove cases founded on diversity jurisdiction more than one year after commencement of the action.²² The later portion of this limitation on removal no longer applies to class actions under CAFA. That is, a defendant may now remove a class action within 30 days of receiving a pleading, motion, order, or other paper that demonstrates that the case is removable, regardless of when the case was commenced.²³

Appellate Review of Remand Orders

CAFA also expands defendants' opportunities for appellate review in class actions. Traditionally, district court remand orders are "not reviewable on appeal or otherwise."²⁴ While this general rule still applies in the non-class-action context, CAFA authorizes interlocutory appeals of orders that either grant or deny motions to remand class actions to state court.²⁵ These appeals operate much like an appeal to the U.S. Supreme Court—the appellate courts have discretion whether or not to accept and consider such an appeal. However, if an appeal is accepted for review, CAFA provides that the appellate court must render judgment "not later than 60 days after the date on which [the] appeal was filed."²⁶

CAFA also attempts to impose strict time limits on the parties that would seek to appeal remand orders by providing that "application [must be] made to the court of appeals not *less* than 7 days after entry of the order."²⁷ Initially, the appellate courts construed this provision to

mean that appeals must be filed not *more* than seven days after entry of the order, concluding that Congress simply could not have intended to enact a seven-day waiting period before an appeal could be filed.²⁸ However, a recent decision from the Seventh Circuit seems to resolve the confusion by concluding that although the plain language of CAFA curiously imposes a seven-day waiting period before an appeal can be filed, the Federal Rules of Appellate Procedure impose a 30-day deadline on the filing of all appeals.²⁹ Thus, the Seventh Circuit construed CAFA's language literally and refused to rewrite the statute for Congress. Until the Seventh Circuit's reasoning gains widespread acceptance, however, all defendants should be aware of the various approaches used to calculate the appeal deadline under CAFA.

Strategic Removal Considerations Post-CAFA

Corporate counsel must resist the temptation to reflexively remove class actions to federal court under CAFA, and should rather carefully consider a variety of factors before deciding to take advantage of CAFA's modifications to traditional jurisdictional and removal provisions. These factors will likely continue to include a comparison of the relevant state and federal standards for class certification, admissibility of expert testimony, and interlocutory review to determine where any advantages may be achieved. But the structure of CAFA has created at least two additional considerations that corporate counsel would be wise to include in the removal calculus.

First, as noted above, a putative class action can only be removed under CAFA's minimal diversity standard if the aggregate amount in controversy exceeds \$5 million. As the removing party, the defendant may be required to supply affidavits with either its notice of removal or a subsequent opposition to a remand motion to make a prima facie showing that the \$5 million amount-in-controversy requirement is satisfied. This is especially true if the potential value of the plaintiffs' claims is not explicitly stated in the complaint. For large corporate defendants, this may require counsel to act quickly to gather facts and locate a potential affiant. Moreover, although such a showing does not amount to an admission

that the plaintiffs' claims are in fact worth at least \$5 million, there nevertheless may be circumstances in which a defendant may be uneasy invoking this provision.

Second, under traditional jurisprudence, a removing defendant has the initial burden of demonstrating that federal jurisdiction exists and that its removal was procedurally proper.³⁰ This is no different under CAFA.³¹ However, plaintiffs subsequently seeking remand under CAFA's jurisdictional exceptions have been assigned the burden of proving the applicability of these exceptions.³² As noted above, all three exceptions require federal courts to determine, among other things, the percentage of putative class members that are citizens of the state in

Prior to removing a case under CAFA, corporate counsel should consider the risk of getting bogged down in a drawn-out jurisdictional discovery process in federal court.

which the case was originally filed. The local controversy and home-state controversy provisions require that at least two-thirds of the putative class members be citizens of the forum state; the discretionary provision requires that at least one-third of the putative class members be citizens of the forum state. The highly factual nature of this inquiry into the citizenship of the putative plaintiff class has led some federal courts to allow plaintiffs to engage in jurisdictional discovery to develop facts that shed light on the applicability of CAFA's exceptions. Thus, prior to removing a case under CAFA, corporate counsel should consider the risk of getting bogged down in a drawn-out jurisdictional discovery process in federal court.

