

The Class Action Fairness Act of 2005: The Federalization of Class Actions

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On February 18, 2005, President Bush signed into law the Class Action Fairness Act of 2005, an act that promises to dramatically impact multi-state class action practice. This Act expands federal jurisdiction over class actions, accelerates appellate review of orders granting or denying a remand, limits coupon settlements, and restricts other class action practices. The key features of the Class Action Fairness Act and its potential consequences are summarized below.

EXPANSION OF DIVERSITY JURISDICTION

The Act dramatically expands federal courts' diversity jurisdiction, which will allow the removal of most large, multi-state class actions to federal court. This expansion is the most significant aspect of the new law. No longer will complete diversity jurisdiction between all plaintiffs and all defendants be required to invoke the jurisdiction of federal courts. Nor will a class member (or all class members, depending on the circuit at issue) be required to have a claim in excess of \$75,000. Instead, 28 U.S.C. § 1332 has been amended to provide district courts original jurisdiction over any civil action in which (1) the *aggregate* amount in controversy exceeds \$5 million exclusive of interest and costs, and (2) diversity of citizenship exists between *one* plaintiff class member and *one* defendant. The diversity of citizenship requirement is met where *any* plaintiff (not limited to a named plaintiff) is a citizen of a state that is different from *any* defendant's state, or where the action is between a citizen of a state and a foreign State or citizen.

The Act identifies certain circumstances in which a district court may or must decline to exercise this expanded subject matter jurisdiction. A court *may* decline to exercise jurisdiction "in the interests of justice and looking at the totality of circumstances," if greater than one-third but less than two-thirds of the members of the aggregate

proposed plaintiff classes and the primary defendants are citizens of the state where the action was originally filed. In making such a determination, the court must consider the following six factors: (1) whether the claims involve matters of national or interstate interest; (2) whether the claims will be governed by the laws of the state where the case was originally filed or by the laws of other states; (3) whether the class action has been pleaded in a manner that seeks to avoid federal jurisdiction; (4) whether the action was brought in a forum with a distinct nexus with the class members, the alleged harm, or the defendants; (5) whether the number of citizens of the state of original filing in all proposed plaintiff classes in the aggregate is substantially larger than the number of citizens from any other state and the citizenship of other proposed class members is dispersed; and (6) whether during the three-year period preceding filing, one or more other class actions asserting the same or similar claims on behalf of the same persons have been filed. The parties may need to engage in significant discovery before a district court would be in a position to evaluate these factors in connection with a motion to remand or dismiss.

A federal court *must* decline to exercise jurisdiction over a class action in which (1) greater than two-thirds of the members of the aggregate proposed plaintiff classes are citizens of the state in which the action was originally filed; (2) at least one defendant (from whom significant relief is sought and whose alleged conduct forms a significant basis for the claims asserted by the class) is a citizen of the State in which the action was originally filed; and (3) the principal injuries were incurred in the state in which the action was originally filed, so long as no other class action has been filed within the preceding three years asserting the same or similar factual allegations against any of the defendants. A federal court

must also decline to exercise jurisdiction where two-thirds or more of the members of all aggregate proposed plaintiff classes and the primary defendants are citizens of the State in which the action was originally filed.

The new jurisdictional provisions are subject to a few other limited exceptions. For example, a federal court may not exercise jurisdiction over a class action based on state law claims brought primarily against states, state officials, or “other governmental entities against whom the district court may be foreclosed from ordering relief.” And the Act does not apply to a state law class action in which the total number of class members is less than 100. Finally, the Act excludes from its purview most shareholder class actions or derivative suits based on state corporate law.

FAST-TRACK APPELLATE REVIEW

The Act modified 28 U.S.C. § 1447(d) to provide courts of appeals discretionary appellate jurisdiction over a district court’s order granting or denying a motion to remand a class action, subject to an expedited timetable. An appellant has seven days from the date of the order to file an application for permission to appeal. If the appellate court accepts jurisdiction, it must render judgment within 60 days after the appeal is accepted, unless (a) all parties agree to an extension; or (b) good cause is shown for a delay, in which case any extension is limited to ten days.

COUPON SETTLEMENTS AND ATTORNEYS’ FEES

A court may approve a coupon settlement only after holding a hearing and finding in writing that the settlement is “fair, reasonable and adequate to class members.” If class counsel has a contingency fee arrangement, then any award of attorneys’ fees in a coupon settlement must be valued by the amount of coupons redeemed, rather than the value of coupons issued.

OTHER PROVISIONS

Other prohibitions on settlement. The Act forbids a district court from approving a proposed

settlement involving payments to class counsel that would result in a net monetary loss to class members, absent a finding that the loss is substantially outweighed by nonmonetary benefits. The Act also forbids a proposed settlement that provides for greater sums to certain class members based simply on their geographical proximity to the court.

Notice and reporting provisions. The Act provides for notification to state and federal officials with primary regulatory or supervisory responsibilities over defendants before a proposed settlement can be approved. The Act also directs the Judicial Conference of the United States to draft a report on class action settlements containing recommendations on best practices for ensuring fairness for class members and appropriate fees for counsel.

Effective Date. The Act applies to any civil action filed on or after February 18, 2005 and does not affect class action cases filed before and pending on that date.

ANALYSIS OF POTENTIAL CONSEQUENCES

The stated purposes of the Act are to reduce frivolous class actions, discourage forum shopping, and curtail class action settlements that provide significant fees to counsel while only negligible benefits to class members.

The Act undoubtedly will have its intended effect of transferring much of the multi-state class action caseload from state to federal courts. It remains to be seen whether Congress’ goal of limiting the type and number of cases that can proceed as class actions also will be accomplished. Many have speculated that fewer multi-state classes will be certified, particularly in the consumer fraud context, because the application of the consumer protection laws of multiple states will make class actions unmanageable.

There may be many unintended consequences as well. Plaintiffs’ counsel may try to circumvent the Act by filing multiple actions in the federal

courts of multiple states, and then seeking to consolidate or coordinate the cases through 28 U.S.C. § 1407, the statute governing multidistrict litigation. Such a strategy may increase litigation costs for defendants.

Similarly, the new rules discouraging coupon settlements may make it more difficult for defendants to “buy off” plaintiffs’ class counsel, forcing defendants into the tougher choice of paying a monetary settlement or risking going to trial.

Defendants also may be forced to provide confidential information, such as customer lists, early in the litigation to enable the court to make a determination on the percentage of the potential plaintiff class residing in the forum state.

Finally, in states like Texas that already have passed measures designed to restrict class actions, the expansion of federal jurisdiction may prove to be a boon to plaintiffs’ counsel. In Texas, federal jurisdiction may provide plaintiffs’ counsel with a means to circumvent the fee-limiting restrictions imposed under House Bill 4.

Whether the Class Action Fairness Act results in more “fairness” to litigants remains to be seen. However, there can be no doubt that the Act will fundamentally reshape class action practice throughout the country.