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test to forestall a court decision on the issue of damages.

Unfortunately for issuers, Section 13(d) does not provide any express right for issuers, or even the stockholders that Section 13(d) was enacted to protect, to bring a private cause of action seeking monetary damages to redress violations of Section 13(d). Nor is there is an express right for issuers to seek injunctive relief for violations of Section 13(d). Therefore, issuers have, on numerous occasions, sought to have a federal court infer that a private cause of action to seek such remedies exists for violations of Section 13(d). These efforts, at least with respect to the right to seek monetary damages, have generally not been successful.

The Federal Circuits, though certainly not all, have been somewhat more receptive to inferring the right of issuers to seek injunctive relief for violations of Section 13(d). The decision of the Fifth Circuit in the *Motient* case is just the latest decision by a federal court to hold that there is no private cause of action for monetary damages under Section 13(d).

NOTES

1. *Motient Corp. v. Dondero*, 529 F.3d 532, Fed. Sec. L. Rep. (CCH) P 94737 (5th Cir. 2008).
2. Rule 13d-2 under the Securities Exchange Act of 1934, as amended.
3. See Complaint of CSX Corp. in *CSX Corp. v. The Children's Investment Fund Management (UK) LLP, et al.*, No. 08-Civ. 2764 (S.D.N.Y. filed March 17, 2008)
4. See *Id.*
5. *CSX Corp. v. The Children's Investment Fund Management* (UK) LLP, et al., No. 08 Civ 2764 (LAK) (S.D.N.Y. June 11, 2008).
6. Rule 13d-3(b) of the Exchange Act provides as follows: "Any person who, directly or indirectly, creates or uses a trust, proxy, power of attorney, pooling arrangement or any other contract, arrangement, or device with the purpose of effect of divesting such person of beneficial ownership of a security or preventing the vesting of such beneficial ownership as part of a plan or scheme to evade the reporting requirements of section 13(d) or (g) of the Act shall be deemed for purposes of such sections to be the beneficial owner of such security."
7. See *Id.* at 72.
8. See *GAF Corp. v. Milstein*, 453 F.2d 709, Fed. Sec. L. Rep. (CCH) P 93300 (2d Cir. 1971).
9. See Complaint of CSX Corp. in *CSX Corp. v. The Children's Investment Fund Management (UK) LLP, et al.*, No. 08-Civ. 2764 (S.D.N.Y. filed March 17, 2008), at p 29-30.
10. See *Id.* at 115.
11. See *Id.* at 115.

DHB Industries Sec. Lit.—

The Government's Use of the CAFA to Object to a Securities Class Action Settlement

BY TODD G. COSENZA

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A debate has emerged over whether the notice of settlement provision[1] of the Class Action Fairness Act of 2005[2] (the "CAFA") applies to securities class actions. Pursuant to this notice, within ten days after a proposed settlement is filed in federal court, each settling defendant is required to provide notice of the proposed settlement to various federal and state officials. Although several provisions of the CAFA specifically carve out securities class actions, the CAFA's statutory notice provision, in contrast, does not explicitly exempt securities class actions from its purview. In light of this ambiguity, many defendants have elected to provide notice of securities class action settlements to the appropriate governmental agencies. And a recent case, *In re DHB Industries, Inc. Securities Litigation*,[3] ("*DHB Industries*") illustrates how the CAFA's notice provision may lead to governmental agencies interjecting themselves into the merits of securities class action settlements and further complicating the idiosyncratic process of settling such actions.

