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Focus

Class-Action Act Puts New Limits on Plaintiffs, Venue

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Congress has handed President Bush one of the first victories of his second term by passing the Class Action Fairness Act. But who are the winners and losers?

Supporters of class action reform say it will eliminate the practice of filing nationwide class actions in plaintiff-friendly state courts and then extorting settlements that pay huge sums to the plaintiffs attorneys but little or nothing to class members.

The new law's detractors say it will reduce the number of class actions filed, thereby reducing consumer protection and making businesses less accountable.

The Class Action Fairness Act expands federal diversity and removal jurisdiction in class actions. Under the new law, federal courts will have original jurisdiction over any class action in which any class member is a citizen of a state different from any defendant and the total amount in controversy exceeds \$5 million, subject to several limitations discussed below.

These new rules also apply if any member of the class or any defendant is a foreign state or a citizen of a foreign state. The new law applies only to lawsuits filed after its enactment and will not affect existing cases.

The Class Action Fairness Act represents a significant departure from existing law. The new law aggregates all class members' claims to satisfy the amount in controversy requirement. Under prior law, aggregation was not permitted and each class member's

claim had to be worth \$75,000 or more to satisfy the amount in controversy requirement. Because most class members' claims typically are worth less than \$75,000, the "no aggregation" rule prevented federal diversity jurisdiction in most cases.

The new law imposes new limits on a plaintiff's ability to "destroy" diversity by naming a local defendant. Under existing law, a plaintiff could name a non-sham defendant to destroy diversity. Now, subject to exceptions discussed below, diversity exists in a class action if any defendant is from a different state from any class member.

The Class Action Fairness Act also represents a significant departure from existing removal rules. The new law provides that any class action may be removed to federal court "without regard to whether any defendant is a citizen of the State in which the action is brought" and without the consent of all defendants. The elimination of the rule precluding "local defendants" from removing class actions will make it more difficult for plaintiffs to avoid removal to federal court.

The new law also provides that a defendant can appeal a district court's order remanding a class action to state court. Current law does not allow for appeal of remand orders. This change could lead to fewer remand orders as district courts could be subject to immediate review.

The class action reform is not without limits, however. The federal district court must decline jurisdiction if two-thirds or more of all proposed class members and either the "primary defendant" or at least

one "significant" defendant are citizens of the state in which the action was filed.

This provision was intended to ensure that state courts will continue to exercise jurisdiction over intrastate class actions. The new law leaves open the question of who is a "primary defendant" or "significant" defendant, and there will probably be substantial litigation over those issues.

The federal district courts also may decline to exercise jurisdiction over a class action in which the "primary" defendant and a third to two-thirds of the class members are citizens of the state in which the action was originally filed.

The new law provides several factors that the court must weigh when exercising its discretion to decline jurisdiction, including whether the claims involve matters of national or interstate interest; whether the claims will be governed by the laws of the forum state; whether there is a nexus between the forum state and either the class members, the alleged harm or the defendants; whether the number of forum-state class members is substantially larger than those from any other state; whether the plaintiff tried to avoid federal jurisdiction; and whether other class actions have been filed asserting similar claims during the previous three years.

How these factors will be applied remains to be seen.

The new law does not apply to any class action in which the primary defendants are states, state officials or certain other government entities, or if the number of all proposed class members is less than 100.

The new diversity jurisdiction rules do not apply to certain securities class actions or class actions pertaining to the internal affairs or governance of corporations.

The new class action rules will apply to “mass actions” in which monetary relief claims of 100 or more persons are proposed to be tried together, subject to certain limits.

The Class Action Fairness Act requires that certain state and federal officials be notified of class action settlements. It also provides for increased judicial supervision of “coupon settlements,” including attorney fees limitations and authorization for disgorgement of unredeemed coupons.

Under the new law, an award of attorney fees may be based either on the value of the coupons that are redeemed or the amount of time the attorney reasonably spent working on the case, and it must include an appropriate fee for obtaining equitable relief. This provision probably will reduce the number of coupon settlements and may encourage plaintiffs to insist on some form of equitable relief.

The court also may require that a portion of the value of unclaimed coupons be distributed to charitable or governmental organizations. This provision may not be as significant in California because California law already requires distribution of the unpaid residual of a class action settlement.

Final approval of a proposed settlement cannot be issued until 90 days after state and federal officials receive the required notice. Class members are not bound by any settlement that fails to comply with

these notice requirements. Defendants in heavily regulated industries will need to evaluate whether their settlements will attract the attention of regulators who could pursue their own lawsuits or administrative actions.

How will plaintiffs and defendants respond to the new law? Plaintiffs seeking to avoid federal court will be severely limited. Plaintiffs will be able to avoid federal court only if they sue in the state where the defendant is a citizen and limit the class definition to citizens of that state. A defendant corporation resides in the state where it is incorporated or where it has its principal place of business.

If plaintiffs want to avoid federal court, the new law encourages them to limit the class definition to local plaintiffs and either sue where the defendant resides or add a local defendant who either is a “primary defendant” or from whom “significant relief” is sought.

If a plaintiff expands the class definition beyond the forum state, it risks removal to federal court. Further, defining the class as including no fewer than “two-thirds” of citizens of the forum state could make class certification inappropriate. Limiting the class definition in this way would impose an arbitrary line that would make it difficult, if not impossible, to ascertain the class.

Plaintiffs counsel will want to think carefully before trying to avoid federal jurisdiction. If plaintiffs seek to limit the class definition to stay in state court, they risk having their case stayed in favor of a broader, nationwide class

action filed in federal court.

There will probably be substantial litigation over proving the citizenship of at least a third or more than two-thirds of the class members. Ordinarily, the removing defendant has the burden of proving jurisdiction. Defendants will need to do a substantial amount of investigation and may be subject to early discovery into the identity and location of potential class members.

The increased scrutiny and reduced attorney fees for coupon settlements will probably affect defendants more than consumers. The dirty little secret in the class action field is that most cases can be settled quickly by “paying off” the plaintiffs lawyer and giving coupons to class members.

Everyone knows that most coupons are seldom redeemed and, therefore, the settlement costs less. By imposing limits and increased scrutiny on coupon settlements, the new law may make resolving class actions more difficult and more costly for defendants.

The lasting impact of the Class Action Fairness Act may not be known for several years. Whether it results in a system that is fairer to businesses and consumers depends on how it is implemented by attorneys and judges around the country.

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