

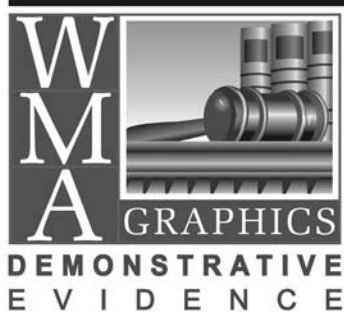
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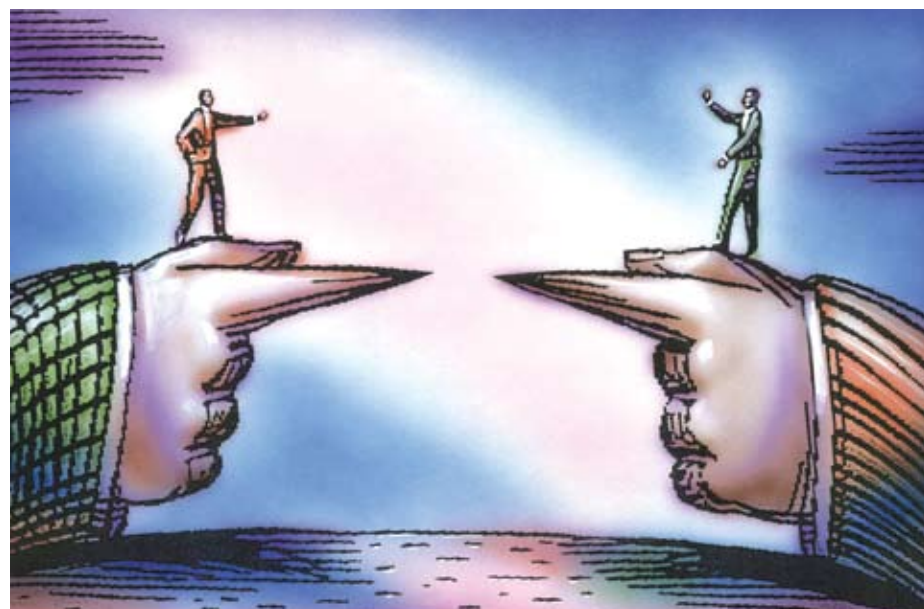
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# A New Battleground For the Class Action War

*Are waiver provisions in consumer  
contracts enforceable?*



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**BY JEFFREY I. CARTON  
AND LINDSAY M. HELD**

IN RECENT YEARS, open warfare between the two diametrically opposed sides of the class action struggle has been waged on a variety of fronts. One side couches the debate in terms of the “public policy” implications of not reigning in class actions. The other counters that class actions, in most cases, are, for all practical purposes, the sole method of allowing consumers to redress harm in the context of claims that are small in value but costly to litigate individually.

Anti-class action interests portray corporate defendants as the “David” facing the class action bar “Goliath” and promote their position—and subsume the class action debate—under the umbrella of “litigation

reform” that has achieved some grass-roots political resonance as part of a conservative “progressive” agenda. In opposition, class action defenders have similarly attempted to re-focus the debate on the policy impact of eviscerating a key “private attorney general” remedy in the fight against corporate and consumer fraud.

Yet, the so-called public policy debate is, simply put, a fig-leaf for a zero-sum battle being waged by two groups that have a lot to lose.

One battle in this war centered around the fairly recent Class Action Fairness Act of 2005 (CAFA),<sup>1</sup> although the so-called “fairness” is clearly in the eye of the beholder.

CAFA gives U.S. federal courts greater jurisdiction in the realm of class action litigation by granting to defendants greater rights to remove state-filed class actions to federal court. In essence, CAFA was designed to place procedural obstacles in the way of class action attorneys who previously were able to forum shop in particular state courts.

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Prior to CAFA, a class action brought in New York State Supreme Court on behalf of a putative nationwide plaintiff class would remain in state court if the defendant could not show that each member of the class met the \$75,000 amount in controversy regardless of the aggregate amount. Moreover, the presence of plaintiff class members from every state (due to the existence of a putative nationwide class) would have presumably destroyed complete diversity between each member of the class and the defendant, which, as a result, would have prevented removal.

Under CAFA, in order to remove this same class action from state to federal district court, a corporate defendant would need only show that "minimal diversity" exists between itself and the members of the putative plaintiff class, and an aggregate amount in controversy in excess of \$5 million.

