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CLASS ACTION ALERT

"CLASS ACTION FAIRNESS ACT" CREATES MAJOR CHANGES FOR INTERSTATE CLASS ACTIONS: NEW JURISDICTIONAL PROVISIONS, RULES ON REMOVING TO FEDERAL COURT AND SCRUTINY OF SETTLEMENTS

On February 17, 2005, the 109th Congress enacted substantial changes to the law governing class actions involving parties from more than one state. The "Class Action Fairness Act" (S.5) is headed to the White House, which has indicated it will sign the bill into law. In general, the Act allows (or in some situations *requires*) large national class actions to be decided in federal court, while intending that class actions involving purely local matters remain in state court. The Act accomplishes this goal in three ways: i) changing federal "diversity" jurisdiction so that only "minimal" diversity, instead of "complete" diversity, is now required for large, interstate class cases, so long as other new requirements also are satisfied; ii) changing the rules for removing such cases from state to federal court; and iii) changing the procedures for reviewing proposed class settlements, and imposing some limits on how to apportion recoveries by certain class members and their attorneys.

NEW GROUNDS FOR FEDERAL JURISDICTION OF STATE-LAW CLAIMS

Under prior case law interpreting the federal "diversity" jurisdiction statute, 28 U.S.C. § 1332, a case involving solely state laws could proceed in federal court only if *each named* class member was from a state different than the defendant. In addition, most appeals courts required that at least one named class member had to seek $75,000. In other appeals courts, this also was true of *each* class member, that is, they could not add their claims to satisfy the amount-in-controversy requirement.

The Act amends the diversity statute to add a new § 1332(d). In general, the law creates three categories of class action cases: i) those in which federal diversity jurisdiction is *available at the request of a party*; ii) those in which federal diversity jurisdiction is *barred*; and iii) cases in between the first two categories where the district court has *discretion*. The rules are more easily understood if they are considered in the following order, rather than as listed in the Act.

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***Federal jurisdiction present.* § 1332(d)(2).** The Act provides that federal courts have original jurisdiction of class actions if *any* class member is from a state different from any defendant and the aggregated controversy exceeds $5 million (exclusive of interest and costs). Section (d)(5) also requires that there be 100 or more class members. As a practical matter, because of the provisions discussed below, the law automatically vests jurisdiction in the federal courts only if 1/3 or less of the class members are from the forum state. Section (d)(9) exempts cases solely involving securities law or claims relating to business governance under the law of the state in which the business entity is organized.

***Federal jurisdiction lacking.* § 1332(d)(4).** The law intends to leave "home state" and "local" controversies to the state courts. There are two alternatives under which a federal court *must* decline jurisdiction under § 1332(d)(2):

§ 1332(d)(4)(B). If 2/3 or more of the class members are from the forum state, and so are the primary defendants, the federal court lacks diversity jurisdiction. "Primary defendants" is not defined, but the legislative history suggests that the purpose is to leave in state court class actions brought against a company in its home state in which 2/3 of class members are from that state.

§ 1332(d)(4)(A). The court also lacks diversity jurisdiction if more than 2/3 of the proposed class members and at least one defendant are from the forum state, the principal injuries occurred there, that defendant's conduct is a significant basis for the claim, *and* significant relief is sought from that defendant. For this rule to apply, there also must have been no class lawsuit in the prior 3 years involving similar factual allegations against any of the defendants. The rule seeks to keep truly local cases in state court but prevent fraudulent joinder of a local defendant.

***Discretionary federal jurisdiction*. § 1332(d)(3).** A federal district court may decline to exercise jurisdiction under § 1332(d)(2) if more than 1/3 but less than 2/3 of the class members are from the forum state and so are the primary defendants. In this gray area between the other provisions, the court considers the "totality of the circumstances" to determine what is in "the interests of justice." Six factors are relevant: (A) whether the matter is of national or interstate interest; (B) whether the laws of the local state or other states will govern; (C) whether there was artful pleading of the class to otherwise avoid federal jurisdiction; (D) whether the forum has a close tie with the class members, the harm, or the defendants; (E) whether the number of class members from the local state is substantially greater than the rest of the class, with the others being dispersed around the country; and (F) similar class actions in the prior 3 years.

