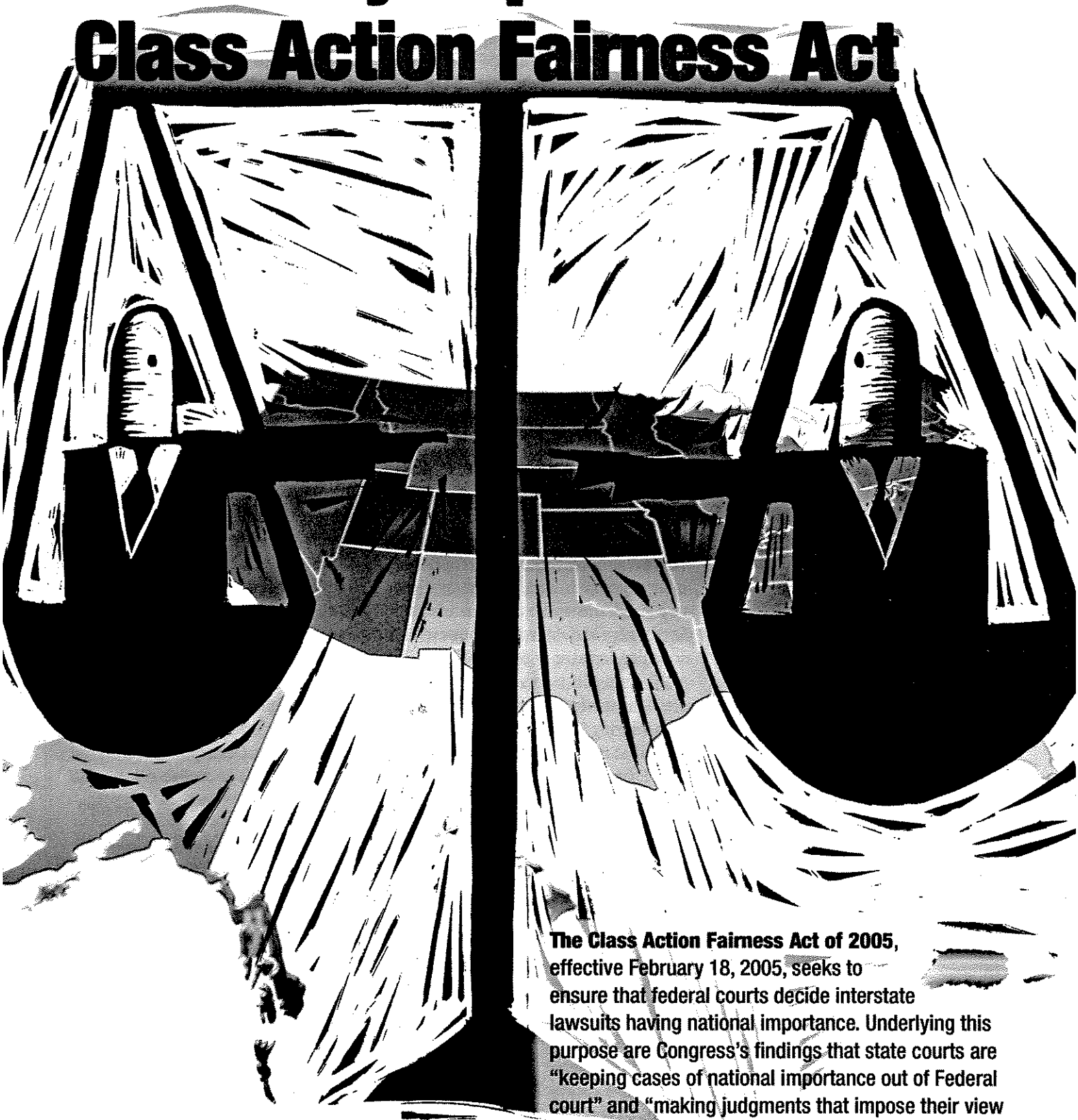
The Likely Impact of the Class Action Fairness Act



