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COMPLEX LITIGATION

Class Litigants Face Tougher Forum

Will closer scrutiny by federal judges curb costs?

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The proper role of class actions alleging multistate harm has long been a hot button issue. An emerging trend in federal court has been to closely scrutinize efforts to use class actions as a vehicle for mega-cases that attempt to litigate state law claims of thousands of class members from many states. Particularly when the claims of the prospective class members rest on the divergent laws of multiple states, federal courts have been reluctant to find the commonality or predominance elements of Federal Rule of Civil Procedure 23 satisfied. This increasing scrutiny of proposed class actions was reinforced with the 1998 amendments to Rule 23, permitting interlocutory appeal of class certification decisions. See Fed. R. Civ. P. 23(f).

As the federal courts have become more exacting in their application of Rule 23, the perception has grown that some state courts are more "class action friendly." This phenomenon has led to complaints of forum shopping for sympathetic jurisdictions that are more prone to impose a single state's view of the law on corporate defendants' nationwide business practices, sometimes with enormous resulting liabilities. Also, critics have complained that many class actions are prosecuted largely for the benefit of plaintiffs' counsel, who often receive millions in fees while returning negligible recoveries to each individual class member.

In response to these perceived inequities, Congress passed the Class Action Fairness Act of 2005, which the president signed on Feb. 18, 2005. CAFA makes sweeping changes to the jurisdictional provisions of Title 28 of the Untied States Code. These changes create federal subject matter jurisdiction over most multistate class actions. In addition, CAFA seeks to curb perceived abuses involving "coupon settlements" and attorney fee awards to class counsel.

Expansive Federal Court Jurisdiction

Diversity redefined. For 200 years, federal diversity jurisdiction has required the presence of "complete diversity." The presence on both sides of the "versus" of any citizens of the same state has defeated complete diversity and robbed the federal courts of jurisdiction under 28 U.S.C. § 1332. See, e.g., *Strawbridge v. Curtiss*, 7 U.S. 267 (1806). This has enabled plaintiffs' counsel to keep exclusively state-law based class actions in the state courts, even when the purported class is nationwide. For example, suppose three named class representatives from New Jersey brought a class action, on behalf of themselves and class members residing in thirty other states, against several corporations, one of which was headquartered in New Jersey. Under pre-CAFA law, this action could not be adjudicated in federal court because complete diversity was absent.

CAFA removes this impediment by replacing the complete diversity requirement with a minimal diversity requirement. CAFA amends Section 1332 to provide for diversity jurisdiction where (A) any class member is a citizen of a state different from any defendant, (B) any class member is a foreign state or citizen/subject of a foreign state and any defendant is a citizen of a state, or (C) any class member is a citizen of a state and any defendant is a foreign state or citizen/subject of a foreign state.

The sweeping nature of this change is apparent. Joinder of a non-diverse defendant solely to defeat diversity is no longer possible. Moreover, it suffices that diversity exists only as to unnamed class members, even if all the named class representatives are citizens of the same state as all the defendants. These changes effectively vest the federal courts with jurisdiction over virtually all class actions where the alleged class is multistate. CAFA does not apply where the proposed class has fewer than 200 members, or where the primary defendants are states, state officials or "other governmental entities against which the district court may be foreclosed from ordering relief." Section 1332(d)(5)(A). Actions related to securities or to the internal affairs of a corporation are also excluded. This has been referred to as the "Delaware carve-out," as its effect is to prevent state-law based

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shareholder derivative cases from winding up in federal court.

Aggregation of damages. The complete diversity rule was not the only former roadblock to jurisdiction in class actions. Section 1332 also contains a minimum "amount in controversy" requirement of $75,000. Under pre-CAFA law, the problem in the class action setting was that the Supreme Court had held in *Zahn v. International Paper Co*., 414 U.S. 291 (1973), that every class member had to have a claim for that amount. Aggregation of thousands of smaller claims to achieve $75,000 was not permitted.

CAFA overrules *Zahn*'s non-aggregation holding. CAFA raises the minimum amount in controversy for class actions to $5 million, but provides that the class members' claims shall be aggregated to measure that amount. This amendment invites into federal court the typical mass tort or consumer class action, comprised of thousands of class members with small individual claims.

