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BY DAVID KLINGSBERG AND ALAN E. ROTHMAN

The Class Action Fairness Act of 2005

On Feb. 18, 2005, President George W. Bush signed the Class Action Fairness Act of 2005 (CAFA), which significantly expands federal diversity jurisdiction and contains other provisions to address unfair class settlements, inflated attorney's fees and state court class action abuses. CAFA applies to cases filed on or after Feb. 18, 2005.

Historically, Congress had limited the constitutional grant of federal diversity jurisdiction by requiring "complete diversity" among all parties (no plaintiff is a citizen of the same state as any defendant), imposing a jurisdictional minimum and raising that minimum five times. What led to this turn-about was a growing concern with class certification — or the threat of certification to induce settlements — by state courts in some venues, which have deviated from the federal courts' strict enforcement of the requirement for a predominance of common issues of law or fact.

Because a state court's class certification must be accorded full faith and credit, a single state court judge could override the legal standards applied by federal courts and other state courts which reject class certification in similar circumstances. Typically, those state class actions could not be removed to federal court because, even though there was complete diversity between plaintiffs and the out-of-state corporate defendant, the jurisdictional minimum (in excess of $75,000) was not satisfied. For example, most consumer fraud claims, which seek return of the purchase price of a product whose safety or efficacy was allegedly misrepresented, involve individual class members' claims below the jurisdictional minimum, even though the total amount of class damages is huge.

Expanded Diversity Jurisdiction

Under CAFA (subject to certain exceptions), a federal court has original diversity jurisdiction over class action lawsuits involving at least 100 proposed class members, as long as any class member is a citizen of a state different from that of any defendant, and the matter in controversy — after aggregating the claims of all class members — exceeds $5 million. These actions also may be removed from state to federal court.

David Klingsberg *Alan E. Rothman*

CAFA specifies exceptions for class actions that Congress decided should remain in state court. A federal court must decline to exercise jurisdiction (and remand a removed action) if: (1) more than two-thirds of the class members are citizens of the forum state; (2) at least one defendant, against whom "significant relief" is sought and whose conduct forms a "significant basis" for the claims the putative class asserts, is a citizen of the forum state; (3) "principal injuries resulting from the alleged conduct or any related conduct of each defendant were incurred in the [forum] State;" and (4) no other class action complaints asserting the "same or similar factual allegations" have been filed in the last three years against any of the defendants.

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A federal court also must decline jurisdiction (and remand a removed action) if two-thirds or more of the class members and the "primary defendants" are citizens of the forum state. Federal courts are accorded discretion to deny jurisdiction (or to remand removed actions) where more than one-third of the class members and the primary defendants are citizens of the forum state and where the court concludes that the action appropriately belongs in state court based on the "interests of justice and the totality of the circumstances," considering six listed factors, which generally relate to the state or interstate nature of the class action.

CAFA eliminates the complete diversity requirement for cases with 100 proposed class members seeking more than $5 million in the aggregate (which do not fall within the exceptions). CAFA also impacts the split among circuits as to whether the supplemental jurisdiction statute, 28 USC §1367, permits diversity jurisdiction where at least one plaintiff's claim is above the jurisdictional minimum, and thus overruled the 1973 Supreme Court decision in *Zahn* (414 US 291), which disallowed aggregation of individual class members' claims to satisfy the amount in controversy. Under CAFA, if there are at least 100 class members with claims aggregating more than $5 million (and not falling within any exception), each plaintiff and class member need not independently seek more than $75,000 to sue in, or for their action to be removed to, federal court. In other cases, the split of authority remains, and will be the subject of argument before the Supreme Court this month, March 2005.

The legislative history (but not the statute) indicates Congress' intent that plaintiffs bear the burden of establishing the factors for discretionary or mandatory remand (e.g., the percentage of class members who are citizens of the forum state) as well as of challenging the factual predicates for expanded federal jurisdiction, including whether the proposed class has 100 members whose claims aggregate more than $5 million. If this burden shifting is adopted by the

David Klingsberg, *who is also a visiting lecturer at the Rutgers School of Law, and* **Alan E. Rothman** *practice complex litigation at Kaye Scholer LLP.*

courts, it could create a dilemma for plaintiffs' counsel who wishes to return to state court, but does not want to argue for lower class damages or limit class size.

In applying the exceptions, litigants and courts will have to flesh out the criteria for identifying a defendant against whom "significant relief" is sought as distinguished from a "primary defendant." For example, in a products liability suit, if — in an attempt to avoid removal — plaintiffs name an in-state physician and allege malpractice in treating a plaintiff's injury, is "significant relief" sought from the physician even if the physician is not a "primary defendant"? CAFA does not define a "primary defendant," but the legislative history suggests that it is the defendant that would be expected to be assessed with most of the damages.

Corporations incorporated or headquartered in jurisdictions where state courts have favored class certification will find less comfort in the new legislation. If such a corporation is the only "primary defendant" in a state court class action, removal options will be limited where statewide certification only is sought. However, under CAFA, these corporations will gain significant protection from nationwide class certification in state court because it is unlikely that more than one-third of the class members in a proposed nationwide class will be citizens of the forum state.

