

**THE CLASS ACTION FAIRNESS ACT OF 2005
AND ITS IMPACTS ON CLASS ACTION DEFENSE**

**Hispanic National Bar Association Convention,
October 2005**

**Cristina Hernandez-Malaby, Esquire
Quarles & Brady LLP¹
411 E. Wisconsin Ave.
Milwaukee, WI 53202
(414) 277-5377
chernand@quarles.com**

¹ Quarles & Brady LLP is a 400-attorney law firm with offices in Chicago, Milwaukee, Madison, Naples, and Phoenix. Cristina is a partner in the Firm's Milwaukee office; her practice focuses on commercial litigation.



The Class Action Fairness Act – enacted on February 18, 2005 – materially changed the legal parameters, jurisdictionally and otherwise, for class action litigation in the United States. Whether you view the changes as positive or negative may depend in large part on which side of the courtroom your client sits and the particular case.

This paper will not analyze whether CAFA should or should not have been enacted and the public policy implications of its enactment; the materials submitted as part of this CLE presentation by my co-presenters contain significant and interesting discussions of these matters. Rather, it will summarize some of the practical and positive impacts of CAFA for class action defendants, as well as suggesting possible detriments.

I. Federal court is now the likely jurisdiction for purported classes of any significant size.

A. Federal court jurisdiction over class actions has been expanded.

One of the more notable and widely reported impacts of CAFA is its expansion of federal diversity jurisdiction to include most class actions. Specifically, Section 3 of the Act modified 28 U.S.C. § 1332 (“Diversity of citizenship; amount in controversy; costs”) to add the following language that gives district courts jurisdiction over virtually every class action of significant size so long **any** class member is diverse from at least one defendant:

The district courts shall have original jurisdiction of any civil action in which the matter in controversy exceeds the sum or value of \$5,000,000, exclusive of interest and costs, and is a class action in which –

- (A) any member of a class of plaintiffs is a citizen of a State different from any defendant;
- (B) any member of a class of plaintiffs is a foreign state or a citizen or subject of a foreign state and any defendant is a citizen of a State; or
- (C) any member of a class of plaintiffs is a citizen of a State and any defendant is a foreign state or a citizen or subject of a foreign state.

28 U.S.C. § 1332(d)(2). The \$5,000,000 threshold for federal class action jurisdiction – which is determined by the aggregated damages allegedly suffered by the class (28 U.S.C. § 1332(d)(6)) – is also a significant departure from the requirements of the former statute. Indeed, until recently, courts interpreted Section 1332 as requiring that every single plaintiff must allegedly have suffered damages totaling at least the jurisdictional minimum of \$75,000 in order to implicate diversity jurisdiction.²

² The United States Supreme Court recently overturned *Zahn v. International Paper, Inc.*, 414 U.S. 291 (1973), in which the court previously held that the monetary requirements for diversity jurisdiction must be met by all plaintiffs. *Exxon Mobil Corp. v. Allapattah Services, Inc.*, 125 S.C. 2611 (2005).

Notably, these materials changes in 28 U.S.C. § 1332(d)(2) **cannot** apply in the following circumstances:

- (1) When over 2/3 of the members of the purported class reside in a single State, at least one defendant from whom relief is sought and whose conduct forms “a significant basis” for the claims resides in the State, the principle injuries were incurred in the State, and no other class action concerning the same or similar factual allegations have been filed during the past three years. 28 U.S.C. § 1332(d)(4).
- (2) When “the primary defendants are States, State officials, or other governmental entities against whom the district court may be foreclosed from ordering relief.” 28 U.S.C. § 1332(d)(5)(a).
- (3) When the purported class numbers less than 100. 28 U.S.C. § 1332(d)(5)(b).
- (4) If the action “concerns 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” or if the action “relates to the rights, duties (including fiduciary duties), and obligations relating to or created by or pursuant to any security (as defined under section 2(a)(1) of the Securities Act of 1933 and the regulations issued thereunder).” 28 U.S.C. § 1332(d)(9). Class actions that include claims under the Securities Act of 1933 and the Securities Exchange Act of 1934, however, are still subject to federal jurisdiction as such statutes implicate federal question jurisdiction. Such claims are also still subject to the Private Securities Litigation Reform Act (“PSLRA”), enacted to address the problem of “professional plaintiffs” and other abusive practices in private security class actions. *See* 15 U.S.C. § 78u-4 *et seq.* and 15 U.S.C. § 77z-4 *et seq.*
- (5) If the action “relates to the internal affairs or governance of a corporation or other form of business enterprise and that arises under or by virtue of the laws of the State in which such corporation or business enterprise is incorporated or organized.” This has been referred to as the “Delaware carve-out,” designed to allow certain corporate matters to continue to be heard in Delaware state courts, particularly the Delaware Chancery Court.