The Class Action Fairness Act of 2005, effective February 18, 2005, seeks to ensure that federal courts decide interstate lawsuits having national importance. Underlying this purpose are Congress's findings that state courts are "keeping cases of national importance out of Federal court" and "making judgments that impose their view of the law on other States and bind the rights of the residents of those States."

by Mark Herrmann and Pearson Bownas

The Act changes neither substantive law nor the procedural rules by which courts determine whether a lawsuit should be certified for class treatment. Instead, it expands federal jurisdiction over class actions asserting state law claims. This expansion of federal jurisdiction nonetheless fundamentally changes the landscape of class action litigation; it subjects many more class actions to a body of federal class action law that is well-developed and often less hospitable to large, multistate class actions. The Act, however, depends on novel and untested procedures and undefined terms, so its ultimate impact will be determined by the courts. New defense strategies are also needed to obtain maximum protection under the Act.

Expanded Federal Jurisdiction over Class Actions

The Class Action Fairness Act (Pub. L. No. 109-2, codified at 28 U.S.C. §§1332(d), 1335(a)(1), 1453, 1603(b)(3) & 1711–15), expands federal court jurisdiction to include actions pleading state law claims that are brought under Federal Rule of Civil Procedure 23 or any similar state rule or statute in which (1) *any* class member is a citizen of a state different from *any* defendant and (2) the total amount in controversy exceeds $5 million. This changes both the diversity of citizenship and amount in controversy requirements that had prevented many class actions from being heard in federal court. Before the Act, federal courts had jurisdiction to hear state law class actions only if *all* named class representatives and *all* defendants were citizens of different states. Federal jurisdiction therefore did not exist over a class action against a California defendant having one named plaintiff from California, even though the proposed class also included members from the other 49 states.

Federal courts also previously had jurisdiction over state law class actions only if the value of at least one named plaintiff's claim (or, according to some courts, each proposed class member's claim) individually exceeded $75,000. In some common types of class actions, such as those seeking economic damages based on the purchase of consumer products, this requirement was almost never met since individual plaintiffs rarely bought more than $75,000 worth of those products. Thus, these class actions remained in state court even though the damages sought by the class in aggregate totaled millions, or even billions, of dollars. The Class Action Fairness Act now permits aggregating the value of all class members' claims to satisfy the new $5 million threshold.

Diversity jurisdiction under the Act, as in all other cases, is based not on the parties' residency, but on their citizenship. For individuals, this is the state in which they are domiciled—"the place where a person has a fixed and permanent home to which he intends to return whenever he is absent therefrom." *Schieszler v. Ferrum College*, 236 F.Supp.2d 602, 612–13 (W.D. Va. 2002). College students, for example, may *reside* during the school year in the state where their college is located, but "they are generally presumed to lack intention to remain in [that] state indefinitely." *Id.* at 613. By requiring only "minimal diversity" to create federal jurisdiction over class actions, the Act renders cases with broad class definitions removable. Therefore, defendants should now read class definitions in complaints carefully to determine whether diversity of citizenship exists. Proposed classes that include (whether intentionally or because of careless drafting) all *residents* of the defendant's home state, for example, will surely include *citizens* of other states, creating minimal diversity and an opportunity for removal.

Exceptions to Federal Jurisdiction

The three exceptions to this expanded jurisdiction are intended to permit truly localized disputes to be heard by state courts. For any of the three exceptions to apply, more than one-third of the proposed class members and at least one "primary" or "significant" defendant must be citizens of the forum state.

Federal courts "may decline" to exercise their new jurisdiction where: (1) more than one-third but less than two-thirds of all proposed class members are citizens of the forum state, and (2) all of the "primary defendants" are citizens of the forum state. This scenario is most likely to arise naturally in class actions brought against regional businesses, such as regional banks having their headquarters and most branches in one state with a few branches in neighboring states.