Removal restrictions eased. Merely expanding diversity jurisdiction would not have achieved the congressional purpose of federalizing multistate class actions, if longstanding roadblocks to removal jurisdiction had remained. Accordingly, CAFA also makes significant changes to the rules governing removal. First, CAFA eliminates the impediment in 28 U.S.C. § 1441(b) that formerly barred removal from state court if any defendant was a citizen of the forum state. 28 U.S.C. § 1453(b). Secondly, CAFA eliminates the requirement that all defendants consent to removal. Id. Thirdly, CAFA eliminates the one-year drop-dead deadline found in 28 U.S.C. § 1446(b) that formerly prevented removal of a case after one year even if changes in the case create diversity jurisdiction for the first time. Congress apparently perceived that this one-year deadline invited mischief. For example, plaintiff's initial complaint could have restricted the class definition to citizens of a single state, only to be amended to a nationwide class a year later, thus defeating removal. Finally, CAFA provides that the courts of appeal may accept an appeal from either the grant or denial of removal of a class action, 28 U.S.C. § 1453(c), thus eliminating the ban on appellate review of remand orders found in 28 U.S.C. § 1447(d).

Abstention. While expanding federal jurisdiction to encompass virtually every multistate class action, Congress simultaneously created categories of cases in which the district courts either may or must decline to exercise jurisdiction. Both categories — permissive and mandatory abstention — involve matters where there is a significant nexus to the forum state.

CAFA permits the district court to abstain when more than one-third but less than two-thirds of the members of all proposed plaintiffs classes and the "primary defendants" are citizens of the original forum state. When this threshold is met, CAFA directs the district court to consider an array of factors in deciding whether to abstain. These factors involve an exploration of the nexus between the forum state and the action, and are set forth at length in Section 1332(d)(3).

Where more than two-thirds of the proposed members of all classes in the aggregate are citizens of the original forum state, CAFA requires the district court to abstain if either: (A) the "primary defendants" are citizens of the original forum state, or (B)(i) at least one defendant from whom significant relief is sought and whose conduct is a significant basis for the claims is a citizen of the original forum state, (ii) "principal injuries" from the conduct of each defendant were incurred in the original forum state, and (iii) no other similar class action has been filed against any of the defendants during the preceding three years.

Note: CAFA contains a drafting error, whereby certain prefatory language necessary to make this section of the statute read properly was omitted. Also, with respect to one mandatory abstention category, CAFA mandates that "greater than two-thirds" of the plaintiff class be citizens of the forum state, while the second mandatory abstention category requires instead "two-thirds or more." It is unlikely that Congress thought two-thirds sufficient in one instance, but two-thirds plus one necessary in the other, but the statute does, in fact, create that distinction.

Application to "mass actions." CAFA's jurisdictional expansion applies not only to representative class actions, but also to what CAFA dubs "mass actions." Mass actions are, with certain enumerated exceptions, any cases "in which monetary relief claims of 100 or more persons are proposed to be tried jointly on the ground that the plaintiffs' claims involve common questions of law or fact." Section 1332(d)(11). Although such cases may be brought as mass joinder cases, rather than as class actions, CAFA's jurisdictional provisions will apply, but only to those individual claims that exceed Section 1332's $75,000 amount in controversy requirement. The aggregation of smaller claims is not permitted for "mass actions."

CAFA provides one difference in treatment for "mass actions." Unlike class actions, mass actions removed to federal court under CAFA may not thereafter be transferred by the Judicial Panel for Multidistrict Litigation pursuant to 28 U.S.C. § 1407, unless a majority of the plaintiffs request such a transfer.

Consumer Class Action Bill of Rights

In addition to the CAFA's jurisdiction changes, new Chapter 114 to Title 28 contains a "Consumer Class Action Bill of Rights," which attempts to address perceived abuses of the class action device. Seeking to curb attorneys' fee awards that grossly outweigh the value of the settlement to class members, the "Bill of Rights" provides new rules for contingent fees where the settlement involves giving coupons to class members. Elevated judicial scrutiny will be applied to coupon settlements, and defendants offering coupons may be required to pay a portion of the value of unclaimed coupons to charitable organizations. In addition, the new provisions contain detailed notice requirements that could invite scrutiny of settlements by the U.S. Attorney General, state attorneys general or regulating authorities.

Coupon settlements. In an effort to remedy the potential for abuse, CAFA makes important changes in contingent fee awards related to coupon settlements. If a proposed settlement provides for recovery of coupons by class members, "the portion of any attorney's fee award to class counsel that is attributable to the award of the coupons shall be based on the value to the class members of the

coupons that are redeemed." 28 U.S.C. § 1712(a). The court may accept expert testimony to determine the value of the redeemed coupons. 28 U.S.C. § 1712(d). The requirement that a contingent fee be based on the value of coupons redeemed represents a significant departure from pre-CAFA practice, which had permitted counsel fees to be based upon the gross value of the coupons provided to the class. When and how the courts are to determine the value of redeemed coupons is unclear. In any event, these changes will significantly reduce the permissible counsel fee awards in coupon settlements.