The district courts are given some discretion to decline jurisdiction under CAFA, but such discretion is only implicated when over 1/3 of the purported class members are citizens of the State in which the action was originally filed. In such circumstance the district court may consider the following factors in determining whether to maintain jurisdiction:

- (A) Whether the claims asserted involve matters of national or interstate interest.
- (B) Whether the claims asserted will be governed by laws of the State in which the action was originally filed or by the laws of other states.
- (C) Whether the class action has been pleaded in a manner that seeks to avoid Federal jurisdiction.

- (D) Whether the number of citizens of the State in which the action was originally filed in all proposed plaintiff classes in the aggregate is substantially larger than the number of citizens from any other State, and the citizenship of the other members of the proposed class is dispersed among a substantial number of States.
- (E) Whether 1 or more class actions asserting the same or similar claims on behalf of the same or other persons have been or may be filed.

28 U.S.C. § 1332(d)(3). As of the date of the submission of this paper, no published decisions had been located in which a district court engaged in this analysis. But certainly these factors can be viewed as giving all parties significant latitude to present various materials to the district court either supporting or opposing federal jurisdiction.

B. CAFA makes removal easier.

CAFA also created 28 U.S.C. § 1453, which sets forth more relaxed requirements for removal of class actions than those articulated in 28 U.S.C. § 1446 (the statute that generally covers removal). For example, the consent of all defendants is **not** required to remove a matter governed by Section 1332(d)(2). 28 U.S.C. § 1453(b). This certainly may benefit the defendant with the most at stake in a matter in that such defendant need not consult with other defendants with whom it ultimately may not be allied.

The timing of removal has also been expanded for actions subject to Section 1332(d)(2) in that the one year limitation of 28 U.S.C. § 1446(b) does not apply. *Id.* This allows a defendant to remove an action at any time when a complaint is amended (explicitly or otherwise) so as to implicate CAFA. It relatedly dissuades plaintiffs from framing their initial pleadings in a way so as to avoid CAFA and thus federal court and later amending such pleading so as to increase either the scope of the class or the amount of damages alleged by the class.

Finally, and perhaps most importantly, CAFA sets forth an expedited appellate review process for any remand decision brought under this statute. 28 U.S.C. § 1453(c). Prior to the passage of CAFA, it was at the very least questionable whether appellate review was appropriate in a remand situation. *See, e.g., Things Remembered, Inc. v. Petrarca*, 516 U.S. 124, 126 (1995) (“As long as a district court’s remand is based on a timely raised defect in removal procedure *or on lack of subject matter jurisdiction* – the grounds for remand recognized by [18 U.S.C.] § 1447(c) – a court of appeals lacks jurisdiction to entertain an appeal of the remand order under § 1447(d).” (citation omitted)); *Phoenix Container, L.P. v. Sokoloff*, 235 F.3d 352 (7th Cir. 2000) (adopting *Things Remembered*). Now, a court of appeals has the ability to review a remand order if an application for such appeal is made within seven days of the order. The court of appeals is then required to complete the appeal within sixty days, unless an extension is granted by the agreement of the parties or for good cause (the extension for “good cause” can only be for ten days). 28 U.S.C. § 1453(c)(1)-(3).