Although CAFA has had some negative impact on class action litigation, and has afforded defendants the opportunity to litigate in federal rather than in state courts, the statute did not go as far as some class action opponents would have liked. Accordingly, in what appears to set up the next battleground, class action waiver provisions are being seen in some consumer contracts. These provisions on their face seek both to compel arbitration and to waive the consumer's right to initiate or participate in a class action.

### Class Action Waivers

The fight over the enforceability of these waiver provisions has already begun.

An example of one such provision is found on the Blockbuster.com Web site:

All claims, disputes or controversies (whether in contract or tort, pursuant to statute or regulation, or otherwise, and whether pre-existing, present or future) arising out of or relating to: (a) these Terms and Conditions of Use; (b) this Site; (c) any advertisement or promotion relating to these Terms and Conditions of Use or this Site; or (d) transactions effectuated through this Site, or (e) the relationship which results from these Terms and Conditions of Use (including relationships with third parties who are not party to these Terms and Conditions of Use) (collectively "Claims"), will be referred to and determined by binding arbitration governed by the Federal Arbitration Act and administered by the American Arbitration Association under its rules for the resolution of consumer-related disputes, or under other mutually agreed procedures. *Because this method of dispute resolution is personal, individual and provides the exclusive method for resolving such disputes, you further agree, to the extent permitted by applicable laws, to waive any right you may have to commence or participate in any class action or class-wide arbitration against Blockbuster related to any Claim.* (Emphasis

added.)

Review of this specimen class action waiver raises significant issues relating to enforceability.

The first issue is whether class action waivers are merely extensions of, and thus subject to similar analysis to, garden variety arbitration provisions, which under the Federal Arbitration Act (FAA) and analogous state statutes, are routinely upheld, or whether such waivers are a different type of animal.

Second, if in fact class action waivers are deemed to be substantively different from arbitration clauses—which can be perceived as merely allowing the parties to select the "procedural" context in which their dispute will be determined (i.e., private arbitration versus court litigation)—to what extent, and under what circumstances, do these waivers, which may effectively block remedies for plaintiffs with small individual claims, violate public policy and constitute unconscionable contractual provisions?

### California Speaks

The battle over the enforceability of class action waivers is necessarily being fought on a state-by-state, as well as a circuit-by-circuit, basis, according to each state's public policy and definitions of "unconscionability."

Given California's significance in terms of commercial activity and thus, prominence in class action activity, a leading case in the development of class action waiver law is *Discover Bank v. Superior Court (Boehr)*, 36 Cal. 4th 148 (Calif. 2005), which involved a class action waiver and arbitration provision in a consumer credit agreement.

In *Discover Bank*, the California Supreme Court held that when a class action waiver was found in a consumer contract of adhesion in a setting in which disputes between the contracting parties predictably involved small amounts of damages, and when it was alleged that the party with the superior bargaining power had carried out a scheme to deliberately cheat large numbers of consumers out of individually small sums of money, such waivers were unconscionable under California law, were not preempted by the FAA and should not be enforced.

The California Supreme Court, though, remanded the case for determination by the lower court of whether the Delaware choice of law provision would apply, which would effectively enforce the waiver because Delaware law provides for such enforceability.<sup>2</sup>

The *Discover Bank* Court made the distinction between "procedural rights"—e.g., those embodied in the choice of forum embedded in an arbitration clause—and "substantive rights" that are implicated by a class action waiver:

Some courts have viewed class actions or arbitrations as a merely procedural right, the waiver of which is not uncon-

*Class action waiver provisions that are being seen in some consumer contracts seek, on their face, both to compel arbitration and to waive the consumer's right to initiate or participate in a class action. The fight over enforceability has already begun.*



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# Federal Long-Arm Statute Under Rule 4(k)(2)

Continued from page S7

ment that has raised the most unique set of problems: How is the court to determine that the defendant is not subject to personal jurisdiction in any state? Is the defendant required to cite one or more states that can assert personal jurisdiction, in essence forcing the defendant to consent to personal jurisdiction there? Is the plaintiff required to demonstrate that no state can assert personal jurisdiction over the defendant, obligating the plaintiff to undertake a 50-state survey of long-arm rules and demonstrate the defendant's lack of contacts with every state? Because this requirement can potentially force a party to argue against its own interests, courts have taken a variety of approaches to resolving it.