Some of the best examples of this also arose in the context of Hurricane Katrina. Multiple putative class actions were filed

in state courts in the weeks and months following the hurricane on behalf of individuals that were patients at various hospitals across the New Orleans region. In general, the plaintiffs in these cases alleged that the hospitals had failed to plan for and conduct proper evacuations and, as a result, the plaintiffs suffered damages both during the storm and in its chaotic aftermath. Several of these cases were removed by the defendants to federal court under CAFA, and the plaintiffs subsequently moved for remand under CAFA's jurisdictional exceptions. In two particular cases from the Eastern District of Louisiana, the courts ordered that certain jurisdictional discovery be carried out prior to resolving the plaintiffs' remand motions.

CAFA requires increased judicial scrutiny of coupon settlements and modifies the method of calculating fee awards in such cases.

In the *Preston* case, the district court ordered the defendant hospital to provide the addresses and phone numbers of its patients, as well as the emergency contacts on file for the patients.³³ Relying on this information, as well as several affidavits from putative class members indicating their desire to return to New Orleans once conditions improved, the court determined that the requisite percentage of putative class members were citizens of the forum state and thus remanded the case to state court under CAFA's exceptions.³⁴ The defendants appealed under CAFA's interlocutory appeal provision, but the Fifth Circuit affirmed the district court's remand order.³⁵

In the *Martin* case, the district court allowed plaintiffs' counsel to mail questionnaires to putative class members, many of whom had evacuated New Orleans for Hurricane Katrina, in an effort to determine their citizenship.³⁶ The questionnaires sought to elicit information that could be used to demonstrate domicile,

which is synonymous with citizenship for purposes of jurisdiction. For example, the questionnaire inquired into whether an individual had been displaced by the storm and, if so, whether or not he or she intended to return to New Orleans. Although it is not clear how many questionnaires were initially mailed, plaintiffs' counsel ultimately received 68 responses, 53 of which appeared to be Louisiana citizens.³⁷ Based on these numbers, the district court remanded the case to state court under CAFA's exceptions.³⁸

Finally, counsel needs to consider carefully whether the client will be better off in federal court. While federal courts provide the benefits of greater judicial resources and a certain level of protection from perceived home-state-court bias, often times federal courts impose some disadvantageous and costly requirements, such as initial disclosures, aggressive discovery and case schedules, and more stringent e-discovery requirements. In making the decision whether to remove to federal court, defendants need to be careful what they ask for, because they just might get it.

CAFA's Impact on Class-Action Settlements

Rule 23 of the Federal Rules of Civil Procedure governs class actions and imposes various procedures and requirements for settling class actions in federal court. Generally, class-action settlements must receive court approval to be effective, but may only be approved after notice and a hearing, and only if the court finds that the settlement is fair, reasonable, and adequate.³⁹ Objectors may appear at the fairness hearing to set forth objections to the proposed settlement, and objections can only be withdrawn with court approval.⁴⁰ Moreover, all side agreements must be identified, and a settlement may be rejected by the court if it fails to provide class members with an opportunity to opt out following examination of the settlement terms.⁴¹

Many of these provisions were strengthened and supplemented by the amendments to Rule 23 that took effect on December 1, 2003. Indeed, the recent Report of the Judicial Conference of the United States on Class Action Settlements, which was submitted to Congress

in 2006 pursuant to a directive in CAFA, concluded that the best practices for class-action settlements are now contained in Rule 23 as amended.⁴² CAFA expands upon the 2003 amendments by further increasing court scrutiny over class-action settlements. Corporate counsel should be particularly aware that CAFA seeks to curb the use of both coupon settlements and disproportionate settlements and requires state and federal regulators to be notified of proposed class-action settlements. These modifications may make it more difficult or expensive to secure court approval for certain class-action settlements and should be considered first when deciding whether to remove a class action from state court and subsequently when crafting a potential class-action settlement in federal court.

Coupon Settlements

In the past, attorneys frequently crafted class-action settlements that required defendants to issue coupons to class members for rebates or discounts on the defendants' products instead of providing actual cash payments to class members. In such cases, the monetary fee award to class counsel was typically calculated based on the face value of the coupons that were issued. CAFA generally requires increased judicial scrutiny of these types of coupon settlements and modifies the method of calculating fee awards in such cases. Specifically, CAFA provides that "the portion of any attorney's fee award to class counsel that is attributable to the award of the coupons *shall* be based on the *value* to class members of the coupons that are *redeemed*."⁴³ In determining the value of the coupons that are redeemed, the court may "receive expert testimony from a witness qualified to provide information on the *actual* value to the class members of the coupons that are redeemed."⁴⁴ These restrictions are designed to deter the use of questionable coupon settlements in federal court.