Under some circumstances, the actual value of redeemed coupons may not represent an appropriate basis for counsel fee award. Apparently in recognition of this potential, the statute specifically preserves the ability of class counsel to seek instead an award of fees based upon time actually worked, as well as the ability to use the so-called loadstar method with a multiplier. 28 U.S.C. § 1712(b)(1) and (2).

In cases where a proposed settlement includes both recovery of coupons and equitable relief, section 1712(c) now requires that the portion of the attorney's fee award attributable to coupons "shall be calculated in accordance with subsection (a)" (i.e., the value of coupons redeemed) and the portion of the fee attributable to the equitable relief "shall be calculated in accordance with subsection (b)" (i.e., time spent working on the action). See 28 U.S.C. § 1712(b) and (c).

While CAFA specifically addresses fee awards calculated on a mixed basis of coupon and equitable relief, the statute is silent on settlements involving both coupons and cash. Presumably, the traditional rules regarding the percentage of recovery could be applied to the cash portion of the settlement. However, since the language of subsection (b) is not particularly clear, an argument could be made that a combined coupon and cash settlement would be subject to the time spent/lodestar approach set forth in § 1712(b). See 28 U.S.C. § 1712(b). If the courts were to interpret § 1712(b) to also include combined coupon and cash settlements, it would represent a significant change in practice and may have a chilling effect on coupon settlements.

CAFA also requires "Judicial Scrutiny of Coupon Settlements" in that the court may approve such settlements "only after a hearing to determine whether, *and making a written finding that*, the settlement is fair, reasonable and adequate for class member." 28 U.S.C. § 1712(e) (emphasis added). This requirement for "judicial scrutiny" is not a significant change in existing practice because Rule 23 has always required the court to conduct a hearing and approve any settlement only if it is "fair, reasonable and adequate." Fed. R. Civ. P. 23(e)(c). Now, however, "written findings" must substantiate the fairness, adequacy and reasonableness of the settlement.

Importantly, the "judicial scrutiny" provisions of CAFA now empower the court with discretion to require that a proposed settlement agreement provide for the distribution of a portion of the value of the unclaimed coupons to one or more charitable or governmental organizations, as agreed to by the parties. 28 U.S.C. § 1712(e). Thus, the potential exists for coupon settlements to be significantly more costly for defendants than in pre-CAFA practice. Also, while this distribution may involve a cash payment, the statute prohibits an attorney's fee award being based upon the value of any such charitable contribution. Id.

Notifications to appropriate federal and state officials. The final section of CAFA's "Consumer Class Action Bill of Rights" contains new, detailed notice requirements that represent a significant departure from existing practice. Section 1715 requires that "[n]ot later than 10 days after a proposed settlement of a class action is filed in court," notice of such proposed settlement, providing detailed information and attachments listed in the statute, must be served by "each defendant" upon the "appropriate Federal official" and the "appropriate State official of each State in which a class member resides." 28 U.S.C. § 1715(b). Thus, multistate classes significantly increase the administrative burdens on defendants to complete a settlement.

The "appropriate State official" is the person having "primary regulatory or supervisory reasonability" over the defendant, the licensing authority or, if there is no primary regulator, the state attorney general. 28 U.S.C. § 1715(a)(2). Section 1715 generally defines the "appropriate Federal official" as the attorney general of the United States or in the case of regulated financial institutions, the federal official having "primary federal regulatory or supervisory responsibility with respect to the defendant." 28 U.S.C. § 1715(a)(1)(B).

Significantly, CAFA provides that final approval of a class action settlement "may not be issued earlier than 90 days after the later of the dates on which the appropriate Federal official and the appropriate State official are served" with the required notices, and "[a] class member may refuse to comply with and may choose not to be bound by a settlement agreement or consent decree in a class action" if the class member demonstrates that the required notice was not provided. 28 U.S.C. § 1715(d).

Benefits and Pitfalls of CAFA

The jurisdictional reforms. While the federal courts doubtlessly will not welcome the influx of cases that will accompany their expanded jurisdiction, on balance CAFA's jurisdictional reforms make good sense. CAFA targets those actions where the alleged harm is multistate or even nationwide. Greater uniformity of procedural treatment is desirable, and drawing these cases into federal court should achieve that result.

Moreover, CAFA may achieve significant judicial economy in the context of redundant, multistate cases. When an alleged nationwide "wrong" occurs, seldom does only a single class action result. Counsel throughout the country often file actions in multiple venues, all putatively on behalf of identical or overlapping classes. In federal court, 28 U.S.C. § 1407 allows the inefficiency of multiple, similar actions to be rectified through pretrial consolidation by the Judicial Panel for Multidistrict Litigation. Until now, however, there was no means to bring any state court actions into the consolidated JPML umbrella. Now, CAFA will permit most of these redundant state court actions to be removed to federal court, from which they can then be transferred and consolidated by the JPML.