In *United States v. Offshore Marine Ltd.*, 179 F.R.D. 156 (D. V.I. 1998), the court applied a burden of proof analysis. Because the plaintiff has the burden to prove that the court has personal jurisdiction over the defendant, the court dismissed the case when the plaintiff was unable to demonstrate that the defendant was not subject to personal jurisdiction in any state.

Other courts have approached the issue in other ways. In *Int'l Brotherhood of Teamsters*, the court found this requirement satisfied because the defendant would not be amenable to service under the long-arm statute of the forum state. 945 F.Supp. at 618-20. In *Richards v. Tsunami Softgoods, Inc.*, the court held that the rule did not apply because the defendant would likely be subject to the personal jurisdiction of one or two other states. 239 F.Supp.2d at 87-88. In *Norvel Ltd.*, the court asked the parties to brief the issue and permitted the plaintiff to identify the other jurisdictions most likely at issue in its papers. 161 F.Supp.2d at 200.

Two federal courts of appeals have formulated specific tests for this requirement. In *ISI Int'l, Inc. v. Borden Ladner Gervais L.L.P.*, 256 F.3d 548 (7th Cir. 2001), the U.S. Court of Appeals for the Seventh Circuit noted that "one might read Rule 4(k)(2) to make matters worse by requiring 51 constitutional decisions: The court must first determine that the United States has power and then ensure that none of the 50 states does so." The Seventh Circuit concluded, however, that "[c]onstitutional analysis for each of the 50 states is eminently avoidable by allocating burdens sensibly. A defendant who wants to preclude use of Rule 4(k)(2) has only to name some other state in which the suit could proceed.... This procedure makes it unnecessary to traipse through the 50 states, asking whether each could entertain the suit." 256 F.3d at 552. Because the defendant in the action before the court did not concede that it was subject to personal jurisdiction in another state, the Seventh Circuit ruled that this requirement of Rule 4(k)(2) was satisfied and the defendant was not subject to the jurisdiction of any state.

The U.S. Court of Appeals for the First Circuit has taken a completely different approach. In *United States v. Swiss American Bank*, 191 F.3d 30 (1st Cir. 1999), the defendants, like the defendants in *Offshore Marine*, argued that the government was required to allege facts demonstrating that no state had personal jurisdiction over the defendants: "This paradigm in effect requires a plaintiff to prove a negative fifty times over—an epistemologically quandary which is com-

pounded by the fact that the defendant typically controls much of the information needed to determine the existence and/or magnitude of its contacts with any given jurisdiction." 191 F.3d at 40.

In contrast, placing the burden on a defendant to demonstrate the applicability of this requirement "threatens to place a defendant in a 'Catch-22' situation, forcing it to choose between conceding its potential amenability to suit in federal court (by denying that any state court has jurisdiction over it) or conceding its potential amenability to suit in some identified state court." *Id.* at 41.

To avoid this dilemma, the First Circuit formulated a different test. First, a plaintiff must make a prima facie case for the applicability of Rule 4(k)(2), under which the plaintiff would certify that, based on information readily available, the defendant is not subject to suit in the courts of general jurisdiction of any state. The plaintiff would also have to demonstrate that the defendant has sufficient contacts with the United States as a whole to justify the assertion of personal jurisdiction under Rule 4(k)(2). Once this prima facie case has been made, the burden shifts to the defendant to produce evidence demonstrating either that it is subject to the personal jurisdiction of a state, or that its contacts with the United States as a whole are insufficient. *Id.*

To date, no other circuit has adopted the First Circuit's test.<sup>1</sup> However, the Fifth Circuit and the D.C. Circuit have adopted the Seventh Circuit's approach and shifted the burden to the defendant to name a state in which it is subject to personal jurisdiction. *Adams v. Unione Mediterranea Di Sicurtà*, 364 F.3d 646, 651 (5th Cir.), cert. denied, 543 U.S. 979 (2004); *Mwani v. Bin Laden*, 417 F.3d 1, 11 (D.C. Cir. 2005). Whether other circuits will follow the lead of the Seventh or First circuits or take their own paths in determining how to satisfy this vexing requirement is unclear.

## Contacts With United States

The third requirement, demonstrating that the defendant's contacts with the United States as a whole satisfy the requirements of due process for the assertion of personal jurisdiction, follows the conventional approach for demonstrating that due process has been satisfied with respect to state long-arm statutes. Specifically, in determining whether the defendant has minimum contacts with the United States, the approach is the same as with respect to an individual state. If the defendant's contacts with the United States are "continuous and systematic," and the exercise of jurisdiction is reasonable, the district court can exercise general jurisdiction over the defendant for any claim, even one unrelated to those contacts.