A recent case from the Southern District of Florida is illustrative of this point. In the *Figuroa* case, the plaintiffs filed suit individually and on behalf of all consumers in the United States who purchased allegedly defective ionizing air purifiers from Sharper Image.⁴⁵ On the eve of the class-certification hearing, the parties reported that a nationwide coupon settlement had

been reached that would provide a \$19 coupon to class members for each unit purchased and close to \$2 million in fees for class counsel. In reviewing the proposed settlement, the court performed a traditional Rule 23 analysis by examining the following factors: the likelihood of success at trial; the range of possible recovery; the complexity, expense, and duration of litigation; the substance and amount of opposition to the settlement; and the stage of proceedings at which the settlement was achieved. Although the court ultimately rejected the proposed settlement—primarily because only 1 percent of the class members responded favorably to the settlement offer and the attorneys general of 35 states had appeared as amicus curiae to oppose the settlement—perhaps the most interesting aspect of the case was the court’s reading of CAFA to “imply the application of a greater level of scrutiny to the existing [Rule 23] criteria than existed pre-CAFA.”⁴⁶

Disproportionate Settlements

CAFA also imposes heightened scrutiny on disproportionate class-action settlements. For example, CAFA protects class members against geographic discrimination by prohibiting courts from approving settlements that provide “for the payment of greater sums to some class members than to others solely on the basis that the class members to whom the greater sums are to be paid are located in closer geographic proximity to the court.”⁴⁷ In the same vein, a court may now approve a proposed settlement “under which any class member is obligated to pay sums to class counsel that would result in a net loss to the class member *only if* the court makes a written finding that nonmonetary benefits to the class member substantially outweigh the monetary loss.”⁴⁸ Corporate counsel should be cognizant of these new restrictions when crafting class-action settlements.

CAFA’s Notice Requirements

Arguably the most significant provision of CAFA governing class-action settlements requires defendants to serve notice of proposed settlements on government regulators. Within 10 days of filing a proposed class-action settlement with a federal court for approval, each defendant *must* send

the settlement, a copy of the complaint, and certain related materials to the “appropriate federal official” and the “appropriate state official of each state in which a class member resides.”⁴⁹ The “appropriate federal official” is typically the attorney general of the United States.⁵⁰ The “appropriate state official” is “the person in the state who has the primary regulatory or supervisory responsibility with respect to the defendant, or who licenses or otherwise authorizes the defendant to conduct business in the state, if some or all of the matters alleged in the class action are subject to regulation by that person.”⁵¹ If there is no such person, or if the matters alleged in the class action “are not subject to regulation or supervision by that person,” then the appropriate state official is the state attorney general.⁵²

Notably, a court may not give final approval to a class settlement until at least 90 days after the defendant gives the required settlement notice to the appropriate officials.⁵³ This means that government officials will have time to decide if they want to object to the settlement or otherwise oppose its approval or attempt to negotiate for different settlement terms. The impact of these notice provisions can be significant and must be considered in crafting a class-action settlement. Indeed, to the extent that a settlement is perceived to be unfair by government regulators, these officials now have an opportunity to object and persuade the court to reject the settlement, as occurred in the *Figueroa* case discussed above. This factor is particularly important in this era of increased activism by state and federal attorneys general and other officials. Compliance with CAFA’s notice requirements is critical. A defendant’s failure to send the required notice to government officials allows class members to refuse to comply with the settlement agreement.⁵⁴ Therefore, a class member that can subsequently demonstrate that the required notice was not provided “may choose not to be bound by the settlement agreement” and could then individually sue the defendant on the claims that were settled.⁵⁵

Strategic Settlement Considerations Post-CAFA

In deciding whether to remove a class action under CAFA, corporate counsel should consider the fact that these

modifications to settlement provisions could make it more difficult, time-consuming, and expensive to gain approval of a class-action settlement in federal court. Indeed, not only are certain types of class-action settlements now subjected to increased judicial scrutiny, but also government regulators now have an opportunity in light of CAFA’s notice provisions to take a more active role in objecting to class-action settlements. If a case ultimately is removed to federal court, counsel must be particularly careful to ensure that CAFA’s dictates are strictly adhered to in crafting class-action settlements.