CAFA creates a new category called "mass actions," 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." "Mass actions" do not include actions where: (1) "all of the claims in the action arise from an event or occurrence in the state in which the action was filed, and that allegedly resulted in injuries in that state or in states contiguous to that state" (designed to exclude cases involving a plane crash or toxic spill); (2) the claims were joined by a defendant's motion; (3) the claims were asserted on behalf of the general public, pursuant to a state statute permitting such actions (e.g., "private attorney general" statutes); or (4) the claims were consolidated solely for pretrial proceedings.

Under CAFA, a "mass action" is treated as a "class action" with respect to eliminating the need for complete diversity, so that a mass action may be removed to federal court where there is only minimal diversity, i.e., where the citizenship of any plaintiff differs from that of any defendant (subject to the same exceptions as class actions when more than one-third of the plaintiffs are citizens of the forum state). Federal diversity jurisdiction can only be exercised over those plaintiffs in a "mass action" whose individual claims seek more than $75,000; whereas there can be (subject to the listed exceptions) diversity jurisdiction over a "class action" with 100 proposed class members with aggregate claims exceeding $5 million, regardless of the amount of recovery sought by any one plaintiff or class member. The "mass action" provision prevents state legislatures or courts from circumventing the class action removal provisions by permitting the joinder of 100 plaintiffs in a single nonclass action.

Similar to the circuit split regarding class actions, the circuits are also divided as to whether each plaintiff in a nonclass action must seek in excess of $75,000 for a federal court to exercise diversity jurisdiction over the entire action. Under CAFA, a plaintiff in a "mass action" must seek in excess of $75,000 to remain in federal court.

Unlike class actions, "mass actions" removed to federal court may not be transferred, pursuant to 28 USC §1407, to a multidistrict litigation (MDL) proceeding, absent a request by a majority of the plaintiffs. Where there are numerous other similar lawsuits, which otherwise could be consolidated for pretrial purposes in an MDL, a defendant in "mass actions" will not be able to obtain MDL treatment and the accompanying benefits of avoiding duplicative discovery and inconsistent pretrial decisions. Further, plaintiffs' choice to "propose" joinder of 100 plaintiffs could literally preclude MDL transfer, but a sham proposed joinder should not qualify as a mass action.

For class actions and mass actions covered by the act, CAFA eliminates 28 USC §1441(b)'s bar to removal when an in-state defendant is named. CAFA also eliminates 28 USC §1446(b)'s one-year limitation on diversity-based removals in actions covered by the act that are subject to removal. Further, CAFA eliminates the requirement in those actions that all (properly joined and served) defendants consent to removal.

Previously, when district courts remanded a removed action to state court for lack of subject matter jurisdiction, those decisions were usually not appealable. CAFA permits appellate review of any order denying or granting remand in cases covered by the act. Once such an appeal is filed (not less than seven days after the order's entry) and accepted, the Court of Appeals must decide the appeal within 60 days, with at most a 10-day extension permitted (unless all parties consent to a longer period). If the court fails to rule within that period, the appeal is deemed denied. While these tight time limits may eliminate appellate rights in many cases, CAFA should provide some safeguard against inconsistencies in interpretation of CAFA, and possibly conflicting approaches to remand issues such as fraudulent joinder and misjoinder.

Settlement of Class Actions

For coupon settlements, CAFA requires judicial hearing and written approval based on a fairness finding. But this merely codifies federal court practice under FedRCivP §23(e). Additionally, CAFA provides that any portion of attorney's fees awarded to class counsel attributable to a coupon award must be based on the value to class members of the coupons actually redeemed. Nevertheless, coupon settlements are not outlawed by CAFA, and can be a useful tool, particularly to resolve consumer class action lawsuits.

Beyond coupon settlements, CAFA provides that a "court may not approve a proposed settlement that provides for the payment of greater sums to some class members than to others solely on the basis that class members to whom the greater sums are paid are located in closer geographic proximity to the court." While geographic location should not be a factor, some courts have endorsed larger payouts to named plaintiffs, who as class representatives are subject to discovery and possibly trial. In addition, where a proposed settlement net of attorney's fees results in a monetary loss to a class member, the court may only approve the settlement upon "a written finding that nonmonetary benefits to the class member substantially outweigh the monetary loss." Final court approval of class action settlements requires at least 90 days advance notice by each defendant to federal and state officials specified in the act for particular types of class actions.

Beyond the technical provisions specifically relating to settlements, the more effective safeguard against unfair settlements is CAFA's provision for expanded federal diversity jurisdiction, coupled with expanded removal to federal court, which takes many class actions out of the hands of state judges, some of whom (as reflected in the legislative history) are prone to approve class action settlements without due regard for the elements of Rule 23 or the states' equivalent rules.

The enactment of CAFA is a landmark event in the annals of federal diversity jurisdiction and class action procedures. The practitioner is well-advised to study CAFA's detailed provisions (as this article does not address all of CAFA's exceptions and special provisions) and monitor how the federal judiciary interprets its provisions. Time will tell whether the Class Action Fairness Act of 2005 will live up to its name and remedy the perceived abuses that led to its enactment.