This article will provide general background on the CAFA and its notice provision and then discuss the CAFA notice provision's potential impact on securities class action settlements using *DHB Industries* as an example.[4]

Purposes of the CAFA

Before enacting the CAFA, Congress was concerned that possibly due to the large fees awarded to class action lawyers and the split of a class action award among numerous individual members of a class, these members "often receive little or no benefit from class actions" (*e.g.*, coupons or other awards of little or no value).[5] According to the Senate Judiciary Committee's Report on the CAFA, Congress was particularly troubled that class action lawyers were "gaming" the procedural rules and keeping nationwide or multistate class actions in state courts before judges with reputations for readily certifying classes and approving lawyer-friendly settlements.[6] With that in mind, the CAFA was enacted to reduce the "abuses of the class action device" that "harmed class members" and "undermined public respect" for the judicial system.[7]

To remedy these problems, the CAFA expands original federal jurisdiction over class actions. Specifically, the CAFA amends the federal diversity jurisdiction statute[8] to provide federal district courts with jurisdiction over class actions when (i) the amount in controversy exceeds $5 million in the aggregate, and (ii) any member of the putative class is a citizen of a different state from any of the defendants.[9] In addition to expanding the federal courts' original jurisdiction over class actions, the CAFA amends the laws governing federal removal[10] to provide defendants with additional rights to elect to remove interstate class actions from state to federal court.[11] Before removing a class action filed in state court to federal court, each defendant can now remove "without the consent of all defendants."[12] Further, a defendant who is a citizen of the state in which the action was brought has the right to remove a class action filed in state court to federal court.[13] The CAFA also eliminates the prohibition on the removal of a class action to federal court more than one year after the action was commenced as long as the removal notice is filed within 30 days from the date the action became removable.[14]

The CAFA not only enhances the jurisdiction of federal courts over class actions but it also mandates increased judicial scrutiny of class action settlements.[15] For instance, if the parties agree to a settlement including the use of coupons, the court can approve the settlement only after it holds a hearing and makes a written finding that the settlement is fair, reasonable, and adequate in its treatment of class members.[16] In making that determination, the CAFA requires the court to consider, among other things, the monetary value and utilization rate of the coupons that class members are to receive as part of the settlement.[17]

Although the CAFA effectively created a new federal jurisdictional structure for class actions and the approval of settlements, the CAFA's amendments to the diversity statute contain an express provision that renders those amendments inapplicable to securities class actions.[18] Similarly, the CAFA carves out securities class actions from the changes that were made to the federal removal statute.[19] As a result, at the time of its enactment, the CAFA was generally understood not to apply to securities class actions.

The CAFA's Notice Provision

General Notice Requirements—The CAFA contains a strict notice provision for class action settlements. Within ten days of filing a proposed class action settlement, each defendant "that is participating in [a] proposed settlement" must serve the "appropriate" federal officials and state officials in any state in which a class member resides.[20] Service is generally directed to the Attorney General of the United States and each defendant's primary regulator, supervisor, or licensing authority in the state who has the primary regulatory or supervisory responsibility with respect to that defendant or the state attorney general.[21] Once the settling defendant provides notice, the CAFA imposes a 90-day waiting period before the court can issue an order approving a proposed settlement.[22] The notice provision does not place any affirmative duties on state and federal officials to take any action once they receive notice of a proposed settlement.[23] Instead, it was intended to

"ensure that a responsible state and/or federal official . . . is in a position to react if the settlement appears unfair to some or all class members or inconsistent with applicable regulatory policies."[24]

The proposed settlement notice sent to the appropriate government officials must include the eight items following: (1) a copy of the complaint and any amended complaint; (2) notice of any scheduled judicial hearing; (3) certain proposed or final notifications to the class members; (4) any proposed or final settlement; (5) any other agreement between class counsel and defense counsel; (6) any final judgment or notice of dismissal; (7) certain written judicial opinions; and (8) either a list of class members by state and the estimated proportionate share of each state's class members' share of the entire settlement or a reasonable estimate of that information.[25]

Noncompliance with the CAFA's notice provision could result in severe consequences for the settling defendant. If a settlement does not comply with the CAFA, class members can elect not to be bound by that settlement,[26] which in most cases would eliminate any incentive for settling a class action given the lack of finality and prospect of further litigation.