In discussing CAFA’s impact on class-action settlements and its relaxation of jurisdictional and removal provisions, we have highlighted the ways in which CAFA is requiring corporate counsel to modify their traditional approach to managing class-action litigation. Indeed, in some respects, the increased judicial scrutiny of the removal and settlement of class actions may be an added burden on defendants. However, as noted in the introduction, CAFA has been successful in shifting most multi-state and national class actions into federal court. Thus, although CAFA may not have been a perfect remedy for all class-action ills, a working knowledge of its various provisions and exceptions is essential for corporate counsel who seek to utilize CAFA to their clients’ advantage. ■

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Endnotes

1. Pub. L. No. 109-2, 119 Stat. 4 (2005) (codified in various sections of 28 U.S.C.).
2. The FJC reports are available at www.fjc.gov/library/fjc_catalog.nsf.
3. Federal Judicial Center, The Impact of the Class Action Fairness Act of 2005 on the Federal Courts: Fourth Interim Report to the Judicial Conference Advisory Committee on Civil Rules (April 2008), available at www.fjc.gov/library/fjc_catalog.nsf.
4. *Id.*
5. 28 U.S.C. § 1332(a); Supreme Tribe of Ben Hur v. Cauble, 255 U.S. 356 (1921).
6. Exxon Mobil Corp. v. Allapattah Servs., Inc., 545 U.S. 546 (2005).

7. 28 U.S.C. § 1332(d)(2). This expanded diversity jurisdiction also encompasses class actions in disguise, cases that CAFA identifies as mass actions. Mass actions are generally defined under CAFA as “any civil action . . . in which monetary relief claims of 100 or more persons are proposed to be tried jointly on the ground that the plaintiffs’ claims involve common questions of law or fact.” 28 U.S.C. § 1332(d)(11)(B)(i); *see* Lowery v. Alabama Power Co., 483 F.3d 1184 (11th Cir. 2007); *Abrego Abrego v. Dow Chem. Co.*, 443 F.3d 676 (9th Cir. 2006). However, there are a number of exceptions to this broad definition of mass actions. *See* 28 U.S.C. § 1332(d)(11)(B)(ii).

8. *See* 28 U.S.C. § 1332(d)(5), (6), (9); 28 U.S.C. § 1453(d).

9. *See, e.g.*, *Bond v. Veolia Water Indianapolis, LLC*, 571 F. Supp. 2d 905, 908 (S.D. Ind. 2008) (“A suit by local utility customers asserting only state law claims against the local utility would seem to be a good candidate for [all three CAFA] exceptions.”).

10. 28 U.S.C. § 1332(d)(4)(B).

11. S. Rep. No. 109-14 (Feb. 28, 2005), *as reprinted* in 2005 U.S.C.C.A.N. 3.

12. *Cooper v. R.J. Reynolds Tobacco Co.*, 586 F. Supp. 2d 1312, 1318 (M.D. Fla. 2008) (citation omitted); *see also* *Harrington v. Mattel, Inc.*, No. C07-05110 MJJ, 2007 WL 4556920 (N.D. Cal. Dec. 20, 2007) (relying on the legislative history to find that both Mattel and its wholly owned subsidiary Fischer-Price qualified as primary defendants under CAFA and ultimately denying remand motion because Fisher-Price was not a citizen of the forum state).

13. 28 U.S.C. § 1332(d)(4)(A).

14. *See* *Caruso v. Allstate Ins. Co.*, 469 F. Supp. 2d 364 (E.D. La. 2007).

15. *Id.* at 369 (citations omitted); *see also* *Evans v. Walter Indus., Inc.*, 449 F.3d 1159, 1167 (11th Cir. 2006) (“[A] class seeks ‘significant relief’ against a defendant when the relief sought against that defendant is a significant portion of the entire relief sought by the class.”).

16. 28 U.S.C. § 1332(d)(3).

17. 28 U.S.C. § 1332(d)(3)(A)–(F).

18. *See* 28 U.S.C. § 1441(b) (providing that cases founded on diversity jurisdiction are “removable only if none of the parties in interest properly joined and served as defendants is a citizen of the State in which such action is brought”).

19. *See* 28 U.S.C. § 1453(b).

20. *See, e.g.*, *Pritchett v. Cottrell, Inc.*, 512 F.3d 1057, 1062 (8th Cir. 2008) (collecting cases interpreting 28 U.S.C. § 1446(b)).

21. 28 U.S.C. § 1453(b).

22. 28 U.S.C. § 1446(b).

23. 28 U.S.C. § 1453(b).

24. 28 U.S.C. § 1447(d).

25. 28 U.S.C. § 1453(c)(1).

26. 28 U.S.C. § 1453(c)(2). An appellate court may extend the 60-day period by 10 days for good cause, or for even longer with the agreement of the parties. 28 U.S.C. § 1453(c)(3).