If the stringent requirements for general jurisdiction are not satisfied, the court may still exercise specific jurisdiction over the defendant if the claim directly relates to or arises out of the defendant's contacts with the United States, the defendant has purposely availed itself of the benefits and protections afforded by U.S. law, and the exercise of jurisdiction is reasonable under the circumstances.

*United States v. Swiss American Bank*, 274 F.3d 610 (1st Cir. 2001), contains an extensive analysis of general and specific

personal jurisdiction under Rule 4(k)(2). After the district court ruled that the assertion of personal jurisdiction would not satisfy due process, the First Circuit concluded that, in the absence of offices or non-sporadic direct business activity in the United States, the defendant's conduct of business over the Internet and with correspondent banks that made it part of an international banking community that did business in the United States did not satisfy the "continuous and systematic" test for general jurisdiction. 274 F.3d at 619-20.

The First Circuit then concluded that there was an insufficient relationship between the claims asserted in the action and the United States to establish specific jurisdiction. 274 F.3d at 620-22. It rejected the plaintiff's argument that the claims were related to the United States because the defendant's actions caused "wrongful effects" there, concluding that the analysis of the effects of a defendant's activities in the forum should be focused on the defendant's purposeful availing of the laws of the forum prong rather than the relatedness prong. 274 F.3d at 622-24.

Other courts have been more willing to find specific jurisdiction's relatedness requirement satisfied because the defendant's activities caused effects in the United States. In *Int'l Brotherhood of Teamsters*, for example, the court concluded that the assertion of personal jurisdiction satisfied due process because, even though the defendant transacted no business in the United States, its interference with elections undertaken by an international union in Canada interfered with the United States' ability to eliminate corruption from the union pursuant to a RICO consent decree. 945 F.Supp. at 621-22. Similarly, in *Mwani v. Bin Laden*, the D.C. Circuit held that al Qaeda's bombing of U.S. embassies in Africa satisfied the relatedness test because their effects reverberated in the United States, and because al Qaeda purposefully directed its terrorist activities at the United States. 417 F.3d at 13. As these cases demonstrate, the due process determination, whether for specific or general jurisdiction, and whether focused on a state or the United States under Rule 4(k)(2), is a fact-specific inquiry depending upon individual contacts that each defendant has with the United States.

## Conclusion

Judicial interpretation of Rule 4(k)(2) is still relatively limited. In today's international business climate, however, the rule has enormous importance. If your client is a foreign corporation facing litigation with a U.S. citizen because of a business relationship functioning largely outside the United States, Rule 4(k)(2) may be your greatest impediment to avoiding U.S. litigation. On the other hand, if your client is an American citizen in a dispute with a foreign national, Rule 4(k)(2) offers an opportunity that would not otherwise exist to litigate the claim in the United States. Either way, Rule 4(k)(2) is a rule of great potential significance to any litigator practicing in the international arena.

1. The First Circuit test was recently applied by a judge in the Southern District of New York. *Porina v. Marwood Shipping Co., Ltd.*, 2006 WL 2465819 at \*3-4 (S.D.N.Y. Aug. 24, 2006).

# Class Actions

Continued from page S11

scionable.<sup>3</sup> But...class actions and arbitrations are, particularly in the consumer context, often inextricably linked to the vindication of substantive rights. Affixing the "procedural" label on such devices understates their importance and is not helpful in resolving the unconscionability issue.<sup>4</sup>

## In the Federal Courts

Several federal Courts of Appeals have dealt with class action waivers in different contexts and with differing results.

For example, consistent with the California holding in *Discover Bank*, the Ninth Circuit in *Ting v. AT&T*, 319 F.3d 1126 (9th Cir. 2003), held that California law prohibited enforcement of a class action waiver in consumer adhesion contracts. In addition, the First Circuit, in *Kristian v. Comcast Corp.*, recently held that a class action waiver could not be used by a corporate defendant to block an antitrust class action because, by doing so, the defendant would effectively deprive the individual plaintiff of any recovery.<sup>5</sup>

In so holding, the *Kristian* court relied on language used by the U.S. Supreme Court in *Green Tree Financial Corp.-Alabama v. Randolph*, 531 U.S. 79 (2000), which reaffirmed that an arbitration provision could only be enforced so long as the prospective litigant could effectively vindicate his or her statutory rights, stating that "[i]t may well be that the existence of large arbitration costs could preclude a litigant...from effectively vindicating federal statutory rights in the arbitral forum."<sup>6</sup>

