# CLASS ACTION FAIRNESS ACT OF 2005 ENACTED

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On February 18, 2005, President Bush signed landmark legislation that revises the rules for class action lawsuits in key respects. In order to curtail "forum shopping" by plaintiff class action lawyers, the Class Action Fairness Act of 2005 (the "Act") broadens the scope of federal jurisdiction over multi-state class actions, and relaxes the requirements for removal so that even one defendant in a multi-defendant case can more easily remove a class action to federal court. A new consumer class action bill of rights institutes several measures designed to protect all members of putative federal classes from collusive and unfair settlements. The Act applies to any purported class action commenced on or after February 18, 2005, but not does not apply to actions pending prior to that date.

**Expanded Federal Court Jurisdiction Over Multi-State Class Actions**

The central feature of the Act is its amendment of the federal diversity jurisdiction statute, 28 U.S.C. § 1332, to provide for original federal court jurisdiction over large, multi-state class actions that involve issues of national scope. The amendment responds to concerns about the dramatic increase in recent years in state court class actions brought on behalf of purported nationwide classes, *i.e.*, residents of all 50 states. These class actions have tended to cluster around certain state court class action hotbeds, including Madison County, Illinois, Jefferson County, Texas and Palm Beach County, Florida. Recent studies have shown that nationwide classes composed of members with widely varying individual circumstances are far more likely to be certified in such state courts. Unlike federal court, where certification decisions may be subject to immediate review under Fed. R. Civ. P. 23(f), in many state courts there is no meaningful recourse to interlocutory appellate review of certification decisions. Recent federal case law has widely recognized that, regardless of the merits of the claims, certification of a large class may coerce a defendant to settle rather than "bet the company."

The Act's proponents asserted that the increase in state court filings in part resulted from a perceived flaw in the federal jurisdictional statute which enabled plaintiffs' lawyers to avoid removal to federal court by including a non-diverse plaintiff, naming a local defendant with tenuous connection to the class claims, or by alleging that the proposed class action fails to meet the $75,000 amount in controversy requirement. While federal courts routinely hear simple tort and contract cases involving amounts slightly in excess of $75,000, state courts have recently supervised and adjudicated many class actions involving plaintiffs from several states who collectively alleged damages in the millions but sought less than $75,000 in damages per class member. This anomaly is contrary to traditional notions of federalism, and the pre-Act regime resulted in certain state courts issuing rulings that imposed the forum state's law on citizens of the other 49 states, contrary to a battery of federal (and state) case law.

The Act enlarges federal diversity jurisdiction over multi-state class actions. Under the pre-Act jurisdictional statute, diversity existed if the named plaintiffs and all defendants were citizens of different states. 28 U.S.C. § 1332. As to amount in controversy, circuit authority was divided nearly evenly as to whether federal diversity jurisdiction over interstate class actions attached only if each class member's claim exceeds $75,000, or whether it is sufficient for only the named plaintiffs to meet the jurisdictional amount.

The Act simplifies the jurisdictional inquiry, but implements the change through labyrinthine categories of (i) cases in which federal courts have diversity jurisdiction, (ii) cases where federal courts *may* decline jurisdiction, and (iii) those in which they *must* decline jurisdiction.

The Act authorizes federal subject matter jurisdiction over cases (a) involving 100 or more putative class members, if (b) the entire amount in controversy exceeds $5 million (exclusive of interest and costs) and (c) at least one of the class members is from a different state or country than any defendant. By eliminating the complete diversity requirement, looking to the citizenship of absent class members and allowing class members to aggregate the value of their individual claims to satisfy the amount in controversy requirement, the Act greatly expands federal court jurisdiction over class actions that implicate national interests or the laws of multiple states.

The Act's expansion of diversity jurisdiction is not without limitation. First, even if a case satisfies the above criteria, the Act makes the exercise of jurisdiction discretionary in cases where it is unclear whether the litigation is interstate in character. Thus, where greater than one-third but fewer than two-thirds of the class members *and* the "primary defendants" are citizens of the state in which the lawsuit was originally filed, courts may look at the "totality of the circumstances" and decline to exercise jurisdiction based on the following statutory factors:

- whether the claims asserted involve matters of national or interstate interest;
- whether the claims asserted will be governed by the laws of the State in which the action was originally filed or by the laws of other States;
- whether the class action has been pleaded in a manner that seeks to avoid Federal jurisdiction;
- whether the action was brought in a forum with a distinct nexus with the class members, the alleged harm, or the defendants;
- 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; and

- whether, during the three-year period preceding the filing of that class action, one or more other class actions asserting the same or similar claims on behalf of the same or other persons have been filed.

The Act also includes a local controversy exception, which *requires* federal courts to decline jurisdiction over class actions in which more than two-thirds of the putative class members reside in the State in which the action was originally filed, and either (a) the primary defendants also are citizens of the State in which the action was originally filed; or (b) at least one defendant is a local defendant from whom significant relief is sought and its alleged conduct forms a significant basis for the claims asserted by the purported class. In addition, for this local controversy exception (b) to apply the principal injuries resulting from the alleged wrongdoing must have been incurred in the State in which the action was originally filed, and during the three-year period preceding the filing of the class action, no other class action has been filed asserting the same or similar factual allegations against any of the defendants.