The Act does not explain what qualifies a defendant as a "primary" one. The Senate Judiciary Committee's Report on the Act states that only "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" are primary defendants. S. Rep. No. 109–14 at 43. The term "primary defendant" includes "any person who has substantial exposure to significant portions of the proposed class in the action, particularly any defendant that is allegedly liable to the vast majority of the members of the proposed classes...." *Id.*

Federal courts decide whether to decline jurisdiction over these cases based on "the interests of justice and looking at the totality of the circumstances" after considering six factors:

- Whether the claims have national or interstate implications;

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- Whether the class claims will be governed by the forum state's law or by other states' laws;
- Whether the lawsuit has been pleaded in a manner seeking to avoid federal jurisdiction. (This factor is intended to overcome "gerrymandered" class definitions that unnaturally exclude potential class members or claims in an apparent effort to avoid federal jurisdiction.);
- Whether the forum state has a nexus to the class members, their alleged injures, or the defendants;
- Whether more class members are citizens of the forum state than of any other state, and whether the non-forum state citizen class members are dispersed among a substantial number of other states; and
- Whether any class actions asserting the same or similar claims have been filed in the preceding three years. (This factor is intended to bring as many related actions as possible into federal court to permit transfer and coordination under 28 U.S.C. §1407 to promote efficient and consistent resolution of issues.)

Courts' decisions on these discretionary factors made in the context of assessing jurisdiction may be argued to affect decisions the courts must make later in the case. To avoid this result, courts may decide remand motions without specifically addressing each of the six factors. If courts choose to address these factors individually, they should do so carefully. The second factor, for example, requires a court to determine at the outset of a case whether only the forum state's law governs the class claims. This is presumably a narrow decision; the federal court should answer "yes" or "no" to the question of whether only the forum state's law governs, which would suggest that the lawsuit has few interstate implications. If the court finds for jurisdictional purposes that only the forum state's law governs the class claims, then unless the court hearing the case (either federal or state after remand) is willing to reconsider that ruling at the class certification stage, the claims may appear suitable for certification in part because they raise few choice of law questions. Courts should, however, feel free to reconsider the jurisdictional choice of law determination, since it will be a threshold interlocutory order based on a preliminary evidentiary record.

The Act also specifies two types of class actions over which federal courts "shall decline" to exercise jurisdiction. First, under the so-called "home state" exception, federal courts shall decline to exercise jurisdiction over a class action in which:

The Act does not explain what qualifies a defendant as a "primary" one.

(1) two-thirds or more of all proposed class members are citizens of the forum state; and (2) all of the primary defendants are citizens of the forum state.

Second, under the "local controversy" exception, federal courts shall decline to exercise jurisdiction over a class action in which: (1) more than two-thirds of all proposed class members are forum state citizens; (2) at least one defendant is a forum state citizen from whom "significant relief" is sought by class members and whose alleged conduct forms a "significant basis" for the class claims; (3) the "principal injuries" resulting from the alleged conduct of "each defendant" were incurred in the forum state; and (4) no other class action making the same or similar allegations against any of the defendants has been filed by "the same or other persons" in the preceding three years.

The Act does not explain what constitutes "significant relief" or a "significant basis" for the class claims. Although Congress used different words in the Act to describe the in-state defendants required to anchor a class action in state court under the "home state" exception ("all primary defendants") and the "local controversy" exception (at least one "significant" defendant), the Act's legislative history suggests that the analyses may be similar. *See* S. Rep. No. 109-14 at 43 (explaining that a "*primary* defendant" is one who has "substantial exposure to *significant* portions of the proposed class") and 40 (explaining that a "*significant*" defendant "must be a *primary* focus of the plaintiffs' claims"). [Emphasis added.]

Changes to Remand Proceedings

These exceptions to federal jurisdiction will significantly change remand proceedings in class actions. Remand decisions are made early in a lawsuit without the benefit of much, if any, evidentiary support. To determine whether a class action should be heard in federal court, the court must immediately determine how many putative class members are citizens of the forum state. In many class actions—most of those under Federal Rules 23(b)(1) and (b)(2)—the names of all class members may never be known. Even in Rule 23(b)(3) class actions, the names and addresses of individual class members generally are not learned until after a class is certified and notices are being mailed or proof of claim forms submitted. The Act accelerates the time for learning class members' citizenship.

