

Class Action Fairness Act of 2005

2005-02-18

President Bush today signed into law "The Class Action Fairness Act of 2005." The Act's statutory amendments expand federal jurisdiction over class actions, and create new rights to remove class actions from state to federal court, including a valuable right to appeal district court orders rejecting attempted removals. The Act also implements a "consumer class action bill of rights," which requires district courts to subject "coupon" settlements to heightened scrutiny, and limits the extent to which plaintiffs' lawyers can rely on coupon value in seeking attorneys' fees. Potentially complicating some settlement efforts, the "bill of rights" further requires settling defendants to give early notice of any proposed class action settlement to various federal and state regulators in all states in which class members reside. The amendments made by the Act apply to any civil action commenced today or in the future; the Act is not retroactive to existing class actions.

Overview of Legislation

I. 1. **Expansion of Diversity Jurisdiction for Class Actions**

- A. 1. The Act establishes federal jurisdiction over class actions in which the total amount in controversy for all class members exceeds \$5,000,000 (regardless of the amount of any single class member's claim) and any plaintiff class member is a citizen of a different state from any defendant. Complete diversity of citizenship between all plaintiffs and all defendants is no longer required for class actions. (The Act also expands jurisdiction over class actions involving citizens of foreign states and citizens of the United States.)
- B. 2. The Act covers any case where class action status is claimed pursuant to Rule 23 or a comparable state rule, but does not reach so-called "private attorney general" actions where the named plaintiff seeks to act for the benefit of the general public.
- C. 3. The Act's expansion of jurisdiction does not apply to cases in which:
 1. Two-thirds or more of the plaintiff class members, and the primary defendants, are all citizens of the state in which the action was filed;
 2. Two-thirds or more of the plaintiff class members, and any key defendant (i.e., any defendant alleged to have caused injury and from whom relief is sought), are citizens of the state in which the action was filed, if injuries occurred in that state and no comparable class action was filed during the preceding three years;

3. The primary defendants are states, state officials or other government entities against whom the district court might be foreclosed from ordering relief;
 4. The proposed plaintiff class contains fewer than 100 members; or
 5. The class action at issue solely involves a claim (i) concerning a "covered security" as defined under the Securities Act of 1933 and the Securities Exchange Act of 1934; (ii) that relates to the governance of a corporation; or (iii) that relates to the "rights, duties, and obligations relating to or created by or pursuant to any security."
- D. 4. The district court has discretion under the Act whether to assume jurisdiction over a class action where between one- and two-thirds of the plaintiff class members, and the primary defendants, are from the same state in which the action was filed.
1. The Act lists factors the court should consider in exercising that discretion including, among others, whether the case raises national issues, what law will apply and whether the plaintiffs have sought to artfully plead around federal jurisdiction.
- E. 5. The Act introduces "mass actions."
1. A "mass action" is a civil action seeking monetary relief on behalf of 100 or more persons, in which the plaintiffs propose to try the claims jointly because they involve common questions of law or fact.
 2. A case is not a mass action if (i) all the claims arise in the state of filing and caused injury in that state or contiguous states, (ii) the claims were joined on a defendant's motion, (iii) it is a private attorney general action, or (iv) the claims are joined for pretrial purposes only.
 3. Federal jurisdiction will exist over a mass action that meets the Act's new relaxed requirements regarding diversity of citizenship (i.e., if any plaintiff and any defendant are citizens of different states), but the claim of each plaintiff in a mass action must exceed the minimum amount in controversy set forth in 28 U.S.C. 1332(a) (currently \$75,000).
 4. A mass action cannot be transferred to another court by the judicial panel on multidistrict litigation unless a majority of the plaintiffs request such a transfer.
- F. 6. The Act limits the citizenship of an unincorporated association to the state in which it has its principal place of business and the state "under whose laws it is organized." This is a change from current law, which makes such an association a citizen of the state of all its members.

II. 2. **Expansion of Removal Rights for Class Actions**

- A. 1. The Act abolishes for class actions the current rule that a case cannot be removed from state to federal court based on diversity of citizenship more than one year after its commencement, allowing removal whenever the grounds for diversity jurisdiction

arise.