The Act also excludes from federal jurisdiction cases in which (i) the primary defendants are States, State officials, or other governmental entities; (ii) the allegations concern covered securities under the federal securities laws; or (iii) the allegations relate to the internal affairs or governance of a corporation, a traditionally state law matter.

**Easier Removal of Multi-State Class Actions Filed in State Courts**

The Act liberalizes the procedures for removal of multi-state class actions. A class action that falls within the federal court's jurisdiction may be removed to the appropriate federal district court by any defendant without the consent of all defendants. This provision overrules in the class action context federal law requiring that all defendants consent to removal. In addition, the Act eliminates in class actions the prohibition on removal to federal court based on diversity after one-year from commencement of the case, 28 U.S.C. § 1446(b), but retains the requirement that removal must be effected within 30 days of first notice of grounds for removal. Removal of class actions also may be effected without regard to whether any defendant is a citizen of the State in which the action is brought.

Although the grant or denial of a motion to remand a case to state court ordinarily is not appealable, the Act adds 28 U.S.C. § 1453 to create discretionary, interlocutory appellate review of federal court orders granting or denying a motion to remand a class action to state court, but imposes tight appellate deadlines. Application must be made to the court of appeals within seven days of entry of the remand order. If the appeal is accepted, all appellate proceedings, including the rendering of judgment, must be completed in 60 days, unless the parties agree to extend the time or good cause for an extension is shown. The good cause extension may not exceed 10 days.

**Consumer Class Action Bill of Rights**

The Act contains a consumer class action bill of rights designed to protect federal class members from unfair settlements.

*Judicial scrutiny of coupon settlements:* Amplifying a theme expressed in many recent decisions, the Act provides that a federal judge may approve a proposed settlement under which the class would receive coupons only after a hearing to determine whether, and making a written finding that, the settlement is fair, reasonable and adequate for class members. The Act does not define "coupon," but the background to the Act makes it evident that this provision intends to address settlements that include non-cash or non-equitable consideration in the form of a voucher that may be redeemed toward the obtainment of goods or services. The court, in its discretion, may require that a proposed settlement agreement provide for the distribution of a portion of the value of unclaimed coupons to charitable or governmental organizations, as agreed to by the parties.

To further discourage the use of settlement coupons of limited value or transferability, the Act requires that attorneys' fees in coupon settlement cases be based on the value of coupons actually redeemed by class members or the amount of time class counsel reasonably expended in prosecuting the action. Upon motion of a party, the court may in its discretion receive expert testimony from a witness qualified to opine on the actual value to class members of the coupons that are redeemed. If a class settlement provides both coupons and equitable relief, the portion of counsel fees attributable to coupons will be based on the value of coupons actually redeemed, and the portion attributable to equitable relief based on time reasonably expended. The Act permits use of a lodestar with a multiplier when fees are based on time expended.

*Protection against loss by class members:* Responding to several well-publicized class settlements which, after attorneys' fees, resulted in class members being out-of-pocket, the Act provides that federal courts may not approve a settlement in which class members will be obligated to pay fees to class counsel that would result in a net loss to class members unless the court makes a written finding that non-monetary benefits to the class substantially outweigh the monetary loss.

*Protection against discrimination based on geographic location:* To prevent bounty payments to local plaintiffs, specific class members no longer may receive a larger recovery than others simply because they reside closer to the courthouse where the settlement is filed.

*Notification to appropriate federal and state officials:* Each settling defendant in all federal class actions commenced after February 18, 2005 must provide the appropriate federal official and State official of each State in which a class member resides (potentially 50 State officials for each defendant) with a specified notice package within 10 days of the filing of a proposed settlement with the court. The appropriate federal official is the U.S. Attorney General or, for depository institution defendants, the institution's primary federal regulator. The appropriate State official is the defendant's primary regulator or licensing authority. If there is no such regulator or authority, the State official is the State Attorney General. The notice package includes, *inter alia*, the complaint, notice of any hearing scheduled, any proposed or final class notice, the proposed settlement agreement and any side agreements and, if feasible, the names of class members who reside in each State and the estimated proportionate share of the claims of such members to the entire settlement to each State's appropriate State official. If not feasible,

the defendant must provide a "reasonable estimate of the number of class members residing in each State and the estimated proportionate share of the claims of such members to the entire settlement." Federal and state depository institutions may satisfy their notice obligations by delivering the required information to their respective primary regulators.

The court may not finally approve a settlement until 90 days after the later of the dates on which the defendant serves the appropriate Federal official and the appropriate State official(s) with the notice required. Failure to comply with the notification requirements could have dire consequences on the preclusive effect of a settlement. A class member 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. The Act mitigates this potential problem somewhat by providing that class members are bound by a settlement if the required notice was directed to the appropriate Federal official and to either the State attorney general or the person that has primary regulatory, supervisory, or licensing authority over the defendant.