Consider, for example, a putative class action brought against a cookie manufacturer that sells its cookies to distributors, who sell the cookies to grocery stores across the country, who sell the cookies, often in cash transactions, to consumers. Even with the benefit of substantial discovery, it would be difficult to ascertain the citizenship of each cookie buyer. Experts might make gross estimates using population and cookie distribution statistics and by assuming that people generally buy cookies in their home states. But the Act's "greater than one-third but less than two-thirds" language suggests that more precision may be required. And any generalized estimate of how many cookies were sold in a particular state still may not reveal how many class members are residents—let alone citizens—of that state. Should a court presume, for example, that one million cookies sold in Ohio necessarily means that one million putative class members are Ohio citizens? Or are Ohioans hungrier than that?

The Act is silent on these practical issues, but the legislative history suggests

that they are the plaintiffs' problem. While the pre-Act law governing remand imposed on the removing defendant the burden of establishing federal jurisdiction, the Act seems to reverse that burden for the remand motions that it governs. The Senate Report explains that, for class actions, "the named plaintiff(s) should bear the burden of demonstrating that a case should be remanded to state court...." S. Rep. No. 109–14 at 43; *see also id.* at 44. That report also instructs that federal courts "should err in favor of *exercising* jurisdiction over the case." *Id.* at 42. [Emphasis added.]

Although plaintiffs will surely seize on the remand proceeding as an opportunity to seek prematurely from the defendants a list identifying all class members, the Act's legislative history aims to foreclose that result. The Senate Report discourages extensive fact-finding to determine whether jurisdiction exists, instructing that "in assessing the citizenship of the various members of a proposed class, it would in most cases be improper for the named plaintiffs to request that the defendant produce a list of all class members (or detailed information that would allow the construction of such a list)...." *Id.* at 44. "Less burdensome means (*e.g.*, factual stipulations) should be used in creating a record upon which the jurisdictional determinations can be made." *Id.*

Fewer Barriers to Removing Class Actions Filed in State Courts

The Class Action Fairness Act also changes the rules for removing a class action. A common obstacle to removal before the Act was the rule preventing removal where any defendant was a forum state citizen. Plaintiffs could thus prevent removal by the out-of-state target defendant simply by naming a secondary in-state defendant. The Act removes this obstacle, allowing removal whether or not any defendant is a forum state citizen. The Act also eliminates the requirement that all class action defendants must unanimously consent to removal. This will end the pre-Act ploy of naming a co-defendant friendly to the plaintiffs who would not consent to removal. Defendants may, however, disagree among themselves about the strategic benefits of removal in a given case (for reasons discussed below), and there is nothing in the Act that prevents a non-removing defendant from moving to remand. The Act also exempts class actions from the limitation in 28 U.S.C. §1446(b) that diversity cases must be removed, if at all, within one year after the lawsuit is filed. This eliminates a tactic that class action plaintiffs sometimes used of naming a nominal nondiverse defendant or seeking damages of less than the jurisdictional amount to avoid federal jurisdiction, only to jettison this defendant or damages restriction after the one-year removal limitation had expired.

Appellate Review of Orders Remanding Class Actions

The Class Action Fairness Act significantly changes the law regarding appellate review of rulings on motions to remand. Before the Act, orders granting remand motions were rarely reviewable on appeal. 28 U.S.C. §1447(d). Orders denying remand could be appealed, but not until a final judgment had been entered. The Act provides that orders both granting and denying remand motions are promptly appealable. Such appeals must be taken "not *less* than seven days after entry of order." [Emphasis added.] Because the Act generally seeks to expedite appeals of orders granting or denying remand, there is good reason to believe that Congress meant to say that an appeal must be taken not *more* than seven days after entry of the remand order. (The Act's legislative history states that "parties must file a notice of appeal *within* seven days after entry of a remand order." S. Rep. No. 109–14 at 49. [Emphasis added.]) Until courts address this issue, however, following the Act's literal language may be the safer bet; filing exactly on the seventh day after entry of the district court's order is the safe alternative. The Act as written sets no outer limit on the losing party's time to appeal from the remand order, so parties could theoretically wait months or years before filing a disruptive notice of appeal. Appellate courts, however, can be expected to set deadlines rooted either in the federal appellate rules (*e.g.*, Fed. R. App. P. 4(a)(1)(A)) or common sense.