The First Circuit in *Kristian* pointed out that:

In any individual case, the disproportion between the damages awarded to an individual consumer antitrust plaintiff and the attorney's fees incurred to prevail on the claim would be so enormous that it is highly unlikely that an attorney could ever begin to justify being made whole by the court... Moreover, being made whole is hardly a sufficient incentive for an attorney to invest in a case such as this when the time spent on more predictable cases would be advantageous, and frankly, rational.<sup>7</sup>

However, other circuits, including the Third, Fourth, Seventh and Eleventh, have reached a different result than *Kristian* and have enforced arbitration provisions that included class action waivers, albeit in different contexts—e.g., federal Truth-in-Lending class actions rather than more complicated and costly antitrust class actions.<sup>8</sup>

Similarly, the U.S. District Court for the Southern District of New York recently, and in apparent conflict with the *Kristian* decision, held that an arbitration provision that included a class action waiver was enforceable to bar an antitrust class action from proceeding because (i) plaintiffs had failed to establish that the cost of arbitration would be more than that of litigation and (ii) the statutory protections of treble damages and the award of costs and attorneys' fees if plaintiffs

prevail were sufficient to allow arbitration and not deny plaintiffs of their statutory rights.<sup>9</sup> The decision is currently on appeal to the Second Circuit.

**Further Word From State Courts**

A very recent set of New Jersey cases is further illustrative of the development of case law on class action waivers.

On Aug. 9, 2006, the New Jersey Supreme Court held, in *Muhammad v. County Bank of Rehoboth Beach, Delaware*,<sup>10</sup> that a waiver prohibiting class action arbitrations in a consumer loan contract was unconscionable under New Jersey law. The Court reasoned that in light of the relative small value of the plaintiff's claim, the plaintiff would be prevented from enforcing statutory rights in the absence of a class action. The Court severed the illegal waiver but enforced the arbitration clause, compelling the parties to arbitrate on a class-wide basis.

The facts in *Muhammad* were that the plaintiff signed standard form documents in connection with a loan. The first was a "class arbitration waiver," prohibiting the plaintiff from bringing any class claims in arbitration. The second waiver signed by the plaintiff, which the Court referred to as a "broad class action waiver," prohibited her from initiating, participating in or joining any class action in court or arbitration.

The Court held that the class arbitration waiver was unconscionable and thus unenforceable. The consumer contract constituted an adhesion contract under New Jersey law because the corporate lender presented it on a take-it-or-leave-it basis.

Moreover, because of the relatively small amount in controversy and the complexities of the case, the putative waiver violated New Jersey's public policy in that it prevented the plaintiff from effectively enforcing her statutory rights. In so holding, the Court determined that the public interest goal of protecting consumer rights did in fact outweigh a defendant's right to enforce the contractual waiver.

In another case, *Delta Funding Corporation v. Alberta Harris*, which was decided the same day as the *Muhammad* case, the New Jersey Supreme Court utilized the framework outlined in *Muhammad* to clarify further that under New Jersey law a class arbitration waiver is not per se unconscionable but rather should be analyzed on a case-by-case basis in light of the particular facts. Accordingly, as the Court pointed out, it is probable that a class action waiver would be held to be enforceable in a case where the plaintiff's individual claims were not minimal; the arbitration provision provided for the plaintiff to recover legal fees and costs if successful; and there existed other incentives for an attorney to bring individual claims on behalf of plaintiffs.<sup>11</sup>

Thus, the New Jersey Supreme Court made it clear that as a matter of New Jersey public policy, arbitration provisions are enforceable. However, class action waiv-

ers are unconscionable in most consumer contexts because they deny plaintiffs the right to seek effective statutory remedies. Accordingly, class arbitrations must be permitted, and corporate defendants cannot limit the rights to obtain attorneys' fees or other remedies granted by statute in the context of such arbitrations.

**There Is a Middle Ground**

Despite the vigorous, "zero-sum" fight being played out by both sides of the class action/public policy debate, there is a reasonable middle ground approach.

