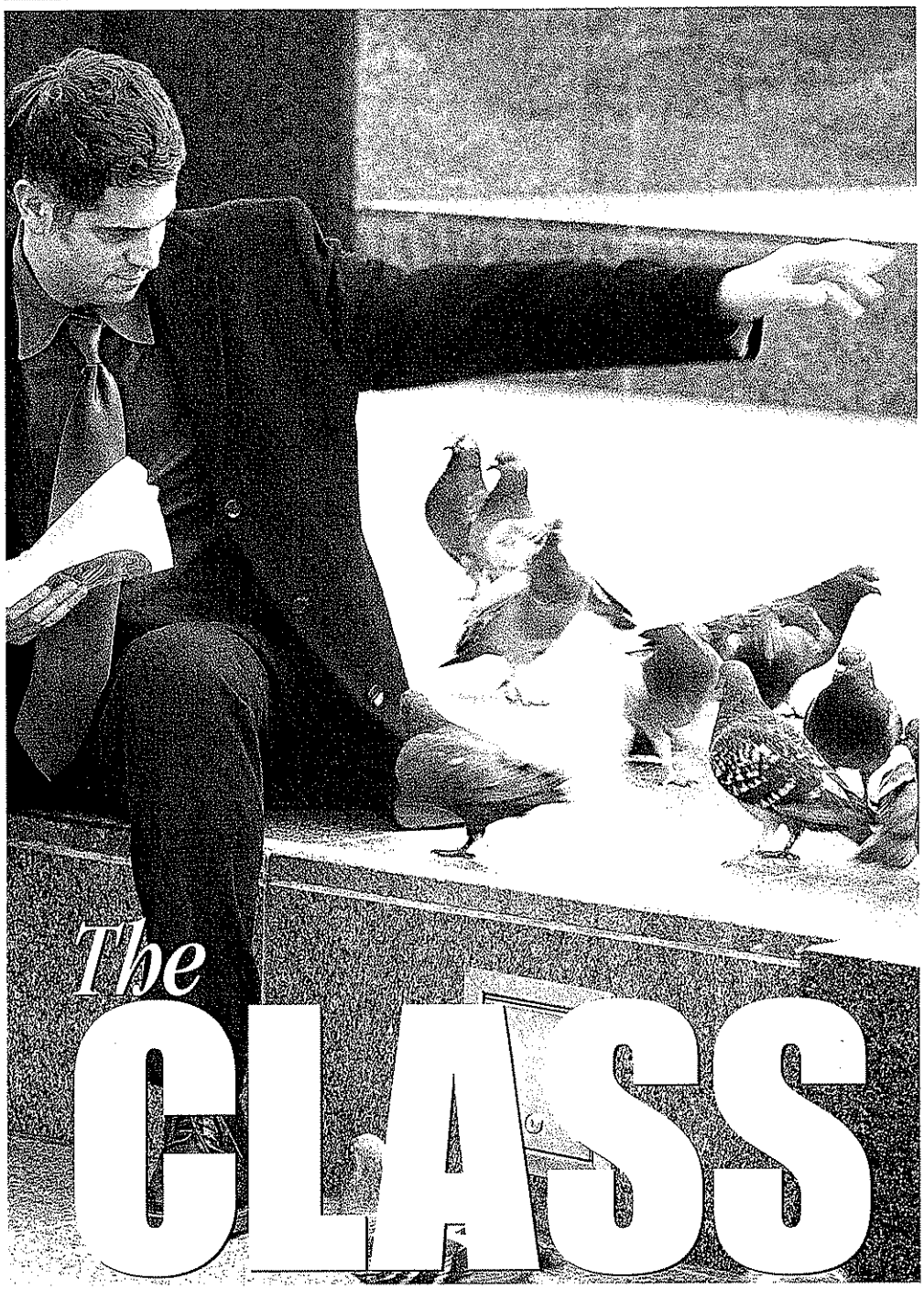

The CLASS ACTION Fairness Act

by Aashish Y. Desai

President Bush, on February 18, 2005, signed into law the Class Action Fairness Act of 2005. The CAFA was intended to reduce "jackpot" justice and was no doubt influenced by the analysis of the American Tort Reform Association's "Judicial Hellholes" study, which outed several counties where class certification and money judgments were purportedly as easy as they were grossly generous. The CAFA goes much further than most think, impacting settlements, attorney's fees, class notice, and so-called "mass actions." But while some predict that class actions are now a thing of the past, the law of unintended consequences may play a significant role in reshaping the never ending debate between corporate governance and consumer rights.

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The Class Action Fairness Act

The main thrust of the Class Action Fairness Act is to expand federal diversity jurisdiction over—or "federalize"—class actions. Section IV of the Act provides that federal courts will have original jurisdiction over any class action in which there are at least 100 members and the *aggregate* amount of controversy exceeds $5 million and: 1) any member of a plaintiff class is a citizen of a different state from any defendant; 2) any member of the plaintiff class is a foreign state or citizen or subject to a foreign state, and any defendant is a citizen of a state; *or* 3) any member of a plaintiff class is a citizen of a state and any defendant is a foreign state or a subject of a foreign state. 28 U.S.C. §1332(d)(2)(A). Obviously, this is an expansive definition which obliterates the old federal jurisdiction rules. *Stawbridge v. Curtiss*, 7 U.S. 267 (3 Cranch 1806) (requiring complete diversity for federal jurisdiction when suit does not involve a federal question).