27. 28 U.S.C. § 1453(c)(1) (emphasis added).

28. *See, e.g.*, *Estate of Pew v. Cardarelli*, 527 F.3d 25 (2d Cir. 2008); *Morgan v. Gay*, 466 F.3d 276 (3d Cir. 2006); *Amalgamated Transit Union Local 1309, AFL-CIO v. Laidlaw Transit Servs., Inc.*, 448 F.3d 1092 (9th Cir. 2006); *Miedema v. Maytag Corp.*, 450 F.3d 1322 (11th Cir. 2006); *Pritchett v. Office Depot, Inc.*, 420 F.3d 1090 (10th Cir. 2005).

29. *See* *Spivey v. Vertrue, Inc.*, 528 F.3d 982, 983–84 (7th Cir. 2008) (“That Congress has written a deadline imprecisely, or even perversely, is not a sufficient reason to disregard the enacted language.”). The *Spivey* court also noted that although an appeal filed during the seven-day waiting period might be premature, Federal Rule of Appellate Procedure 4(a)(2) provides that such an appeal remain on file and springs into effect when the decision below becomes appealable.

30. *See, e.g.*, *Emrich v. Touche Ross & Co.*, 846 F.2d 1190, 1195 (9th Cir. 1988).

31. *See, e.g.*, *In re Farmers Ins. Exch. Claims Representatives’ Overtime Pay Litig.*, MDL No. 33-1439(B), 2008 WL 3896209, at *2 (D. Or. Aug. 18, 2008) (remanding class action where defendant failed to satisfy its initial burden of demonstrating the existence of minimal diversity because the defendant failed “to identify even one putative class member who [was] not a California citizen”).

32. *See* *Hart v. FedEx Ground Package Sys. Inc.*, 457 F.3d 675, 680 (7th Cir. 2006) (“[O]nce the removing defendants prove the amount in controversy and the existence of minimal diversity, the burden shifts to the plaintiffs to prove that the local controversy exception to federal jurisdiction should apply.”); *see also* *Serrano v. 180 Connect, Inc.*, 478 F.3d 1018, 1024 (9th Cir. 2007) (“The well-established rule that the party seeking remand must prove the applicability of such exception governs with equal force in the context of CAFA as with the general removal statute.”); *Evans v. Walter Indus., Inc.*, 449 F.3d 1159, 1164 (11th Cir. 2006) (“[W]hen a party seeks to avail itself of an express statutory exception to federal jurisdiction granted under CAFA, as in this case, we hold that the

party seeking remand bears the burden of proof with regard to that exception.”); *Frazier v. Pioneer Americas LLC*, 455 F.3d 542, 546 (5th Cir. 2006) (“[L]ongstanding § 1441(a) doctrine placing the burden on plaintiffs to show exceptions to jurisdiction buttresses the clear congressional intent to do the same with CAFA.”).

33. *See* *Preston v. Tenet Healthsystem Mem’l Med. Ctr., Inc.*, 463 F. Supp. 2d 583, 592–93 (E.D. La. 2006).

34. *Id.* at 593–94.

35. *See* *Preston v. Tenet Healthsystem Mem’l Med. Ctr., Inc.*, 485 F.3d 804 (5th Cir. 2007). It should be noted that a similar remand order in a separate hospital case was simultaneously reversed by the Fifth Circuit. *See* *Weems v. Touro Infirmary*, 485 F.3d 793 (5th Cir. 2007). The only significant difference between the two putative class actions was that the plaintiffs in *Weems* did not submit affidavits from putative class members as the plaintiffs did in *Preston*.

36. *See* *Martin v. Lafon Nursing Facility of the Holy Family, Inc.*, 548 F. Supp. 2d 268, 270–71 (E.D. La. 2008).

37. *Id.* at 273–74.

38. *Id.* at 277–79.

39. FED. R. CIV. P. 23(e)(1), (2).

40. FED. R. CIV. P. 23(e)(5).

41. FED. R. CIV. P. 23(e)(3), (4). This is essentially a “second” opt-out opportunity—the “first” opt-out opportunity arises once a class is certified.

42. The full report is available at www.uscourts.gov/rules/CAFA_Report.pdf.

43. 28 U.S.C. § 1712(a) (emphasis added).

44. 28 U.S.C. § 1712(d) (emphasis added).

45. *Figueroa v. Sharper Image Corp.*, 517 F. Supp. 2d 1292 (S.D. Fla. 2007).