This approach appropriately respects corporate defendants' desires to select their dispute forum (i.e., arbitration pursuant to adequately disclosed arbitration provisions), while simultaneously preventing those same defendants from tying that forum choice to a substantively unfair waiver that, for all practical purposes, prevents individual consumers from seeking statutorily derived remedies. The framework for this "middle-ground approach" is essentially the framework laid out by

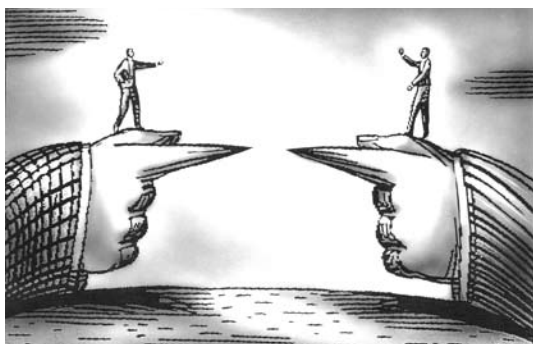
the New Jersey Supreme Court in *Muhammad* and *Delta Funding*.

To wit, corporate defendants should be permitted to enforce arbitration provisions, assuming they are otherwise disclosed clearly. However,

that forum choice should not be used to facilitate consumer fraud by blocking collective action by plaintiffs, which serves, in most consumer cases, as the only path to remedy for claims of consumer fraud, anitrust violations and other statutorily derived consumer rights cases. Accordingly, class arbitrations should be permitted, but broad-based class action waivers should not be enforced as a matter of public policy.



1. Codified at 28 U.S.C. §§1332, 1446 and 1453.
2. *Discover Bank v. Superior Court*, supra, 36 Cal.4th at pp. 162-163, 172-174. The lower court subsequently held that the Delaware choice of law was enforceable because the plaintiff did not argue on appeal that the provision was procedurally unconscionable.
3. (See, e.g., *Strand v. U.S. Bank National Association ND*, 2005 ND 68, 693 N.W.2d 918, 926 (2005); *Blaz v. Belfer*, 368 F.3d 501, 504-505 (5th Cir. 2004); *Johnson v. West Suburban Bank*, 225 F.3d 366, 369 (3d Cir. 2000); *Champ v. Siegel Trading Co., Inc.*, 55 F.3d 269, 277 (7th Cir. 1995); but see *Leonard v. Terminix Intern. Co. L.P.*, 854 So. 2d 529, 538 (Ala. 2002) (class action waiver together with limitation of damages clause in adhesive consumer arbitration agreement deprives plaintiffs of a "meaningful remedy" and is therefore unconscionable); *State v. Berger*, 211 W.Va. 549, 567 S.E.2d 265, 278 (2002), (holding contract provision limiting class action rights unconscionable); *Powertel v. Bexley*, 743 So. 2d 570, 576 (Fla. Dist. Ct.App. 1999) (same).
4. *Discover Bank v. Superior Court*, supra, 36 Cal.4th at p. 161.
5. *Kristian v. Comcast Corp.*, 446 F.3d 25 (2006).
6. See *Kristian*, 446 F.3d at 52.
7. See *Kristian*, 446 F.3d at 59.
8. See *Johnson v. W. Suburban Bank*, 225 F.3d 366 (3d Cir. 2000); *Snowden v. Check Point Check Cashing*, 290 F.3d 631 (4th Cir. 2002); *Livingston v. Assocs. Fin., Inc.*, 339 F.3d 553 (7th Cir. 2003); and *Randolph v. Green Tree Fin. Corp.-Alabama*, 244 F.3d 814 (11th Cir. 2001).
9. *In re American Express Merchants' Litigation*, No. 03cv9592, 2006 WL 662341 (S.D.N.Y. March 16, 2006).
10. *Muhammad v. County Bank of Rehoboth*, 2006 N.J. LEXIS 1154.
11. *Delta Funding Corporation v. Alberta Harris*, 2006 N.J. LEXIS 1155.



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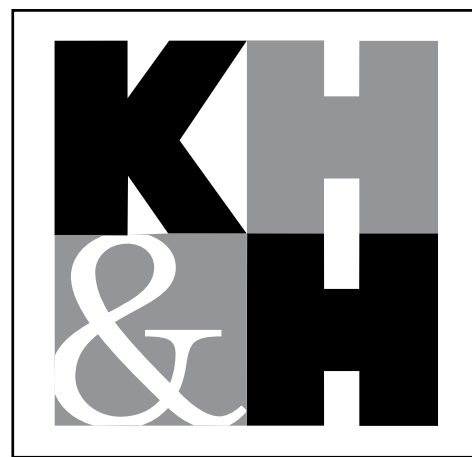
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