

CONGRESS MAKES SIGNIFICANT CHANGES TO RULES GOVERNING CLASS ACTIONS

Effective February 18, 2005, the Class Action Fairness Act of 2005 (“CAFA”) makes significant changes to the rules governing class actions. CAFA creates a new basis for removal of, and federal jurisdiction over, most large class action lawsuits involving parties from different states. It also streamlines settlement options in such class actions.

Congress enacted CAFA to reduce “abuses of the class action device” that “harmed class members,” “adversely affected interstate commerce,” and “undermined public respect” for the judicial system. Congress found that class members “often receive little or no benefit from class actions,” while the class lawyers “are awarded large fees.” The law attempts to limit a plaintiff’s ability to use state -- rather than federal -- courts to prosecute class actions, because state courts “sometimes [act] in ways that demonstrate bias against out-of-state defendants.” Congress sought to cure these ills in two ways: (1) by giving the federal courts original jurisdiction over many class actions and (2) by placing practical restrictions on the use of coupons to settle consumer claims. However, CAFA does not altogether strip state courts of jurisdiction over multi-state class actions, as has been widely misstated by the press, and a defendant’s ability to remove a case under CAFA is subject to a number of exceptions.

I. New Original Jurisdiction of Federal Courts

A. General Rules

Before CAFA, federal law allowed a defendant to remove a case to federal court only when a federal question existed, or when the citizenship of each named plaintiff was completely diverse from each defendant *and* the amount of every plaintiff’s claim -- named or unnamed -- exceeded \$75,000.

CAFA alters these rules. The new law grants federal district courts original jurisdiction over any class action in which (1) the matter in controversy exceeds \$5 million, exclusive of costs and interest, and (2) diversity of citizenship exists between any one member of the plaintiff class (whether a named plaintiff or not) and any defendant.

Thus, CAFA changes diversity jurisdiction for class actions in two major ways. First, complete diversity of citizenship between plaintiffs and defendants is no longer required. Second, while the law imposes a greater amount-in-controversy requirement, under CAFA the amount in controversy is determined on an aggregate basis. If the *total* amount at issue is at least \$5 million, and the other minimum diversity requirements are met, the case can be removed to federal court, except as discussed below.¹

¹ Federal jurisdiction under 28 U.S.C. § 1332(a), which requires complete diversity of citizenship and an amount-in-controversy exceeding \$75,000 in cases other than class actions, otherwise remains unchanged.

B. Exceptions

CAFA contains various exceptions to its broad grant of federal diversity jurisdiction over class actions. For example, under certain circumstances specified in CAFA, district courts either must decline jurisdiction or may, in an exercise of discretion, decline jurisdiction over a class action.

1. Mandatory Decline of Jurisdiction

A district court *must* decline jurisdiction in either of the following two situations:

- (1) if two-thirds or more of the class members and all the primary defendants are citizens of the forum state; or
- (2) under the following circumstances, all of which must apply:
 - (a) two-thirds or more of the class members are citizens of the forum state;
 - (b) at least one defendant meets the following criteria: (i) plaintiffs seek significant relief from the defendant; (ii) the defendant's conduct forms a significant basis for the claims asserted; and (iii) the defendant is a citizen of the forum state;
 - (c) the principal injuries resulting from the alleged conduct or "any related conduct of each defendant" were incurred in the forum state; *and*
 - (d) during the three-year period preceding filing, no other class action has been filed asserting the same or similar factual allegations against any of the defendants.

2. Discretionary Decline of Jurisdiction

If more than one-third but less than two-thirds of the members of the proposed plaintiff class and all the primary defendants are citizens of the forum state, a district court *may*, in the interest of justice and based on the totality of circumstances, decline to exercise jurisdiction.² CAFA specifies six factors that the district court must consider before declining to exercise jurisdiction:

- (1) whether the claims involve matters of national or interstate interest;
- (2) whether the claims will be governed by laws of the state where the action was filed or by the laws of other states;

² CAFA authorizes discretionary appellate review of district court orders granting or denying a motion to remand, and provides for expedited rulings on these appeals.

- (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 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 or other persons have been filed.

3. Other Exceptions

CAFA contains four other important exceptions to the new federal jurisdictional structure:

- CAFA does not apply to cases pending at the time of the law's enactment. Class actions pending in state courts on or before February 18 will remain in state court;
- CAFA does not apply to classes with fewer than 100 members;
- CAFA does not apply to classes involving certain kinds of securities or shareholder claims; and
- CAFA does not apply to cases in which states or state officials are the primary defendant.

