

Class Action Alert

March 2005

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On February 18, 2005, and with a great deal of fanfare, President George W. Bush signed into law the Class Action Fairness Act of 2005. The way the Act's passage has sometimes played in the press, the public may be forgiven for believing that Congress has now sounded the death-knell of the class action. In his State of the Union Address, President Bush urged Congress to pass the bill to curb "irresponsible class-actions." On the other side of the aisle, *The New York Times* Op-Ed page accused the Act of "reconfigur[ing] the civil justice system to achieve a significant rollback of corporate accountability and people's rights."

Reports of the class action's demise are premature. The most significant aspect of the Act is to expand the power of federal courts to hear such cases in preference to state courts. In this regard, the Act is aimed at a few "judicial hellholes" in states other than New Jersey where aggressive plaintiffs' lawyers have filed class actions of nationwide impact in order to secure conspicuously pro-plaintiff judges. The Act also requires increased judicial scrutiny of class counsel's fees in cases involving coupon settlements. These reforms are intended to curb forum shopping by plaintiffs' lawyers - that is, the practice of filing large (often multistate) class actions in certain hand-picked, plaintiff-friendly state courts.

Expanded Federal Diversity Jurisdiction Over Class Actions

The Act's most important provision expands federal diversity jurisdiction over state-law class actions that could previously have been filed only in state court. Before the Act, a class action raising solely state-law claims could only be heard in federal court if it met the diversity requirements of 28 U.S.C. § 1332. Under that statute, there had to be "complete diversity" between the parties to the suit - that is, all named plaintiffs and all defendants had to be citizens of different states. Under this provision, plaintiffs' lawyers could easily defeat federal jurisdiction simply by designating a single, non-diverse class member as a named plaintiff. Moreover, under the old statute, the court could not aggregate class members' claims to satisfy the \$75,000 amount-in-controversy requirement for diversity cases. Instead, the Supreme Court had held that to satisfy the requirement, the value of each class member's claim, taken separately, had to exceed \$75,000. *See Zahn v. International Paper Co.*, 414 U.S. 291 (1973). As a practical matter, almost no class action cases fulfilled these criteria, and knowledgeable plaintiffs' attorneys could easily plead their way around them.

The new law largely eliminates these obstacles to federal jurisdiction. It grants federal district courts original jurisdiction - with a few limited exceptions - over class action cases where:

- any class member is a citizen of a different state than any defendant; and
- the *total* amount in controversy - after adding up the claims of all the class members - exceeds \$5 million.

Exceptions to this grant of federal jurisdiction include: (1) suits against state, state officials or “other governmental entities against whom the district court may be foreclosed from ordering relief;” (2) cases involving fewer than 100 class members; and (3) cases that “solely involve a claim” regarding (i) the internal affairs of a corporation or other business enterprise arising under state law, (ii) relating to a right, duty or obligation created by a security, or (iii) concerning a “covered security” within the Securities Litigation Uniform Standards Act of 1998. See 28 U.S.C. § 1332(d)(5), (9).

Since the purpose of the Act is to assure a federal forum for interstate class actions, it does not provide for federal jurisdiction for cases which are primarily focused on a single state. Federal courts may not exercise jurisdiction if more than two-thirds of all class members and the primary defendants are citizens of the forum state. See 28 U.S.C. § 1332(d)(4)(B). The Act also precludes federal jurisdiction where: (1) two-thirds of all class members are citizens of the forum state; (2) at least one defendant from whom “significant relief is sought” and whose alleged conduct forms a “significant basis for the claims” is a citizen of that state; (3) the “principal injuries” were suffered in that state; and (4) no other class action has been filed in the past three years asserting the same or similar factual allegation against any of the defendants. See 28 U.S.C. § 1332(d)(4)(a). State courts will continue to hear such cases.

The Act also permits - but does not require - a federal court to decline jurisdiction “in the interests of justice” where less than two-thirds, but more than one-third of the putative class members and the primary defendants are citizens of the state in which the action was filed. In such cases, the Act sets forth a series of factors that the court must consider to determine whether the claims are truly local or interstate in nature. See 28 U.S.C. § 1332(d)(3).

The loosening of the diversity-of-citizenship and amount-in-controversy requirements will make it more difficult for plaintiffs to use artful pleading to force corporations to defend multistate - and even nationwide - class actions in potentially hostile state courts.

Easier Removal to Federal Court

The expansion of federal diversity jurisdiction also provides defendants with greater opportunities to remove class actions initially filed in state courts to federal court. The Act also contains several specific provisions making removal easier.

Under the new law, any one defendant may now remove a class action suit without the consent of the other defendants. Past law, by contrast, required all defendants to consent prior to removal. Moreover, a district court’s order granting or denying remand is now subject to discretionary review (on an expedited basis) by a federal appellate court. Finally, the Act removes the one-year-from-filing time limit on the removal of class actions on the basis of diversity jurisdiction. See 28 U.S.C. § 1453.

Increased Scrutiny of Coupon Settlements

The Act also reflects Congress’s concern about settlements - especially in the consumer fraud and products liability areas - where class counsel reap

large fee awards, but class members receive only coupons or vouchers with no monetary compensation. The Act codifies current federal practice by requiring a fairness hearing before the approval of any coupon settlement, and further requires a written finding by the court that the settlement is “fair, reasonable, and adequate for class members.”

More importantly, the Act seeks to remove the incentive for class counsel to “sell out” class members by requiring that contingent attorney’s fees be based on the amount of coupons that are actually redeemed, and not on the nominal value of the entire coupon settlement. (In coupon settlements that also include equitable relief, attorney’s fees may be based on a lodestar method, and calculated by applying a multiplier to the amount of time class counsel reasonable spent working on the case.)

Implications of the Act for New Jersey Companies and Class Action Practice

The Act is aimed primarily at curbing the perceived abuses in a small number of class action “magnet courts” - state courts in jurisdictions like Madison County, Illinois; Jefferson County, Texas; and Palm Beach County, Florida, that are known for their plaintiff-friendly jury pools and judges willing to certify large, nationwide class actions. The Act’s expansion of federal jurisdiction will be a boon to New Jersey-based corporations who might otherwise be hauled before far-away and inhospitable state courts as defendants in multistate class actions. Not only will the more lenient removal provisions make it easier to move such cases into the federal courthouse, but the removal of the prospect of an easy class certification and sympathetic trial in state court may dissuade plaintiffs from filing some less meritorious class action suits in the first place.

The Act is not likely to produce a sea change in class action practice in New Jersey state courts, however. As an initial matter, the Act only applies to class actions filed after its adoption, February 18, 2005, so currently-pending cases will continue to proceed under the old rules. Moreover, New Jersey courts have not traditionally been magnets for multistate class actions given their reluctance to certify such cases, and will thus be impacted less by the expansion of federal diversity jurisdiction. In contrast to the plaintiff-friendly courts of Madison County, New Jersey’s courts are generally perceived as providing competent and relatively neutral venues for defendants in class action litigation. Class actions whose plaintiffs, defendants and injuries have a substantial connection to New Jersey will likely still be able to proceed in state court under the Act’s “one-third/two-thirds” provisions - though they may entail expensive litigation relating to identifying the citizenship of putative class members.

The increased scrutiny of coupon settlements may prove to be a mixed blessing to corporate defendants. While the new provisions regulating the payment of attorneys’ fees could discourage some unmeritorious strike suits, defendants may also face a plaintiffs’ class action bar that is increasingly unwilling to settle for anything less than a cash award.

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