The Act gives federal appellate courts discretion to accept appeals from orders on remand motions. If a court accepts the appeal, it has 60 days to rule or else the appeal is "denied." It is unclear exactly what this means, since federal appellate courts are not typically thought to "deny" appeals. Presumably it means that the appeal is treated as if the court had never accepted it for review.

The Act does not specify the mechanism by which federal appellate courts will decide whether to accept an appeal from an order on a remand motion. Unless courts establish a different procedure, parties may choose to file papers similar to the application for permission to appeal described in Federal Rule of Civil Procedure 23(f) (and Federal Rule of Appellate Procedure 5(b)) for appeals from class certification orders. This will allow the appealing party to explain the need for review.

The Act will increase federal appellate activity in class actions at the remand stage. This may unintentionally reduce the federal appellate courts' appetite for appeals from orders entered in other stages of class actions, such as appeals from class certification orders under Federal Rule of Civil Procedure 23(f). The likely overall increase in class actions heard by federal courts under the Act certainly reduces the odds that an appellate court will accept review under Rule 23(f) in any particular case.

"Mass Actions" Treated Like Class Actions for Many Purposes

The Class Action Fairness Act creates a new category of cases called "mass actions." A mass action is a case (other than a class action) in which "monetary relief claims of 100 or more people are proposed to be tried jointly on the ground that the plaintiffs' claims involve common questions of law or fact...." "[A] mass action shall be deemed to be a class action removable under" the provisions of the Class Action Fairness Act, except

that federal jurisdiction exists only over those mass action plaintiffs whose claims individually satisfy the existing $75,000 amount in controversy threshold for non-class action claims.

Cases having four types of claims are excluded from the definition of mass action: (1) claims arising from an event or occurrence in the forum state that resulted in injuries in the forum state or a contiguous state (such as an airplane crash or other mass accident); (2) claims joined at the request of the defendants; (3) claims asserted on behalf of the general public under a state statute specifically authorizing that practice; and (4) claims consolidated or coordinated solely for pretrial proceedings. The second exemption has important ramifications for defendants facing multiple individual actions in a particular state that the defendants may otherwise choose to join together. Plaintiffs and defendants may find themselves in a stare-down when each wants to consolidate the actions but waits for the other to do so; if neither side blinks, and no court acts *sua sponte*, the result may be unnecessary inefficiency. The last exemption may depend (to many litigants' surprise) on the state law under which the individual claims constituting the mass action are consolidated or coordinated. Illinois, for example, permits cases to be consolidated for discovery and pretrial proceedings only; California and West Virginia (the state identified by the Act's sponsors as spawning the most mass action litigation), in contrast, coordinate cases for both pretrial *and* trial purposes. *See* Mark Herrmann, Geoffrey Ritts, and Katherine Larson, *Statewide Coordinated Proceedings: State Court Analogues to the Federal MDL Process* 113, 249, 676 (2d ed. 2004). Claims coordinated to create an Illinois mass action would therefore not be subject to federal mass action jurisdiction, whereas claims coordinated for trial in California or West Virginia could be.

How the Class Action Plaintiffs' Bar May Respond

Under the Class Action Fairness Act, class counsel can no longer seek to certify a nationwide class in state court; the mere pleading of a nationwide class will virtually always subject the case to federal jurisdiction. The class action plaintiffs' bar is therefore likely to pursue one or more of three options.

First, they may file statewide class actions against defendants in the defendants' home state (or states) to avoid federal jurisdiction. Corporate defendants, who are deemed citizens of both the states in which they are incorporated and in which they have their principal place of business (28 U.S.C. §1332(c)), would be subject to state court class actions in both states' courts. This may fuel more litigation over where a company's principal place of business is located.