**Anticipated Consequences of the Act**

A properly constituted class action remains an efficient mechanism to facilitate a comprehensive, consensual resolution of complex disputes arising out of an event or transaction that otherwise could mire a company or an industry in decades of litigation with myriad adversaries. A properly conceived and executed class action settlement can extinguish the claims of actual and potential claimants both in the settled lawsuit and, in appropriate circumstances, in other lawsuits in different jurisdictions. The Act does not affect this signal advantage of class actions.

The expansion of federal jurisdiction over class actions raising issues national in scope and involving parties from multiple states should go far to curb the prior practice of plaintiff class action lawyers seeking to funnel class actions into certain State courts despite the State's tenuous connection to the overall controversy. Defendants' long experience with plaintiff tactics to insulate class actions from removal — joinder of non-diverse defendants with little connection to the claims, selective non-joinder of diverse defendants, disclaiming per class member recovery in excess of $75,000 — essentially is concluded. As a practical matter, diversity jurisdiction usually will exist and most class actions should be removable to federal court unless they involve exclusively local matters and parties. Nevertheless, collateral litigation is likely to proliferate over remand orders, in which appellate courts will need to interpret such matters as the proper standard for accepting appeals of remand orders; how many class members reside in a particular State; the meaning of the undefined statutory term "primary defendant;" whether a case falls within a category of mandatory or discretionary federal jurisdiction and the weight of the myriad factors that inform discretionary jurisdiction; and how much discovery should be available on such matters.

From the defense perspective, there may be several advantages to litigating a class action in federal court, including: (i) controlling applicability of the more exacting requirements for class certification enunciated by federal courts; (ii) greater availability of interlocutory

review of class certification rulings; (iii) greater ability to consolidate related litigation through 28 U.S.C. 1404(a) transfers and the Multidistrict Litigation Panel; (iv) less restrictive use of summary judgment; and (v) access to jury pools outside the immediate locality of plaintiffs. In addition, the greater demands imposed on objectors to settlements in federal court as opposed to many state courts may curb a number of nuisance objectors to proposed settlements.

Companies that are incorporated or maintain their principal place of business in populous states should be mindful that the Act will not shield them from single-state class action complaints filed in a State in which they are domiciled.

The Act's exception for securities-related actions and claims involving corporate governance matters should result in minimal impact on the Delaware Court of Chancery's case load.

Settlements providing coupon consideration, which may be a very attractive option for defendants, have been and should continue to be approved in a variety of contexts. However, the statutorily-mandated scrutiny of such consideration, and using the anticipated value of the redeemed coupons as a benchmark for awarding attorneys' fees, may make it harder to secure class counsel agreement to settlements offering coupon consideration.

The requirement imposed on settling defendants to notify federal and state officials of specified details of any proposed settlement within 10 days of court filing should be of keen interest to companies that may need to settle class action litigation. Each settling defendant must notify the appropriate State official *of each State* in which a class member resides -- potentially 50 State regulators of multiple companies in different lines of business.

In addition to the expense and delay associated with this requirement, notifying federal and state officials may result in efforts by regulators to be heard on the settlement or the initiation of a new regulatory component to the defendant's litigation landscape, particularly in consumer cases presenting uncomplicated allegations and claims that require little specialized knowledge to grasp. And while compliance with certain elements of the notice package is simply a duplicating exercise, other requirements, such as provision of at least "a reasonable estimate of the number of class members residing in each State and the estimated proportionate share of the claims of such members to the entire settlement," may require significant investigation that parties contemplating settlement should waste no time in starting.

The inclusion in the notice package of, *inter alia*, any "other agreement contemporaneously made between class counsel and counsel for the defendants" effectively ends the practice of entering into confidential side agreements to a class action Stipulation of Settlement. The provision will require the production, for example, of agreements containing so-called "blow provisions" usually embodied in a side agreement permitting the defendant to rescind the settlement agreement if more than an agreed percentage of the class opts out of the settlement. The requirement that such agreements be produced to federal and State officials is an extension of the 2003 amendment to Fed. R. Civ. P. 23(e) requiring settling parties to file a statement identifying any agreement made in connection with the settlement.

History instructs that the plaintiff class action bar is resilient and highly creative in response to legislative initiatives directed toward them. Moreover, legislative reforms that target class action abuses often engender unintended consequences. For example, among the unintended consequences of the Private Securities Litigation Reform Act of 1995 has been a decade of increases in the number of cases filed and settlement amounts, and the emergence of ERISA stock-drop cases as companions to many securities fraud lawsuits. We will monitor closely the evolution of the class action device shaped by the Act.

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We encourage you to contact your relationship partner at Simpson Thacher & Bartlett LLP if we can be of further assistance regarding these important developments. The names and office locations of all our partners can be obtained from our website, *www.simpsonthacher.com*.

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