Securities Class Actions—It is unclear whether Congress intended for the CAFA's notice requirements to apply to securities class action settlements. Unlike the provisions of the CAFA that amended the diversity jurisdiction and federal removal statutes, the CAFA's notice provision does not contain an express carve-out for securities class actions. Instead, it merely requires each defendant to provide notice of proposed settlements in "class actions."[27] The CAFA itself defines the term "class action" to encompass "any civil action filed in a district court of the United States under Rule 23 of the Federal Rules of Civil Procedure."[28] Although that would seem to indicate that the CAFA's notice provision applies to securities class actions, there are several indications that Congress did not intend for the notice provision to impact securities class actions settlements.

First, the notice provision appears in Section 3 of the CAFA entitled the "Consumer Class Action Bill of Rights and Improved Procedures for Interstate Class Actions," which is distinct from the sections containing the CAFA's diversity and removal provisions.[29] Coupon-type settlements—which are viewed as traditional consumer class actions—are discussed throughout Section 3, while securities class actions are never mentioned.[30] Second, if the CAFA was intended to apply to securities class actions, it would be logical if the statute required a settling defendant to provide notice to the Securities and Exchange Commission. Rather, the CAFA never mentions the SEC and defines the appropriate federal official as either the Attorney General of the United States or, if the defendant is a financial institution, its primary federal regulator, supervisor, or licensing authority.[31] Third, the legislative history of the CAFA indicates that the notice provisions were not intended to govern securities class actions. Although the Senate Report details how the CAFA would address different types of class action abuses, none of the examples cited in the Senate Report involved a securities class action.[32]

Lastly, Congress had already addressed many of the perceived abuses relating to securities class actions when it enacted the Private Securities Litigation Reform Act of 1995 (the "PSLRA"),[33] and the Securities Litigation Uniform Standards Act of 1998 (the "SLUSA").[34] For instance, the PSLRA provides a procedure by which all class members are granted an opportunity to move to be appointed by the court as lead plaintiff mitigating some of the concerns that securities class actions were attorney-driven.[35] In addition, under the PSLRA—unlike the consumer class actions Congress seemingly meant to address with the CAFA—a lead plaintiff with a significant interest in the outcome of the litigation often plays a meaningful role in securities class actions.[36]

Given these facts, it is unlikely that Congress intended for the CAFA's notice provision to apply to securities class action settlements. However, settling defendants in securities class actions often elect to follow the CAFA's notice requirements anyway because, as outlined above, noncompliance with its terms could have serious ramifications. If a settling defendant fails to provide the requisite notice, a class member "may refuse to comply with and may choose not to be bound by a settlement agreement or consent decree."[37]

Thus, there is a real risk that if a court found that the CAFA's notice provision applied to securities class actions and a defendant failed to comply with the CAFA's notice provision, shareholders would not be bound by the settlement agreement (even if that shareholder had not formally opted out of the settlement). On the other hand, by providing notice, the settling defendant incurs significant administrative costs, undue delay and risk of the government's interference in the settlement process (as illustrated by *DHB Industries*). Due to the ambiguity in the CAFA, a defendant settling a securities class action is now in a "Catch-22" when deciding whether it should comply with the CAFA's notice provision.

In Re DHB Industries, Inc. Securities Litigation

DHB Industries is a good example of how the CAFA's notice provision could result in undue prejudice to a settling defendant in a securities class action. In that case, plaintiffs initiated a securities action in September 2005 alleging that the individual defendants, including the CEO, CFO and COO of DHB Industries, Inc. ("DHB" or the "Company"), inflated the Company's share value by issuing numerous false statements concerning the quality of the Company's bulletproof vests.[38] After announcing that it would stop manufacturing and selling certain of its vests due to concerns raised by law enforcement officials about the vests' effectiveness, shares of DHB stock declined sharply in value.[39]