46. *Id.* at 1321. CAFA’s “notice requirements”—which led to the objections by various attorneys general—and their impact on class-action settlements are discussed below.

47. 28 U.S.C. § 1714.

48. 28 U.S.C. § 1713 (emphasis added); *see* *State v. Homeside Lending, Inc.*, 826 A.2d 997 (Vt. 2003) (allowing the state of Vermont to collaterally attack a nationwide class-action settlement in light of the settlement’s questionable economic value to class members).

49. 28 U.S.C. § 1715(b).

50. 28 U.S.C. § 1715(a)(1).

51. 28 U.S.C. § 1715(a)(2).

52. *Id.*

53. 28 U.S.C. § 1715(d).

54. 28 U.S.C. § 1715(e)(1).

55. *Id.*

IN-HOUSE TOP 10

By Patricia T. Bergeson, General Counsel for Rosalind Franklin University of Medicine and Science

The *In-House Top 10* provides insightful comments from in-house counsel, past or present, put in David Letterman-esque list form.

Top 10 Things to Do When Dealing With the Media

Very often, lawyers have to tell their clients not to talk to anyone about a pending matter—and that’s good advice. But the institutional response has to be different, sometimes, due to the fact that the court of public perception has its own rules too.

10. **Read the newspapers, surf the Web, watch TV, and listen to the radio.** Know what the press is saying about a crisis or matter affecting your company or institution before you get calls from reporters. It is surprising how many lawyers don’t seem up-to-date on current events. Be prepared!
9. **Don’t duck media calls.** Reporters are smart and intuitive, and they’ll be on to you right away. And they won’t forget. Plus, you may need them to run a positive story about your company’s accomplishments someday.
8. **Return calls promptly.** Even if you have to say you are not able to respond at this time or must refer the person to another office, be courteous. Most people will understand.
7. **If you don’t know the answer to a question, tell reporters that you will get back to them.** Getting it right trumps an off-the-cuff response any day. But don’t forget to get back to them either.
6. **Ask to have direct quotes read back to you if the reporter plans to use them in a story.** Choose your words very carefully. Being judicious and succinct gets your company’s point of view across better, and quotes are less likely to get “lost in translation.”
5. **Respect media deadlines, but do not be pressured into a hasty response.** If the reporter’s deadline is at 5 p.m. and he calls at 4:45 p.m., that is going to be his problem and not yours.
4. **Retire the “no comment” comment.** It just means the media will get information from another source about your company, and be forewarned that the information may be highly inaccurate and/or unflattering. If you can’t speak about the matter, briefly explain why.
3. **Don’t try to turn a sow’s ear into a silk purse.** Face bad facts and don’t whine, even if your company takes some hard hits in the press. But do not hesitate to correct a significant error in reporting and demand that it be corrected.
2. **If your company has a press-contacts policy, respect it.** Either refer the media inquiry to the appropriate office for handling the matter, or work with that office to craft a response. Always be mindful of privilege issues with either in-house or outside media firms.

And the number one thing to do when dealing with the media:

1. **In high-profile situations, consider consulting a media relations professional.** These people have a myriad of media contacts and credibility with the press, and they know how to get your company’s side of the story publicized in the most effective way. Media storms are nothing new to them, and they know what really can be “off the record” and what can’t.

If you are on the inside and would like to submit your own Top 10, please contact Christopher Akin, coeditor, at (214) 981-3812 or by email at cakin@lynllp.com. Topics can be instructive, humorous, or anything of interest to the committee’s membership.



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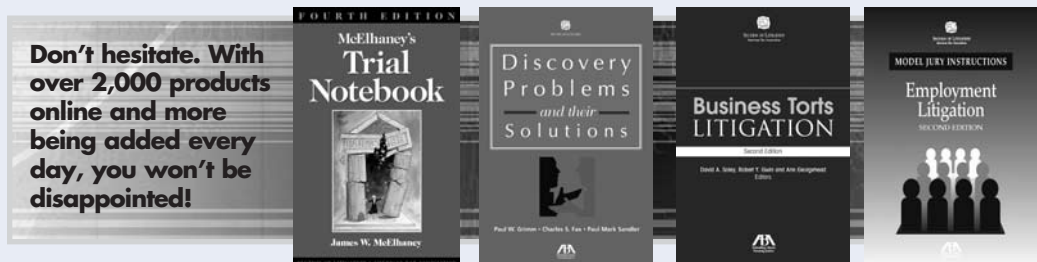
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