There is nothing in the Act that prevents a non-removing defendant from moving to remand.

Plaintiffs may also pick their state court venues with an eye toward the inevitable removal and remand battle. Plaintiffs would thus file more class actions in state court venues that lie within federal districts with judges perceived by plaintiffs to be pro-remand.

The "local controversy" exception is the only provision of the Act that allows a "primary" defendant to be sued outside its home state (or states). To qualify for this exception, plaintiffs need just one in-state defendant from whom they seek "significant relief" and whose conduct forms a "significant basis" of the class claims. In an attempt to satisfy this requirement, plaintiffs can be expected to name more (and larger) in-state retailers, distributors, and component part manufacturers as defendants.

Second, class counsel may file more class actions in federal court. Certain plaintiffs' counsel previously avoided federal court because, among other reasons, they perceived federal courts to be less likely than some state courts to certify nationwide classes. Now that nationwide classes cannot be certified in state court (because, if pleaded, they are unlikely to remain in state court), plaintiffs may be less reluctant to sue in federal court. To increase their leverage, plaintiffs may adopt an entirely new strategy. They may file many single-state class actions in federal courts and then attempt to transfer and coordinate these cases through the multidistrict litigation process. *See* 28 U.S.C. §1407. The resulting proceeding, which would assemble plaintiffs nationally and the defendant before a single judge, could give plaintiffs negotiating leverage akin to that offered by a nationwide class action.

The Act may also create new magnet courts for federal class actions. Just as plaintiffs have done in state courts, they will quickly identify the federal courts they perceive as being most friendly to certification and bring their class actions in those courts (or seek to transfer their class actions to those courts under 28 U.S.C. §1407). Plaintiffs thinking one step ahead may fix their gaze not so much on friendly trial courts as on friendly appellate courts. (This could mean fewer class actions filed in district courts within the Fourth, Fifth, and Seventh Circuits, which many perceive as hostile to class certification, and more in district courts within the Second and Ninth Circuits.) Plaintiffs may ultimately convince these friendlier trial and appellate courts to create substantive law that favors class action plaintiffs. As circuit splits deepen, the Supreme Court may be forced to step in to resolve these issues. If this happens, it would surely be an unanticipated consequence of the Act, which was intended to change only the scope of federal diversity jurisdiction. Additionally, the more plaintiffs try to corral class actions into friendly federal trial or appellate courts, the more defendants are likely to resist on grounds of inconvenient venue or *forum non conveniens*.

Either of these two approaches by class action plaintiffs would require new defense strategies. For example, if plaintiffs file more, smaller class actions in multiple jurisdictions, then tactical considerations such as accelerating cases in

preferred jurisdictions (and decelerating cases in disfavored jurisdictions) to develop early favorable precedent become more important. Defendants would also need to assess the collateral estoppel effects of an early trial of a particular case on the trailing cases.

Third, plaintiffs' counsel may make increased use of state analogues to the federal multidistrict litigation process. Individual actions coordinated only for pretrial purposes are not mass actions removable under the Class Action Fairness Act. If plaintiffs' counsel can identify a critical mass of individual plaintiffs, they could file multiple individual lawsuits against an out-of-state defendant and then coordinate those suits in a single proceeding for pretrial purposes. This would maximize plaintiffs' negotiating leverage while avoiding removal.

New Limitations on Class Action Settlements

The Act's other major provisions concern class action settlements in federal courts. Settlements of class actions brought on behalf of consumers sometimes include payments made with coupons rather than cash. The Act does not restrict the use of coupon settlements; rather, it restricts the fees paid to the class attorneys who obtain coupon settlements for the class. The Act provides that, "[i]f a proposed settlement in a class action provides for a recovery of coupons to a class member, 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," as opposed to the value of all coupons *issued*. The Act allows courts to hear expert testimony regarding the actual value to class members of the coupons that are redeemed. Any portion of an attorney's fee award in a coupon settlement not based on the value of the redeemed coupons "shall be based upon the amount of time class counsel reasonably expended working on the action." This provision does not "prohibit application of a lodestar with a multiplier method of determining attorney's fees."