On July 13, 2006, DHB announced that it had signed a Memorandum of Understanding to settle the class action securities lawsuit.[40] After plaintiffs' motion for preliminary approval of the settlement was granted, the United States—although not a party to the dispute—petitioned the district court to extend the period for the filing of objections to the settlement before the court gave its final approval of the proposed settlement.[41] The court granted the Government's request. The Government then elected to object to certain aspects of the proposed settlement relying on the authority provided to it under the CAFA.[42] Although acknowledging that the CAFA by its terms does not address what action federal or state officials may take following their receipt and review of a proposed settlement, the Government took the position that it had broad powers under the CAFA, including the ability to request leave to file a brief in either opposition or support of the proposed securities class action settlement.[43]

The Government argued that the settlement's terms were objectionable because they "potentially adversely impact[ed] the interests" of the United States in pending criminal actions it had brought against the former CEO, CFO and COO of DHB, as well as an SEC enforcement action against the former CEO and CFO.[44] The Government was concerned that the former officers of the Company might attempt to use the broad release language contained in the proposed settlement "to avoid their obligation, if convicted, to make full restitution."[45] The Government further contented, *inter alia*, that the release and indemnification provisions would impede its ability to effectuate Section 304 liability through the SEC action.[46] As a result, the Government requested that clarifying language be added to the proposed settlement to ensure that the United States would not be hampered in its ability to seek restitution in the parallel pending proceedings.[47]

After initially opposing the Government's request in briefing submitted to the court, DHB eventually agreed not to object to the inclusion of the Government's proposed language.[48] DHB conceded that the parties to the settlement would not seek to limit the remedies available to the Government—including restitution—or to preclude any class member from receiving restitution if it is granted as a result of any criminal action.[49] As a result, the proposed settlement was modified to include the following language proposed by the Government: "Nothing contained in this Settlement is intended to limit the United States' ability to pursue forfeiture, restitution or fines in any criminal, civil or administrative proceeding."[50]

The obvious implication of *DHB Industries* is that despite the apparent ambiguity in the CAFA's notice provision, the federal government appears willing to take the position that it should be provided with notice of securities class action settle-

ments. Furthermore, the government's objections to the form of the settlement agreement entered into by the parties delayed the court's approval of the proposed settlement, resulted in additional briefing and further complicated the structure of the settlement (which had already agreed to by the parties and preliminarily approved by the district court).

Conclusion

The CAFA's statutory notice provision is evolving into one of the most significant provisions of the legislation. A settling defendant complying with the CAFA's notice provision will likely face many administrative burdens, increased costs and regulatory issues. If the government takes the position (as it did in *DHB Industries*) that it has the authority pursuant to the CAFA to become an active participant in the settlement process by supporting or objecting to securities class action settlements, judges are likely to defer approving settlements until the government asserts its position. This would further complicate the settlement of securities class actions, which already entail a delicate balancing act between class members, the various defendants and the defendants' insurers. Settlements also will likely be significantly delayed. A district court cannot issue its final approval of a securities class action settlement until at least 90 days after service of the notice on government officials. And once the appropriate government officials receive notice, they are likely to request additional time from the court to provide their views on the fairness of the settlement.

Most significantly, the government will often have interests beyond analyzing the fairness of settlements. It will closely review the terms and, depending on the conduct alleged, may elect to initiate a proceeding or extract a settlement from a corporate defendant in circumstances in which it otherwise might not take any action. As a result, the new notice requirement will inject greater uncertainty into every class action settlement, particularly given that as many as 51 different governmental authorities can become involved.

It is apparent that a settling defendant will be unreasonably burdened by complying with the CAFA's notice provision in the securities class action context. However, given the potential for significant adverse consequences if notice is not provided in accordance with the CAFA, settling defendants should follow the CAFA's notice requirements until Congress amends the Act. On a going-forward basis, defendants have to weigh the implications of potential government involvement when negotiating a settlement of securities class actions and appreciate that government officials may begin to exert their influence and interfere more frequently during the settlement process.