C. What does this mean for defendants?

1. Defendants may move for a change of venue.

Certainly CAFA made it materially easier for a defendant to move a case into federal court and thus reap the many perceived benefits of federal court litigation (*i.e.* a clearer standard for class certification, likely lower case load for a single judge, more regimented discovery (including the involvement of magistrates), nationwide subpoena power, etc.). One of the greatest benefits of federal jurisdiction is that it gives defendant's the ability to request a change of venue based on, among other things, the fact that the greatest nexus of operative fact occurred in another state. A change of venue can be achieved two ways – first, through a petition to the district court pursuant to 28 U.S.C. § 1404 if the class action (or actions) are pending in a single district court; or, second, through a petition to the Judicial Panel for Multidistrict Litigation (“MDL”) pursuant to 28 U.S.C. § 1407. (More information on the MDL procedures can be found at www.jpml.uscourts.gov.) The ability of defendants to avail themselves of these procedures will more than likely discourage plaintiffs' counsel from filing claims in certain state courts in order to get perceived favorable jury pools when the acts in question did not occur in such state.

2. Defendants may not seek to apply the Act to preexisting cases.

Defense counsel should be aware, however, that this statute does **not** apply retroactively. Section 7 of CAFA specifically states that the provisions in CAFA only apply to civil actions “**commenced** on or after the enactment of this Act.” (emphasis added); *see also Exxon Mobil Corp. v. Allapattah Services, Inc.*, 125 S.Ct. 2611 (2005) (CAFA “is not retroactive....”). Defendants have argued on numerous occasions that such provision does not prevent the removal of pre-CAFA cases in certain instances, for example when an action is amended. (Indeed, the vast majority of published cases to date concerning CAFA discuss this issue.) But these arguments have largely been rejected. For example, the Seventh Circuit recent held in *Schorsch v. Hewlett-Packard Co.*, 417 F.3d 748 (7th Cir. 2005), that the addition of a claim through amendment did not provide a basis for removal. In making such ruling, Judge Easterbrook cautioned defense lawyers as follows:

Knudsen and Pfizer hold, and we reiterate, that creative lawyering will not be allowed to smudge the line drawn by the 2005 Act: class actions “commenced” in state court on or before February 18, 2005, remain in state court. Amendments to class definitions do not commence new suits. We can imagine amendments that kick off wholly distinct claims, but the workaday changes routine in class suits do not. Defendants should recognize that 28 U.S.C. § 1447(c) makes an award of attorneys' fees the norm for improper removal. *See Garbie v. DaimlerChrysler Corp.*, 211 F.3d 407 (7th Cir. 2000). So although we deny the petition for an interlocutory appeal in this case, we also invite the plaintiffs to file (in the district court) an appropriate request for reimbursement of the additional legal expenses to which they have been put by HP's efforts to move this litigation from state to federal court.

Id. at 751-752.³ At the same time, however, Judge Easterbrook included significant dicta in the decision that questioned the legitimacy of the class’ claims, dicta that may ultimately help defendants in the state court proceedings. *Id.*

3. SLUSA is still in place.

In addition, with respect to securities class actions, CAFA did not serve to modify the Securities Litigation Uniform Standards Act (“SLUSA”), enacted in 1998 to close certain loopholes in the PSLRA. SLUSA still exists, and is broadly constructed, as recently reiterated by the Seventh Circuit in *Disher v. Citigroup Global Markets, Inc.*, --- F.3d ---, 2005 WL 1962942 (7th Cir. 2005).

II. Further federal court jurisdiction over “mass actions.”

In addition to giving the federal courts exclusive jurisdiction over many class actions, CAFA also expanded federal jurisdiction over “mass actions.” Under CAFA, mass actions – defined as 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 and fact” – are classified as class actions. A “mass action,” however, does not include any civil action in which all of the claims arise from an event in the State in which the case is brought (i.e. a chemical company accident. “Mass actions” for purposes of this statute also do not include (1) actions where the claims are joined upon motion by the defendants, (2) when the claims are not pursued by individuals, but for the “general public”, or (3) where the case has been consolidated only for pre-trial proceedings. 28 U.S.C. § 1332(d)(11)(B).

It is also notable that mass actions removed pursuant to CAFA **cannot** be transferred to an MDL court without the consent of the majority of the plaintiffs. Thus removal under this provision is not as flexible as that for prototypical class actions.

III. Regulation of certain class action settlements.

CAFA, through its “Consumer Bill of Rights,” also seeks to change how class action settlements are handled, including so called “coupon settlements.” Practically speaking, however, some of these changes were already accomplished through the 2003 amendments to Fed. R. Civ. P. 23. See Georgene M. Vairo, *Class Action Fairness Act of 2005: With commentary and analysis* (LexisNexis 2005). A summary of the major changes as to how class action settlements are handled pursuant to CAFA are set forth below.

