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Class Action Fairness Act of 2005: New Bill Allows Some New Class Action Cases to Be Removed from State to Federal Court

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On Friday, February 18, 2005, President Bush signed the Class Action Fairness Act of 2005 ("the Act") into law. Amazingly, the Act, which its supporters say will curb the ability of plaintiffs' attorneys to abuse the class action procedure, was introduced, debated and passed by both houses of the Legislature in a mere three-week period. According to the President, the Class Action Fairness Act "will help ensure justice by making two essential reforms. First, it moves most large, interstate class-actions into federal courts...[which] will prevent trial lawyers from shopping around for friendly local venues....Second, [it] provides new safeguards to ensure that plaintiffs and class-action lawsuits are treated fairly....[including a requirement that] judges...consider the real monetary value of coupons and discounts, so that victims can count on true compensation for their injuries."

The primary target of the Act, according to the House manager on the passage for the Act, were those class actions filed in courts such as those in Madison County, Illinois and Jefferson County, Texas — what he called "magic" or "magnet" jurisdictions which were much more likely to certify proposed classes.

Of course, any piece of legislation that moves through the system so quickly is bound to raise questions as well as answer them, and the Class Action Fairness Act is no exception.

Expansion of Federal Jurisdiction

The Act grants the federal courts jurisdiction over class actions in which **1)** the proposed class contains at least 100 members; **2)** the primary defendants are someone or something other than states, state officials or other governmental entities against whom the district court may be foreclosed from ordering relief; (3) the total amount in controversy for all plaintiff class members exceeds $5,000,000; and (4) there is diversity between at least one class member and the defendants. The diversity requirement is satisfied when at least one plaintiff is a citizen of a state in which none of the defendants are citizens, when one plaintiff is a citizen of a foreign state and one defendant is a U.S. citizen, or when one plaintiff is a U.S. citizen and one defendant is a citizen of a foreign state. Significantly, jurisdiction does not exist where the diversity and amount in controversy requirements are satisfied but where the only claims in the class action concern **1)** a covered security as defined under 16(f)(3) of the Securities Act of 1933 and section 28(f)(5)(E) of the Securities Exchange Act of 1934; **2)** the internal affairs or governance of a business enterprise under the laws of the state in which the enterprise is organized; or **3)** the rights, duties and obligations relating to any security as defined under section 2(a)(1) of the Securities Act of 1933.

Having created this new basis for federal jurisdiction, the Act then establishes circumstances under which the courts must decline to exercise the available jurisdiction and circumstances under which the courts can, but need not, decline to exercise jurisdiction. Specifically, a federal court must decline to exercise jurisdiction under the following circumstances:

- When both the primary defendants and two-thirds or more of the members of the proposed class are citizens of the state in which the action was filed.
- When two-thirds or more of the individuals in the proposed class and at least one defendant whose conduct forms a significant basis for the class's

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claims are citizens of the state in which the action was filed; provided that the primary injuries also arose in that state and that a similar class action was not filed against the same defendant(s) during the preceding three years.

Likewise, a federal court may — but need not — decline to exercise jurisdiction when both the primary defendants and between one-third and two-thirds of the members of the proposed class are citizens of the state in which the action was filed. In deciding whether to exercise jurisdiction in such cases, the courts are to consider the "interests of justice" and the "totality of the circumstances," including such factors as whether the case involves matters of national or interstate interest, what law will govern the plaintiffs' claims, where the injuries at issue arose, whether the plaintiffs pled their claims in a manner designed to avoid federal jurisdiction, and whether similar class actions have been filed during the preceding three-year period.

The Act thus makes it significantly easier for plaintiffs to file their claims in federal court — primarily because they no longer need to demonstrate that there is complete diversity between the parties (*e.g.*, no plaintiff is a citizen of a state in which any defendant is a citizen). These provisions also put to rest what was an open question – whether the claims of potential class members could be aggregated to determine whether the established monetary threshold has been reached (prior to passage of the Act, that threshold was $75,000).

Many class action plaintiffs, however, have little desire to be in federal court due to the widely-held perception that federal judges are less likely to certify a class action and that even those plaintiffs who prevail will obtain a smaller recovery than they would have received in state court. These perceptions are not borne out by recent statistics from the Federal Judicial Conference, which suggest that the class certification rates are about 20% in both state and federal courts. Regardless of whether the perceptions are warranted, there is no reason to believe that significant numbers of plaintiffs will now begin filing their large class actions in federal court — which is why the portions of the Act dealing with removal are likely the most significant for potential defendants.

Expansion of Removal Rights

The Class Action Fairness Act greatly expands removal rights for class actions. Specifically:

- Generally, a defendant that wants to remove an action to federal court based upon diversity jurisdiction must do so within one year of the date on which the action was commenced. The Act states that the one-year limitation does not apply to class actions.
- A defendant that wants to remove an action based upon diversity cannot do so if there is a "local defendant" — *i.e.*, a defendant that is a citizen of the state in which the action was filed. The Act states that the "local defendant" rule does not apply to class actions.
- Removal of an action on diversity grounds generally requires the unanimous consent of all served defendants. The Act provides that a class action may be removed by any one defendant without the consent of the others.
- The federal courts of appeals may now accept an appeal from an order granting or denying a motion to remand an action to state court, provided the appeal is filed within seven days of the remand order. Any such appeal is to be processed on an expedited basis (within 60 days).