NOTES

1. 28 U.S.C.A. § 1715.
2. Pub. L. No. 109-2.
3. In re DHB Industries, Inc. Securities Litigation (E.D.N.Y. 05 Civ. 4296).
4. For further insight into CAFA, see "Defining CAFA's Scope: Pew v. Cardarelli" by Warren R. Stern & C. Lee Wilson in June 2008 issue of *Securities Litigation Report*; (vol. 5, no. 6).
5. The CAFA, Pub. L. No. 109-2, § 2(a)(3), 119 Stat. 4, 5. A coupon settlement provides class members with a coupon, credit or certificate to discount the price of new products purchased from the settling defendant. Defendants have favored proposing coupon settlements because they reduce the amount of cash required to settle class action claims.
6. Judiciary Committee Report on Class Action Fairness Act, S. Rep. No. 109-14, at 6, as reprinted in 2005 U.S.C.C.A.N. at 10 (the "Judiciary Committee Report"); *see also id.* at 20-21 (noting that some state court judges had enabled a system of "judicial blackmail").
7. The CAFA, Pub. L. No. 109-2, § 2(a)(2), 119 Stat. 4, 5; *see also id.* § 2(b) ("The purposes of this Act are to (1) assure fair and prompt recoveries for class members with legitimate claims; (2) restore the intent of the framers of the United States Constitution by providing for Federal court consideration of interstate cases of national importance under diversity jurisdiction; and (3) benefit society by encouraging innovation and lowering consumer prices.").
8. 28 U.S.C.A. § 1332.
9. *See* 28 U.S.C.A. § 1332(d)(2). The CAFA adoption of a "minimal diversity" standard is a significant departure from the well-established jurisdictional requirement of complete diversity between all named plaintiffs and defendants. *See Hart v.*

FedEx Ground Package System Inc., 457 F.3d 675, 679 (7th Cir. 2006). The CAFA also contains a number of exceptions allowing class actions with a strong state interest to remain in state court. *See* 28 U.S.C.A. § 1332(d)(4). In addition, the CAFA does not extend jurisdiction to any class action when "the primary defendants are States, State officials, or other governmental entities against whom the district court may be foreclosed from ordering relief." *See* 28 U.S.C.A. § 1332 (d)(5)(A).