- B. 2. The Act abolishes for class actions the current rule that a defendant cannot remove a case based on diversity of citizenship from a court of a state in which the defendant is a citizen, allowing removal "without regard to whether any defendant is a citizen of the state in which the action is brought."
- C. 3. The Act abolishes for class actions the rule that unanimous consent of all defendants is required for removal, allowing any single defendant to remove a class action.
- D. 4. The Act abolishes for class actions the rule that a district court order remanding a case to state court is not reviewable on appeal, stating that such review is allowed if sought "not less than seven days after entry of the order." The exact filing deadline for such an appeal is unclear at this point, as the Act appears to require only that the appeal be filed a week or more after the remand order. (We question whether the drafters actually intended to require appeals to be filed within a week of remand particularly given the companion provisions expediting the resolution of such appeals but the Act's text plainly imposes no such limitation. Given this uncertainty, the safest bet may be to file the appeal exactly seven days after entry of the remand order.)

III. 3. Expanded Review of Coupon Settlements and Limitation on Valuation of Coupons for Purposes of Attorneys' Fees

- A. 1. The Act provides that, for purposes of calculating or awarding attorneys' fees, only the value of coupons that are actually redeemed shall be considered (as opposed to current practice which has sometimes allowed attorneys' fees to be based in part on the notional value of all coupons awarded).
 - 1. The Act grants the court discretion, on motion of a party, to receive expert testimony on the actual value to class members of redeemed coupons.
- B. 2. The Act also provides that, if a proposed settlement includes coupons "and a portion of the recovery of the coupons is not used to determine the attorney's fee to be paid to class counsel, any attorney's fee award shall be based upon the amount of time class counsel reasonably expended working on the action." It is not clear, however, how this provision should be construed in the context of its companion provisions.
- C. 3. Before approving a coupon settlement, the court must hold a hearing to determine whether the settlement is fair, reasonable and adequate for class members, and must make written findings supporting its ruling.

IV. 4. Miscellaneous Provisions

- A. 1. The Act allows the court to approve a settlement resulting in a net monetary loss to any class member only if the court makes a written finding that non-monetary benefits to the class member substantially outweigh the monetary loss.
- B. 2. The Act prohibits the court from approving a settlement providing for payment of greater sums to certain class members solely on the basis that those class members are located closer to the court.

- C. 3. The Act requires that, within ten days of the filing of a proposed settlement, each settling defendant must serve upon appropriate federal and state officials including officials of each state in which a plaintiff class member resides notice of the proposed settlement, including pleadings, notices, the settlement agreement and any contemporaneous side agreements, a list of class members and likely recoveries by state, or a reasonable estimate of same, and any pertinent judicial orders or opinions.
1. A class member may elect not to be bound by the settlement if the required notice is not given.
- D. 4. Within one year of enactment, the Judicial Conference of the United States must prepare and transmit to the Congressional Judiciary Committees a report on class action settlements with recommendations on settlement best practices.

Points to Consider

Federal Jurisdiction over Large, Nationwide Class Actions

- The Act will allow defendants to remove large, nationwide class actions from state to federal court, and prevent plaintiffs' lawyers from filing cases in notorious, pro-plaintiff jurisdictions. The long-running debate over whether each class member must satisfy the \$75,000 "amount in controversy" requirement for federal diversity jurisdiction will be put to rest, except that the requirement will remain where the removal involves a "mass action" that is covered under the Act.
- This expansion of federal jurisdiction will increase the number of large cases in already-crowded federal courts, particularly in those federal jurisdictions where plaintiffs' lawyers believe that there are favorable precedents on substantive and Rule 23 motions. This in turn should lead to increased attention to venue and forum non conveniens issues in many cases.
- Plaintiffs' lawyers will seek to avoid federal jurisdiction when possible by filing complaints in state court that purport to be only single-state class actions, which are not covered by the Act. A defendant could face a number of different statewide class actions arising out of the same event or transaction that raises the same issues. This may lead to extensive threshold litigation (most likely in the federal court) over the true composition of the alleged class.
- If multiple class actions are brought against the same defendant raising the same claim, and those class actions are removable to federal court under the Act, the defendant will have the ability to centralize those class actions in a single forum under the multidistrict litigation procedures. However, there is still no mechanism to transfer or consolidate multiple single-state class actions filed in state court if those class actions cannot be removed to federal court.
- If a case is not a pure nationwide or statewide class action, the Act gives the courts discretion to decide whether the case is removable to federal court. Until precedent