C. Practical Effects of the New Federal Jurisdiction

The new jurisdiction granted to federal courts offers several potential benefits to defendants. For example, while most states have corollaries to Federal Rule of Civil Procedure 23, many states' class certification requirements are easier to satisfy than the federal standards. In particular, federal courts typically place a greater evidentiary burden on the plaintiff seeking certification. By authorizing removal of cases to federal court that otherwise would be bound by state court procedure, CAFA potentially offers defendants an opportunity to challenge certification of a class under those generally more favorable procedural standards.

Another potential benefit for defendants is immediate appellate review of class certification decisions. Many state courts do not permit immediate interlocutory appeal of a class certification decision. A defendant typically must litigate the entire case to a final judgment before it can appeal the class certification decision itself. Therefore, an

early certification often results in increased pressure on defendants to settle these state court cases. By contrast, Federal Rule of Civil Procedure 23(f), which will apply to cases removed to federal court under CAFA, gives federal courts of appeal the discretion to hear an immediate interlocutory appeal of a class certification order.

CAFA may also foster greater efficiency and help control litigation costs for defendants that are sued in multiple locations. By authorizing federal jurisdiction over multi-state class actions, CAFA opens access to federal multidistrict litigation (“MDL”) procedure. The MDL procedure offers defendants many advantages, including consolidated discovery and motion practice and the opportunity to consolidate claims in a single venue.

II. Settlement Options Streamlined

CAFA also narrows settlement options in class actions. Specifically, it places limits on both the allowable structure of coupon settlements and the availability of lawyers’ fees in coupon settlements. A coupon settlement is a settlement that provides class members with a coupon, credit or certificate to discount the price of new products purchased from the defendant. In recent years, coupon settlements have gained popularity, because they allowed businesses to settle claims by issuing coupons for their products in lieu of, or as a supplement to, a cash payment. CAFA limits settlements based on coupons when they result in small compensation to class members and large rewards for class counsel.

A. New Structural Requirements of Coupon Settlements

Under the new law, if a coupon settlement is proposed, the court may approve the settlement only after it holds a hearing and makes a written finding that the settlement is fair, reasonable, and adequate to class members. In making that determination, CAFA requires the judge to consider, among other things, the real monetary value and likely utilization rate of the coupons provided by the settlement. The court may also require the settlement provide for the distribution of a portion of the value of the unclaimed coupons to charitable or governmental organizations, as agreed to by the parties.

The law also contains a strict notice provision for such settlements. Each defendant, within ten days after a proposed settlement is filed in federal court, must provide notice of the proposed settlement to (1) the U.S. Attorney General, and (2) an appropriate state official in every state in which a putative class member resides. The notice must include a copy of the complaint, notice of any scheduled judicial hearing on the settlement, a proposed or final notification to the class members, the proposed settlement, and the names of class members who reside in each state. A federal court may not issue a final order approving a settlement until 90 days after the appropriate federal and state officials are served.

B. Availability of Lawyers' Fees in Coupon Settlements

If class counsel has a contingency fee arrangement, an award of attorneys' fees based upon a class settlement with coupons must be valued based on the amount of coupons redeemed, rather than the value of coupons issued. CAFA dictates that attorneys' fees awarded in other coupon settlements shall be based on the amount of time reasonably expended by class counsel.

CAFA also requires that if a settlement requires any class member to compensate class counsel in an amount that would render a net loss to the class member, the settlement may be approved only if the court finds that non-monetary benefits to the class member substantially outweigh the monetary loss.

III. Conclusion

While the full impact of CAFA on class action litigation remains to be seen, the law appears to provide genuine benefits to companies with a national or multi-state customer base. CAFA reduces the risk that such companies will be forced to litigate a class action in an unfriendly state court. CAFA also holds out the promise of a streamlined procedural framework for class actions, more predictable outcomes on motions and judgments, and greater cost efficiency. On the other hand, CAFA may limit a defendant's ability to use coupons to settle class actions falling within the ambit of CAFA.

* * * * *

If you have any questions about this memorandum, please contact Kevin Clark at (202) 303-1105, Joseph Davis at (202) 303-1131, or the attorney with whom you regularly work.

Willkie Farr & Gallagher LLP is headquartered at 787 Seventh Avenue, New York, NY 10019-6099. Our telephone number is (212) 728-8000 and our facsimile number is (212) 728-8111. Our website is located at www.willkie.com.

March 17, 2005

Copyright © 2005 by Willkie Farr & Gallagher LLP.

All Rights Reserved. This memorandum may not be reproduced or disseminated in any form without the express permission of Willkie Farr & Gallagher LLP. This memorandum is provided for news and information purposes only and does not constitute legal advice or an invitation to an attorney-client relationship. While every effort has been made to ensure the accuracy of the information contained herein, Willkie Farr & Gallagher LLP does not guarantee such accuracy and cannot be held liable for any errors in or any reliance upon this information.