CAFA is not, however, without its potential drawbacks. To the extent CAFA seeks to discourage nationwide class certification for state-law based

claims, it is a mistake to assume that such nationwide classes are always bad news for corporate defendants. Nationwide class certification can sometimes provide defendants with the most efficient means of settling claims and obtaining a broad, nationwide release. If the plaintiffs bar reacts to CAFA by creatively structuring pleadings and class definitions to invoke the abstention provisions, or by finding new ways to use multiple "mass actions," each with 99 or fewer claimants, the goal of reducing the amount of litigation could potentially be defeated, and the task of settling made all the more difficult.

Moreover, at least until the appellate courts have had a chance to provide guidance, several CAFA provisions seem likely to spawn significant motion practice. For example, CAFA's abstention provisions have plenty of fodder for litigators. Who are the "primary defendants" and how is the district court to distinguish between them and any other defendants? Will this distinction always be apparent on the face of the pleadings, or might some discovery be required? How will the court determine if two-thirds of the class members are citizens of the forum state? This last question seems particularly vexing. Theoretically at least, the exact demographics of the class may not be known until some substantial amount of class discovery, the outcome of which may then trigger mandatory abstention and resulting remand to state court.

Also, at least one constitutional question is possibly lurking in CAFA's broad jurisdictional grant. While Article III does not mandate complete diversity, it does require at least minimal diversity. For diversity jurisdiction to attach, there must be a case or controversy "between citizens of different States." U.S. Const., Art. III, Sect. 2. As previously discussed, CAFA necessitates this minimum diversity by requiring that at least one "class member" be a citizen of a different state from at least one defendant. The problem, however, may be one of timing. The expanded jurisdictional provisions of CAFA expressly apply from the outset of the case, long before the class is certified. Section 1332(d)(8).

Consider the following hypothetical: Three New Jersey citizens bring an action in New Jersey state court, purportedly on behalf of themselves and a nationwide class of consumers of product X, against ABC Company, the New Jersey corporation that sells product X. Assuming the proper amount in controversy, this action is immediately removable to federal court under CAFA because some members of the proposed nationwide class are citizens of a state other than New Jersey. This begs the following question: prior to class certification, is this a "case" or "controversy" "between citizens of different States" as required by Article III? Until the class is certified, none of the absent class members has rights being adjudicated in the action (and may never have), nor are they yet being represented by the named plaintiffs (and indeed may never be). At least some argument can be made that where all of the named parties to the case are citizens of the same state, there is no case or controversy "between citizens of different States" until the proposed class representatives win the right to represent the out of state, absent proposed class members.

The Consumer Class Action Bill of Rights. The Consumer Class Action Bill of Rights seeks to address class action abuses by reigning in class counsel fees perceived to be extraordinarily disproportionate to class members' recovery in coupon settlements. Limiting counsel fees to the value of redeemed coupons may have the effect of ensuring that class counsel have a truly vested interest in achieving a settlement that provides substantial value to the class. Statutorily required written findings of the fairness, adequacy and reasonableness of coupon settlements may also have the intended effect of ensuring the integrity of such settlements.

However, the net effect of the Consumer Class Action Bill of Rights is likely to be that coupon settlements will be increasingly less attractive for the plaintiffs' bar and potential defendants. Limiting potential fee awards undoubtedly will be a significant disincentive for the plaintiffs' bar to entertain coupon settlements. Indeed, unless a defendant is without sufficient financial resources to fund a cash settlement, there may not be good reasons for a plaintiff's attorney to agree to a settlement structure that would effectively reduce his or her fee. Thus, CAFA has the potential to make settlements involving coupons more expensive for defendants. Indeed, the plaintiffs bar will likely demand a more significant cash component for any combined coupon and cash settlements to account for the contingent fee restrictions. Plaintiffs may even be simply unwilling to participate in coupon settlements because of the uncertainty involved in determining the percentage of redeemed coupons. Finally, the new comprehensive notice provisions (which apply to all class action settlements, not just coupon settlements) invite heightened scrutiny by the U.S. attorney general, state attorneys general or appropriate regulating agencies or authorities, and impose added administrative burdens.

In summary, CAFA makes changes to class action practice that are, on balance, positive. Nevertheless, CAFA is not a panacea that should be expected to reduce dramatically the costs of class action litigation. While easing the economic burdens associated with the problem of state court class actions, CAFA may simultaneously add to the cost of settling federal class actions. In the end, the laudable goal of reducing the cost of litigation to American business likely will depend upon substantive tort reform rather than upon the attempted procedural reforms of CAFA. ■