***Rules do not apply if less than 100 class members.* § 1332(d)(6).** There is presumed and discretionary jurisdiction only if there are 100 or more class members.

***Date for determining citizenship*. § 1332(d)(7).** The date for considering the citizenship of the members of the proposed class is the date that the operative pleading was filed. There is no such provision for determining the citizenship of defendants.

***Rules apply throughout case.* § 1332(d)(8).** The jurisdictional rules apply both before *and* after any class certification order.

Rules apply to "mass actions". § 1332(d)(11). Even in cases not brought under a state counterpart to Rule 23, the new rules apply if monetary relief is sought on behalf of 100 or more persons and there are allegedly common questions of law or fact. In this instance, however, each plaintiff separately must meet the $75,000 in controversy requirement. A few types of cases are excepted from this provision: i) where there was an "event or occurrence" in the forum state (e.g., an airplane crash or other major accident) that caused injuries there or nearby states; ii) the claims were joined at the request of the defendants, or solely for pretrial purposes; or iii) the claims are brought on behalf of the general public, not individual claimants. In addition, removal to federal court under this provision cannot be followed by a transfer to another court as a "multidistrict litigation" case under § 1407, unless the majority of plaintiffs request that, or they seek Rule 23 treatment, or the case is certified under Rule 23 at someone else's request.

NEW RULES FOR REMOVING CASES TO FEDERAL COURT

The Act adds a new section to the chapter of the Judicial Code on the procedures for removal of cases to federal court from state court. 28 U.S.C. § 1453. In general, the provisions of former §§ 1446 and 1447 apply, with the following exceptions.

No time limit for removal based on diversity. The one-year time limit in § 1446(b) for cases that first appear to be removable based on diversity jurisdiction does not apply. The purpose is to prevent plaintiffs from changing their pleadings, such as seeking substantially more money, after the removal deadline has passed.

Defendants' citizenship irrelevant to removal. The procedures for removal in § 1446 apply whether or not any defendant is from the forum state.

Any defendant can remove. Existing case law interpreted the removal statute by imposing a "unanimity requirement," under which all defendants then served with the complaint must consent to removal. Now any defendant can remove a class action that satisfies the Act without obtaining the consent of all defendants.

Immediate appeal of remand rulings. A federal appellate court *may* accept an appeal from an order granting or denying remand under § 1447 if application is made within 7 days. The appellate judgment must be rendered within 60 days of the notice of appeal, unless all parties agree to an extension or there is good cause to extend another 10 days. If this time limit is not met, the appeal is automatically denied.

Corporate and securities cases not covered. There is a general exception for cases involving *solely* securities law or claims relating to business governance under the law of the state in which the business entity is incorporated or organized.

NEW PROCESS AND LIMITS ON PROPOSED SETTLEMENTS

The Act adds a new chapter to the Judicial Code that is described as a "Consumer Class Action Bill of Rights." The new provisions will appear at 28 U.S.C. §§ 1711-15.

***Coupon settlements*. § 1712.** In contingent fee cases where the settlement involves the issuance of coupons to class members, the plaintiffs' attorney's fee must be based on either the value of coupons that are actually *redeemed* or the time reasonably spent on the matter. (For the hourly method, prior law is maintained permitting fees to be determined based on a lodestar with multiplier method.) Such fees are subject to court approval, and must include the value of any equitable (e.g., injunctive) relief obtained for the class. Courts cannot approve coupon settlements without a hearing and written finding that the settlement is fair to class members. The court can hear expert testimony on the value of the redeemed coupons. The court can require that unused coupons be donated to charity or the government.

***Net losses to class members*. § 1713.** If any class member would be required to pay more to plaintiffs' counsel than the money he or she would receive under a proposed settlement, the court can approve it only by making a finding that the non-monetary benefits to the class member substantially outweigh that monetary loss.

***No sweetheart deal for local plaintiffs*. § 1714.** The court may not approve a proposed settlement that would award greater recovery to certain class members based solely on the fact that they live closer to the courthouse.