10. 28 U.S.C.A. § 1441 *et seq.*
11. *See* 28 U.S.C.A. § 1453.
12. *See* 28 U.S.C.A. § 1453(b).
13. 28 U.S.C.A. § 1453(b) states that a defendant can remove a class action "in accordance with section 1446 . . . without regard to whether any defendant is a citizen of the State in which the action is brought."
14. *See id.* The CAFA also allows the discretionary, interlocutory appellate review of a district court's decision to remand a case back to the state court from which it was removed. *See* 28 U.S.C.A. § 1453(c).
15. *See* 28 U.S.C.A. § 1712.
16. *See* 28 U.S.C.A. § 1712(e).
17. *See id.* The CAFA directs the court to strike a settlement involving a payment to the attorneys representing the class that would result in a net loss to class members unless "the court makes a written finding that nonmonetary benefits to the class members substantially outweigh the monetary loss." 28 U.S.C.A. § 1713.
18. *See* 28 U.S.C.A. § 1332(d)(9)(A). Other types of class actions are also carved out of the CAFA's federal diversity jurisdiction amendments, including class actions that relate to "the internal affairs or governance of a corporation . . . that arise under or by virtue of the laws of the State in which such corporation . . . is incorporated or organized," 28 U.S.C.A. §1332(d)(9)(B); or concern fiduciary duties created by securities laws, 28 U.S.C.A. § 1332(d)(9)(C).
19. *See* 28 U.S.C.A. § 1453(d).
20. 28 U.S.C.A. § 1715(b).
21. 28 U.S.C.A. § 1715(a)(1)(A).
22. 28 U.S.C.A. § 1715(d).
23. Judiciary Committee Report at 32, as reprinted in 2005 U.S.C.C.A.N. at 28 ("Nothing in this section creates an affirmative duty for either the state or federal officials to take any action in response to a class action settlement.").
24. *Id.* at 32.
25. 28 U.S.C.A. § 1715(b).
26. *See* 28 U.S.C.A. § 1715(e).
27. *See* 28 U.S.C.A. § 1715(b).
28. 28 U.S.C.A. § 1711(2).
29. The CAFA, Pub. L. No. 109-2, § 3, 119 Stat. 4, 5-9.
30. *See id.* According to the Judiciary Committee Report, one prime purpose of CAFA was to address numerous problems with the current class action system in which "consumers are the big losers." Judiciary Committee Report at 4. Again, if the CAFA was intended to apply to securities class actions, there would likely have been a reference to investors as well as consumers. Further, the Judiciary Committee Report expresses concerns about forum shopping by class action attorneys; duplicative actions proceeding in different state courts; and state court judges issuing rulings that have nationwide ramifications that are in conflict with the laws and policies of other jurisdictions. *See id.* These are not the types of issues that are relevant in the securities class action context.
31. *See* 28 U.S.C.A. § 1715(a)(1).
32. Judiciary Committee Report at 15-21 (citing numerous examples of "coupon settlements" and noting that in those settlements "class members receive[d] nothing more than promotional coupons to purchase more products from the defendants").
33. The Private Securities Litigation Reform Act of 1995, 15 U.S.C.A. §§ 77z-1 - 78j-1.
34. The Securities Litigation Uniform Standards Act of 1998, Pub. L. No. 105-353, 112 Stat. 3227 (1998).
35. *See* 15 U.S.C.A. § 78u-4(a)(3)(B).
36. The PSLRA requires the court to "appoint as lead plaintiff the member or members of the purported plaintiff class that the court determines to be most capable of adequately representing the interests of class members," and creates a rebuttable presumption that the most adequate plaintiff is the one who "has the largest financial interest in the relief sought by the class." 15 U.S.C.A. § 78u-4(a)(3)(B)(i) & (iii)(I). As a result, in large securities class actions, pension funds or other financial institutions are often appointed as lead plaintiff.
37. 28 U.S.C.A. § 1715(e)(1).
38. *In re DHB Industries, Inc. Securities Litigation*, Compl. ¶¶ 11-18, dated Sept. 9, 2005 (E.D.N.Y. 05 Civ. 4296).
39. *See id.* at ¶ 18.
40. 7/13/06 DHB Industries, Inc. Press Release, DHB Industries Enters into Memorandum of Understanding to Settle Class Action and derivative Lawsuits.

41. *In re DHB Industries Inc. Securities Litigation,* the United States' Motion for Leave to File Objections to Proposed Settlement, dated Nov. 19, 2007 (E.D.N.Y. 05 Civ. 4296), at 1.
42. See *id.*
43. See *id.* at 2.
44. *In re DHB Industries, Inc. Securities Litigation,* the United States' Objections to the Proposed Settlement, dated Nov. 19, 2007 (E.D.N.Y. 05 Civ. 4296), at 1.
45. *Id.* at 2.
46. *See id.* at 3-4. The SEC complaint seeks reimbursement from the CEO to DHB of bonuses and profits from stock sales pursuant to Section 304 of the Sarbanes-Oxley Act, which provides for forfeiture of certain bonuses and profits by CEOs and CFOs when a restatement is required due to an issuer's noncompliance with any financial reporting requirements of the securities laws, if the noncompliance arises from misconduct. See 15 U.S.C.A. § 7243 (2002). The Government contended that allowing defendants to be released and indemnified by the company "would undermine the very purpose behind Congress' enactment of Section 304" and requested "the Court not to approve the settlement unless this provision is removed." *In re DHB Industries, Inc. Securities Litigation,* the United States' Objections to the Proposed Settlement, dated Nov. 19, 2007 (E.D.N.Y. 05 Civ. 4296), at 5.
47. See *id.* at 7.
48. *In re DHB Industries, Inc. Securities Litigation,* Sur Reply Memorandum of Defendant Point Blank Solutions, Inc. in Response to the United States' Reply to Responses to Objections to Proposed Settlement, dated Dec. 14, 2007 (E.D.N.Y. 05 Civ. 4296), at 1.
49. See *id.*
50. *Id.* at 2.