³ At the time of the submission of these materials, Judge Ruben Castillo of the Northern District of Illinois had not yet ruled on the plaintiff’s Petition for Fees and Costs. Judge Castillo previously rejected a request for fees and costs.

A. Notice must now be given to federal and state authorities when a settlement is reached.

CAFA requires that within ten days of the filing of a notice of settlement with the district court an “appropriate” federal and state official must be notified of such settlement. 28 U.S.C. § 1715 (b) and (d). (The contents of such notice are dictated in Section 1715(b).) An “appropriate federal official” is the United States Attorney General or, if the defendant is a depository institution, a foreign bank, the person who has primary regulatory responsibility over such entity. 28 U.S.C. § 1715(a)(1). An “appropriate state official” is the person in the State with the primary regulatory or supervisory role with respect to the defendant or the State Attorney General. 28 U.S.C. § 1715(a)(2). Notice must not just be given to the state in which a lead plaintiff resides; it must be given to an official “of each state in which a class member resides.” 28 U.S.C. § 1715(b). A district court may not enter an order finally approving the settlement until ninety days after the last “appropriate” official receives notice.

The impact of failure to give such notice is severe – class members will not be bound to the settlement. 28 U.S.C. § 1715(e). But, notably, a class member has no recourse if the notice goes to the appropriate federal official and either the State attorney general or the relevant State regulator. *Id.*

B. Restrictions on “coupon settlements.”

Interestingly, CAFA does not define what constitutes a “coupon settlement.” Generally speaking, a “coupon settlement” is settlement in which the class members do not get monetary awards, but rather coupons for services or goods. Coupon settlements have been roundly criticized as rewarding class counsel rather than class members. CAFA attempts to address this by making the award of any contingent attorneys’ fees dependent upon the number of coupons redeemed by class members:

If a proposed settlement in a class action provides for recover of coupons to a class member, 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 class members of the coupons that are redeemed.

28 U.S.C. § 1712(a). An alternative way of calculating fees is to base such award “upon the amount of time class counsel reasonably expended working on the action.” 28 U.S.C. § 1712(b). This type of calculation is also implicated when part of the settlement is some sort of injunctive relief. 28 U.S.C. § 1712(c).

In addition, CAFA provides for additional judicial scrutiny of coupon settlements, with the court being required to hold a hearing to determine whether the coupons convey value to the class:

In a proposed settlement under which class members would be awarded coupons, the court may approve the proposed settlement only after a hearing to determine whether, and making a written finding that, the settlement is fair, reasonable, and adequate for class members. The court, in its discretion, may also require that a proposed settlement agreement provide for the distribution of a portion of the value of unclaimed

coupons to 1 or more charitable or governmental organizations, as agreed to by the parties. The distribution and redemption of any proceeds under this subsection shall not be used to calculate attorneys' fees under this section.

28 U.S.C. § 1712(e); *see also* 28 U.S.C. § 1712(d) (allowing the court to receive expert testimony regarding the value of the coupon settlement to the class).

As a practical matter, these provisions may impact settlements in a number of ways, including a lack of interest on the part of plaintiffs' counsel to settle through coupons given these hurdles. The real impact may be better ascertained in an upcoming report by the Judicial Conference of the United States, the entity that, under CAFA, is required to report on the status of class action settlements within a year of its enactment.

III. Conclusion.

The assumption by many in our profession is that CAFA is a complete and total windfall to defendants. To be sure, defendants now have a number of weapons at their disposal to remove cases to federal court where they can take advantage of the well-developed law of class certification and discovery as well as the ability to seek to change venue. But whether this actually results in fewer class action filings and more pro-defendant settlements and judgments is questionable. The greater scrutiny on class settlements may, in fact, make it more difficult for defendants to settle for negligence value. And certainly many federal judges, like many state judges, are not hesitant to make pro-plaintiff decisions in discovery and at summary judgment should the facts warrant such findings. Indeed, defendants with "bad" facts may find themselves at a disadvantage in federal court where the courts have greater resources, more experience with class actions, and well-developed case law concerning class actions that may result in unwanted scrutiny.