***Notification to federal or state officials and waiting period*. § 1715.** Within 10 days of the filing of a proposed class settlement, defendants must serve notice to specified authorities in the federal and state executive branches. In most instances, this is the United States Attorney General or, in the instance of banks, their appropriate regulator. In each state in which a class member resides, this means the primary regulator or licensing authority, or else the state attorney general. The filing must include: the operative pleadings, the notice of hearing on the settlement, the proposed class notice, the proposed settlement, any "side" agreements between plaintiffs' counsel and defendants, the names (or estimated number) of class members in each state and their proportionate share within each state, and the judge's ruling. There is a 90-day window after the notification during which the court cannot give final approval of the settlement. Class members can refuse to be bound if these rules are not followed.

WHAT DO THESE CHANGES MEAN? TOP QUESTIONS AND ANSWERS

1) Is this the *end* of class action litigation? Contrary to reports in the popular press, rumors of its death are greatly exaggerated. In fact, the Act likely will generate many legal arguments about its meaning. The new law also may spur plaintiffs' lawyers to disaggregate their cases and file smaller, single-state class actions in an attempt to avoid federal court.

2) Does the new law apply to *pending* cases? The clear answer is *no*. Although the House previously had proposed to make the law retroactive, it acceded to the Senate's version, which applies only to cases commenced on or after the date of enactment.

3) Does the Act change the *substantive* law? The clear answer is that it does *not* change the underlying rights afforded by federal or state statutes or common law. It largely imposes *procedural* changes. However, the law does impose some limits on how to apportion recoveries by class members and their lawyers.

4) Is the Act *constitutional*? According to Supreme Court decisions, "complete diversity" has long been required by the diversity statute, but is not required by the Constitution. However, because the federal courts are vested with limited jurisdiction, they are instructed to interpret jurisdictional provisions narrowly. It is likely that there will be challenges as to how broadly to construe the powers conferred by the Act.

5) How *many* cases will be affected? It remains to be seen. Proponents and opponents of the bill offered widely different predictions during Senate debate. A study last year concluded that more than half the cases in state courts would remain there, although the impact will vary by state. The Congressional Budget Office has predicted that a few hundred additional cases would be heard in federal court each year. Because the law is complex and in some respects ambiguous, federal judges who are reluctant to assume jurisdiction over traditional state cases may construe the statute narrowly. In addition, many cases may fall in the gray area between "1/3 and 2/3," where federal judges are given discretion to turn them away, and could do so by making fact findings that the statutory requirements are not met.

6) Is it *better* for such cases to be decided in *federal court*? That depends on your point of view. Companies that are the target of class action cases generally should welcome the Act. The consensus of the business community, which supported passage of the bill, is that federal courts are more consistent in how they resolve class issues and are less overburdened. The Act takes truly national cases out of local courts that may have parochial interests, particularly the magnet courts in a few states that have been much criticized.

7) Is the new settlement review process a *good or bad* thing? This also depends on your point of view. There is a mandatory process for the timing and content for notice to the United States Attorney General and applicable state authorities. There also is a mandatory 90-day window for these watchdogs to consider the settlement, thus slowing down approval. Prosecutors could be spurred to challenge proposed settlements or commence their own investigations and lawsuits. On the other hand, compliance with the notification procedures, coupled with the *lack* of a challenge, improves the odds that a settlement will be final and binding on class members.

8) Are *coupon settlements* a thing of the past? The Act continues the trend of questioning settlements that use coupons to compensate consumer class members for losses. Companies that might have desired to resolve claims by issuing coupons that can be applied to future purchases must consider the value of *all* the coupons. There may be a hearing on the value of redeemed coupons, and the court can order that unused coupons be donated to charity or the government.

9) How does the Act affect the *strategy* for class cases? The new grounds for jurisdiction will require an early investigation into the number of class members, where they live and suffered injury, the total size of their claims, and the other factors listed in the Act. In addition, counsel must pay attention to these factors throughout the life of the case, since the statute makes clear that they apply even *after* class certification.

10) How does the Act affect the *selection of counsel*? The new rules for removing class actions to federal court, and the analysis for deciding which cases will stay in federal court, will require defendants to hire counsel who are familiar with the new rules and federal class action practice in general.

CONTACT INFORMATION

If you have any questions or would like to learn more about this topic, please contact the partner who normally represents you, or:

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