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Client Alert

A report for clients and friends of the firm

March 2005

The Class Action Fairness Act of 2005[1]

On February 18, 2005, President Bush signed into law the Class Action Fairness Act of 2005 (the "Act"). According to President Bush, "The [Act] marks a critical step toward ending the lawsuit culture in our country." The stated objective of the Act is to combat "abuses" by amending the procedures applicable to interstate class actions, and assure fairer outcomes for class members and defendants. The Act seeks to reduce frivolous lawsuits, and deter practices in some state court class actions, such as identical filings in multiple states, and other forms of "forum shopping." The Act expands federal jurisdiction over most interstate class actions by eliminating the need for complete diversity of citizenship between plaintiffs and defendants, thus allowing the removal of larger multi-state class actions from state to federal court. The Act also mandates stricter scrutiny of settlements, especially "coupon settlements." Highlights of the new legislation are summarized below:

Expansion of Federal Jurisdiction

District courts have original jurisdiction over any civil action where:

- The matter in controversy exceeds $5 million, excluding interest and costs;
- There are at least 100 class members; and
- Diversity of citizenship exists between any one member of the plaintiff class (whether a named plaintiff or not) and any defendant.

A district court may decline jurisdiction if:

- Over one-third but less than two-thirds of the members of the proposed plaintiff class and the primary defendants are citizens of the State in which the action was originally filed.

A district court must decline jurisdiction if:

- Two-thirds or more of the class members are citizens of the state where the case was filed and:
    - At least one defendant is a defendant:
        - From whom significant relief is sought;
        - Whose alleged conduct forms a significant basis for the claims asserted; and
        - Who is a citizen of a state in which the action was originally filed;
    - The principal injuries resulting from the alleged conduct of each defendant were 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.
- Two-thirds or more of members of the proposed plaintiff class and the primary defendants are citizens of the State in which the action was originally filed.

[1] http://www.theorator.com/bills109/s5.html

Federal jurisdiction does not apply to class actions solely involving:

- Claims concerning a covered security as defined under Section 16(f)(3) of the Securities Act of 1933 (the "Securities Act") and Section 28(f)(5)(E) of the Securities Exchange Act of 1934 (the "Securities Exchange Act");
- Claims related to the internal affairs or governance of a corporation or other form of business enterprise that arise under the laws of the State in which such corporation or business enterprise is incorporated or organized; or
- Claims related to the rights, duties (including fiduciary duties), and obligations pursuant to any security as defined under Section 2(a)(1) of the Securities Act and the regulations issued thereunder.

Coupon Settlements

A court may only approve a proposed coupon settlement after it holds a hearing and issues a written opinion finding that the settlement is reasonable, adequate, and fair to class members.

With respect to contingency fee cases, the Act puts an end basing attorney's fees upon the value of coupon settlements issued and in its place requires the fee to be based upon the value of the coupons actually redeemed, or the amount of time the class counsel actually spent working on the case.

Protection against Geographic Discrimination

Courts must reject a proposed settlement that provides greater recovery to certain class members solely based upon their geographic proximity to the court.

Notification of Settlement

Defendants participating in proposed class action settlement must make specified disclosures concerning the proposal to certain state and federal officials (including the U.S. Attorney General) within 10 days after a proposed settlement is filed with the court. Class members may refuse to be bound by a settlement agreement if the defendants fail to comply with these requirements.

Impact of the Act

The Act enables defendants to remove class actions to federal courts, and could result in a substantial reduction in class actions filed in "magnet" state courts with a reputation for being sympathetic to plaintiffs and returning disproportionately large verdicts. Prior to the enactment of the Act, a defendant could not remove a case to federal court because removal required complete diversity between the parties, which rarely is present in large class actions. Proponents of the bill state that the changes are necessary to combat aggressive trial lawyers from seeking out friendly state courts willing to approve large settlements against out-of-state businesses. Supporters believe the Act will especially benefit smaller companies, which are vulnerable to the tremendous strain on resources caused by class litigation.[2] Critics argue the Act will make it more difficult for plaintiffs to hold companies accountable for violations of state consumer, health, civil rights and environmental protection laws, particularly given the federal courts' hostility to class actions where multiple states' laws may apply.[3] It will take some time, and decisions interpreting the Act, to determine whether the Act will have a substantial effect limiting class actions based on state law.

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[2] "Class Action Fairness Act benefits midsized and small companies" at http://www.rsmmcgladrey.com/Resource_Center/Articles/General/ClassActionFairness.html

[3] "Bush Signs So-Called Class Action Fairness Act of 2005" at http://www.legalnewswatch.com/news_538.html; see also, "Bush Signs Law Curbing Class Action Lawsuits" at http://www.reuters.com/newsArticle.jhtml?type=topNews&storyID=7675999