The Act does not define a "coupon." Earlier versions of the Act provided more guidance, applying to settlements "under which the class members would receive noncash benefits or would otherwise be required to expend funds in order to obtain part or all of the proposed benefit...." S. 274, 108th Cong. §3 (2003). The term "coupon" in the final version of the Act surely applies to discount coupons, such as where a settling video retail store gives each class member a coupon good for 10 percent off his or her next purchase. It could refer more broadly to any relief requiring class members to act affirmatively to receive the benefit of the award, such as where the settling video store gives each class member a voucher redeemable for a free movie without requiring any additional purchase. It could refer even more broadly to any in-kind relief, such as where the settling video store agrees to send each class member a free movie with no action required by the class member. The willingness of class counsel to accept these last two types of settlements will likely depend on whether courts adjudge them to involve "coupons."

The Act also may not answer the question of *when* courts should assess the value of redeemed coupons. Class counsel's fee is to be based on "the value to class members of the coupons that *are* redeemed" [emphasis added], which suggests that fees in coupon settlements cannot be computed until coupons have actually been redeemed. The Act's provision allowing expert testimony on the actual value to the class members of redeemed coupons seems intended to reveal whether a coupon's face value is its true value, not to allow class counsel to project how many class members are likely in the future to redeem coupons and thus to accelerate a fee payment. Depending on the nature of the goods or services at issue, it may be many months or years before class members would choose to redeem coupons obtained in a class action settlement. Class counsel want to secure the longest possible redemption period to give class members more flexibility to use the coupons and to maximize the value of the coupons on which their fee is based. Thus, to the extent coupons continue to be used to settle class actions, they will likely be used only in conjunction with some cash award that will allow class counsel to receive some of their fee immediately. Another possibility is that courts would allow class counsel to receive fees based on projected redemption rates subject to later adjustment once actual redemptions can be counted.

The Act also raises the specter of increased state and federal regulator involvement in class action settlements. The Act requires that, within 10 days of filing a proposed class action settlement for court approval, each defendant must send a copy of the settlement agreement, complaint, settlement hearing information, proposed settlement notice, and information about class members residing in each state to the "appropriate" state and federal officials. In most cases, the appropriate federal official will be the attorney general; a different federal official is appropriate in cases involving certain financial institution defendants. The appropriate state official may be more difficult to discern. The Act requires defendants to notify "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." A defendant attempting to settle a nationwide class action must try to identify in each state the right state official to notify and hope that later courts agree with its selection. The penalty for choosing the wrong state official to notify is a steep one: class members may choose not to be bound by a settlement or consent decree if these notification requirements are not satisfied. Given the severity of the punishment, one would hope that a defendant's good faith attempt to notify the appropriate state official would be deemed to comply with the Act, as the Senate Report on the Act recommends. S. Rep. No. 109–14 at 35. In

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any event, in some cases involving heavily regulated industries or products, it may be prudent for the parties to contact the appropriate regulators even before the settlement agreement is finalized and submitted to the court for approval.

These approval and notification provisions apply to *all* class action settlements in federal court, whether or not the class action is subject to the Class Action Fairness Act's expanded diversity jurisdiction. Notice to state and federal regulators must be provided, for example, even in federal question cases such as those arising under Section 10(b) of the Securities Exchange Act of 1934, 15 U.S.C. §78j(b), and associated Rule 10b-5.

All of these new settlement rules suggest that defendants who may be interested in a prompt settlement (or a coupon settlement) should resist the reflexive urge to remove immediately, particularly for cases filed in states having an established body of law that does not generally favor class certification. Defendants who already are in federal court when they decide they want to settle might agree with class counsel to use a newly filed state court nationwide settlement class action (which the defendants do not remove) as the vehicle for settlement. The risks and benefits of that approach will become more apparent over time.