Safeguards Against Artful Pleading

In recognition of the fact that plaintiffs' counsel may attempt to avoid the new provisions of the Act by filing a class action without actually calling it that, the Act recognizes the existence of a "mass action," which is defined as an action in which 100 or more plaintiffs are seeking to have their claims for monetary relief tried together on the ground that they involve common questions of law or fact.

However, such a joint action will not qualify as a mass action if it satisfies one of the following criteria:

- The plaintiffs' claims were joined together as a result of a motion brought by a defendant;
- The incident(s) giving rise to the plaintiffs' claim(s) arose in the state in which the action was filed and the injuries stemming from the incident(s) occurred there or in contiguous states;
- All of the plaintiffs' claims are asserted on behalf of the general public pursuant to a state statute authorizing such an action (*e.g.*, California Business and Professions Code, § 17200); or
- The plaintiffs' claims were consolidated or coordinated solely for pretrial proceedings.

A mass action that satisfies all the listed criteria qualifies as removable on the same basis as a class action with one important difference. A federal court may only exercise jurisdiction over those mass action plaintiffs whose claims have a monetary value of at least $75,000, exclusive of interest and costs. It thus appears that a defendant who wants to remove a mass action where some, but not all, plaintiffs have claims in excess of $75,000 will be forced to either forego removal or defend two different actions — one in federal court involving the plaintiffs with larger claims and one in state court involving the plaintiffs with small claims.

Restrictions on Settlements

In an attempt to preclude the types of settlements that, in part, prompted the passage of the Act, *i.e.*, those in which class members receive something of minimal value (such as a coupon towards future product or services from the defendant) while their attorneys are paid millions of dollars, the Act requires that any portion of an attorney's fee award that is attributable to the award of coupons must be based on the value of those coupons that are actually redeemed. Furthermore, any settlement in a case involving the payment of coupons is

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subject to approval of the court, which is required to hold a hearing on the fairness of the settlement and is given the discretion to take expert testimony on the topic of the actual value to class members of the redeemed coupons.

Furthermore, the courts are severely restricted from approving a settlement that would result in a net loss to a class member (such as where the plaintiff(s) must pay fees to their attorney that exceed what they received in the settlement) or that provides payment of a greater sum to one or more class members based solely on the fact that they live closer to the court than the other plaintiffs. Finally, every defendant is now required to provide certain state and federal officials with notice of any proposed settlement along with fairly extensive materials supporting the settlement, so that those officials can have a say in the matter. The failure to provide such notice will effectively invalidate the settlement agreement.

These provisions appear quite likely to make class action settlements more difficult. The use of coupons may prove to be so burdensome as to be impractical from the plaintiffs' perspective — particularly since the court will be unable to determine the extent to which coupons were redeemed until the entire redemption period has expired — *e.g.*, a year. As a result, all-cash settlements (which are obviously more expensive for defendants) will probably become the standard. Furthermore, the price of such settlements will undoubtedly increase once the government officials give their input, which likely will include demands for additional concessions/compensation to the class members who reside in their jurisdictions.

The Act's Impact on Employers

Overall, the impact of this bill can be favorable to employers, but is limited. The legislation should reduce somewhat an employer's concern of a nationwide class action being heard in a state, rather than federal, court. However, by limiting the availability of the class action remedy to classes of potential class members in more than one state, the legislation leaves the door open for plaintiffs' attorneys to circumvent the new federal court jurisdiction. If a plaintiff's attorney restricts the potential class to residents of the same state in which one of the significant defendants is a citizen, filing in state court is still required. Thus, for wage and hour cases such as those filed in California against a California defendant *and* limited to class members who are California residents, the impact of the Class Action Fairness Act may be muted.

Furthermore, the effect of the Act will vary according to the nature of a particular state's class action remedies and procedures. As a general matter, any claim valued at more than $5 million dollars, and with potential class members who are residents of more than the forum state can now wind up in federal court. Whether that jurisdiction is beneficial to a particular employer will depend upon what the alternative was in state court. Generalization is really not possible because, as might be expected, the states have very divergent policies on class actions. For example, California and Illinois state courts are traditionally receptive to state court class action claims. As long as the plaintiff does not seek to join potential class members in other states, class actions in such states will continue as they did before passage of the Act. In contrast, claims involving residents of New York State, which is much more restrictive in the kinds of actions that may be prosecuted in its courts on a class action basis, may be affected more significantly by the Class Action Fairness Act.

The plaintiffs' bar can be expected to file cases, where the class action option exists, by basing cases only on potential class members within a single state, in order to avoid the reach of the Act. This may actually result in an increase in the number of class action cases filed in individual state courts.

The legislation will have no impact on the EEOC's ability to bring class action litigation in federal courts.

Thus, overall, the changes wrought by the passage of the Act are as to procedure and remedies, not substance. However, in the right set of circumstances, the protection for employers from certain remedies permitted by state courts can be great, indeed.

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