develops, there will be uncertainty as to how courts will exercise that discretion and whether courts will permit discovery on these issues before any remand decision. As a practical matter, it will often be difficult to determine where class members reside when the complaint is filed, particularly because plaintiffs seeking to avoid removal will allege that their class is limited primarily to statewide members. Fortunately, the Act creates a right of appeal on a remand order that does not otherwise exist.

- Critics complain that the Act will limit the number of class actions that are filed or certified. That may be correct in certain notorious state courts. But a recent study published by the Federal Judicial Center found that federal and state judges were almost equally likely to certify cases as class actions. Specifically, in an examination of cases that were removed to federal court, the study found that state judges certified a class in 22% of the cases that were remanded to state court, while federal judges certified a class in 20% of the cases that remained in federal court. The study also found that federal judges were more likely than state judges to issue rulings denying class certification, while state judges were more likely to take no action regarding class certification. (This last finding might show that defendants are more inclined to settle a class action filed in state court prior to a decision on class certification.)

Coupon Settlements

- The Act requires courts to look very closely at coupons that are used to settle class actions, and to reduce plaintiffs' lawyers fees to reflect redemption rates if "coupons" are used. Plaintiffs' lawyers will also have to wait the entire redemption period, likely a year or longer, before receiving those fees. Since plaintiffs' lawyers are highly sensitive to fee issues during settlement, it will be much more difficult to persuade them to accept any benefits other than cash to settle class actions. Similarly, the "findings and purposes" of the Act will make it harder for courts to approve class action settlements that consist mostly of attorneys' fees. These coupon provisions will likely drive up the cost of resolving class actions, potentially prolonging or resulting in more trials of such cases.
- The Act will also increase the need for parties to use expert testimony to establish the value to class members of any coupons for purposes of establishing that the settlement is fair. Because the Act provides for such a hearing only "upon the motion of a party," there may be more motions by objectors to intervene so that they can call their own experts.
- The Act does not define what a coupon is, and there is substantial uncertainty on this issue. Some critics of class actions refer to any settlement benefits other than cash as coupons. Others define coupons as any benefit that requires the class member to take some action to access the benefit. Still others refer to coupons as any benefit that requires class members to spend money to access the benefit. Since many class action settlements can only be achieved as an economic matter if "in kind" benefits rather than cash are used, the courts' interpretation of the word "coupon" will be significant. Similarly, it is not clear from the Act whether the same scrutiny must be given to coupons if the settlement includes a mixture of cash and in kind benefits.
- Until courts provide further guidance on the scope of the coupon provisions, the absence of

clarity might prompt more objections to class settlements, driving up their costs. Conversely, the scrutiny of coupon-based settlements (and the resulting disincentives to craft them) might reduce the number of opt-outs from settlements insofar as settlements might increasingly provide for "automatic" relief to class members (as opposed to relief requiring redemption activity) that is not coupon-based.

Notice to Regulators

- The Act requires notice of settlements to regulators and state attorneys general who might respond by seeking additional benefits for their constituents. This will almost certainly result in more settlements that are subject to termination if the regulators or attorneys generals' demands are unreasonable. Further, the need to address the potentially competing and expensive demands of multiple regulators might drive up settlement costs and otherwise encumber the settlement process to a degree that hampers, if not eliminates, defendants' ability to achieve a practical and cost-effective resolution of some class claims. These risks may counsel advance consultation with relevant regulators and budgeting for the inevitable add-on requests.
- In addition to potentially impeding settlements of class actions, the notice provisions can also be expected to prompt follow-up regulatory exams or enforcement proceedings related to the allegations made in class action complaints.
- The penalties for noncompliance with respect to the notice provisions are particularly onerous because they create a grave risk of future collateral attack.

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