The Act Is Prospective Only

The Act it not retroactive: it applies to "any civil action commenced on or after the date of enactment," which was February 18, 2005. It may nonetheless apply to certain cases filed before February 18. In Minnesota, for example, an action is not commenced until the summons is served on the defendant. Minn. R. Civ. P. 3.01. Thus, class actions filed in Minnesota state courts before February 18 would be subject to the Act if service of the summons were not effected until February 18 or later.

Conclusion

The Class Action Fairness Act remedies the quirks in federal diversity jurisdiction law that prevented many high stakes, multistate class actions from being heard by federal courts. The Act, however, creates almost as many questions as it answers, and plaintiffs' response to the Act will require defendants to develop new strategies. **FD**

Forensic Accounting, from page 35
strating the loss of earnings, but it is your understanding that he is self-employed and should not have W-2s. Now what?

The forensic accountant you contacted explained that a "self-employed" individual may still receive a W-2 if the entity is a C or S corporation. The accountant then recommended that the individual be questioned in his deposition/trial as to whether or not he was still working, and if so, who determined his salary? These questions forced the claimant to admit that he was still working, and he determined his own wages. The accountant testified that there was no loss because the reduction in W-2 wages actually resulted in an increase in profit for the company owned by the claimant, and this reduction in W-2 wages was an attempt on the plaintiff's part to manipulate wages.

3 Your client, Karen, is a shareholder of a family-operated business. Her brother, John, is also a shareholder and became CEO after their father died three years ago. Your client feels John is living the "high life" while her semi-annual dividend check has been dramatically reduced. John has indicated that the business is not doing well. Your client thinks John is lying or "cooking the books." Now what?

Counsel did not contact a forensic accountant until after discovery was closed. Counsel assumed he could handle the discovery and requested everything that might be applicable. Unfortunately, counsel received everything that was requested, and a conference room full of banker boxes was provided. Counsel retained a forensic accountant to review the information, but the client was concerned with fees. Therefore, a bull's-eye approach was utilized by the forensic accountant. The accountant reviewed top-level statements and determined that business had become less profitable. However, the accountant recommended further analysis in attempts of ascertaining the cause of the reduction in profitability. It was determined that certain large customers were no longer conducting business with the subject company. This fact was pursued in the CEO's deposition. He indicated the customers had gone to a competitor. When the name of the competitor was researched it was determined that it was owned by the brother. Lastly, the accountant discovered substantial disbursement to a computer consultant. The amounts were out of line with previous years and excessive for the size of the business. The accountant researched the consultant and discovered the company address was the brother's home. The accountant testified to all of these facts in state court, clearly demonstrating that the brother was rerouting business to his solely owned business.

Conclusion

Forensic accountants are tremendous resources when litigation involves financial statements because there are stories within the financial statements that may not be clear to laypeople. Financial statements are generally prepared under "GAAP" guidelines which may not be the appropriate figures in a legal dispute.

In summary, the challenges of proving a case involving sophisticated financial analysis can be greatly diminished with the assistance of an effective forensic accounting expert. Such an expert can serve as a consultant and provide invaluable preliminary insight and advice. Or, if needed, he can testify as an expert witness whose opinions are presented convincingly to an opponent.

Finding the right expert—one who has the requisite expertise and ability to communicate to the layperson—is an art in itself. While following the suggestions outlined above will help, ultimately the attorney and forensic accountant must work well together as a team to be successful. Effective communication between the attorney and the expert, combined with a compelling presentation of the damages by expert opinions, will go a long way toward convincing the opposing attorneys or judge and jury of the facts relating to the case's financial picture. **FD**

Writers' Corner, from page 60
adjectives and adverbs, and abstractions or judgments of any kind, can be used as a model for style in the factual portion of a brief. Hemingway explains, "I'm trying in all my stories to get the feeling of the actual life across—not just to depict life—or to criticize it—but to actually make it alive." *Ernest Hemingway on Writing*, 33 (Larry W. Phillips ed, 1984). Hemingway said of his writing, "Some days it went so well that you could make the country so that you could walk into it through the timber to come out into the clearing and work up onto the high ground and see the hills beyond the arm of the lake." *Id.* at 36. If the statement of facts can do that, the advocate will have succeeded. **FD**