The Exceptions to the CAFA

To start, securities class actions, and suits against state officials who are entitled to sovereign immunity in federal court, are exempt from the requirements of the CAFA. But in addition to these blanket exemptions, there is a "home state exception" against removal if two-thirds or more of the class members are from, at least, one "significant" defendant's home state. 28 U.S.C. §1332 (d)(4)(A). Conversely, if there are less than one-third of the class members of the home state, the case will automatically be subject to federal jurisdiction. 28 U.S.C. §1332 (d)(4)(B). For the middle tier, i.e., cases between one-third and two-thirds, federal jurisdiction exists when it is "in the interest of justice."

The bill spells out a six-prong test to control the district court's decision, including factors such as whether the claims asserted are a significant national interest, or governed by laws other than those of the foreign state. Another exception to the CAFA is the so-called "Local Controversy Exception," which mandates remand of class actions where in-state plaintiffs compromise greater than two-thirds of the class and the "primary defendants" are form the home state. The full ramifications of this bill on choice of venue decisions for class counsel are outside of the scope of this article, but obviously must be considered before filing a class action complaint.

Restrictions on Settlements

The CAFA actually has two, somewhat self-defeating, parts. The first gives consumers "protections" from class action settlements in the Consumer Class Action Bill of Rights. The second part expands federal jurisdiction.

In the Bill of Rights, class action lawyers who settle cases for coupons can only be paid based upon the number of coupons which are actually redeemed. Thus, if a settlement has a total value of $10 million, but only $1 million of coupons are actually redeemed, the fees are based on the $1 million, not $10 million. Moreover, the court has discretion to appoint its own expert to determine the actual value of the $1 million of coupons which have been redeemed. While this sounds completely reasonable in theory, a practical look at this provision shows that it is not always so.

It is important to note that, it is almost always the corporation's, not class counsel's, idea to settle a case for coupons. Additionally, coupons are sometimes necessary when the alternative may be that the corporation files for bankruptcy protection as a result of the litigation; here, no one wins. The coupon solution, therefore—in the *right case*—helps to solve a corporate problem, which is often strenuously denied, while providing some, albeit limited, benefit to the consumers who chose to utilize it. Of course, it also provides additional sales of the corporation's product and is therefore viewed as a "win-win" in the boardroom. Class counsel generally obtains attorney's fees on the aggregate settlement value, but they have legitimately forced the corporate wrongdoer to do something which it otherwise would not have done—issue the coupons. Remember the alternatives: bankruptcy, and more expensive and lengthy litigation. Now that the CAFA prevents this rarely utilized, but often publicized, solution, there likely will be no more coupon settlements. This costs both the corporation and consumers who are now, contrary to the goals of the CAFA, *forced to litigate* for large damages; the "win-win" model will no longer exist.

Moreover, the CAFA encourages the

application of the lodestar, instead of the common fund, method of awarding class counsel's fees in coupon settlements. The lodestar methodology, unlike the "percent of the benefit" common fund theory, takes the *actual time* expended by class counsel and then adjusts the amount upward or downward based upon various factors. *Johnson v. Georgia Highway Express, Inc.*, 488 F.2d 714, 717-19 (5th Cir. 1074). But, in practice, the lodestar method proves to be difficult to apply, is time-consuming to administer, has inconsistent results, and is capable of manipulation to reach a predetermined result. It has, therefore, been roundly criticized by legal commentators and courts. *See* Court Awarded Attorney's Fees, Report of the Third Circuit Task Force, 108 F.R.D. 237, 246-53 (1985). In fact, in cases which do not involve statutory fee shifting provisions, the federal trend has been toward the percentage of the fund method. *Camden I Condominium Assoc., Inc. v. Dunkle*, 946 F.2d 768 (11th Cir. 1991).

Notice to Appropriate Federal and State Officials

Section 1715 of the CAFA requires *each settling defendant*, within 10 days of filing proposed class action settlement papers, to provide notice to: 1) the U.S. attorney general (for banks and thrifts); and 2) the state official who has primary regulatory or supervisory responsibility over the defendant or who licenses the defendant. If no official meets this requirement, notice must be provided to the state attorney general. The notice must be comprehensive. It must include: 1) a copy of the complaint; 2) the date and time of any scheduled judicial hearing; 3) the proposed notice to the class; 4) the proposed settlement documents; 5) any final judgment; 6) the names of all class members who reside in each state and the proportional share of their settlement; 7) any other agreement between class counsel and the defendant; and 8) any written judicial opinion related to the settlement.

If a defendant does not comply with these provisions, it risks the benefits of *res judicata* against any class member who later challenges the conduct which brought about the settlement in the first place. Of course, this has the unintended effect of *increasing* the defendant's legal bill in that defense counsel will have to oversee and draft these documents to comply with the additional technical requirements. Moreover, these notice requirements may actually increase regulatory scrutiny and oversight to an otherwise semi-private settlement. For example, if the Department of Insurance learns about one insurance company's settlement for paying independent brokers for selling "vanishing premium" life insurance polices to a certain segment of the population, it may begin its own investigation into the policies of the life insurance industry *in general*, a la New York's infamous attorney general, Eliot Spitzer.

The Unintended Problems with the CAFA

Indeed, the unintended problems with the CAFA are, by definition, largely unknown. But a few provisions give immediate pause for consideration. The CAFA is both broad in scope and inartfully written for application—a deadly mix for legislation. It is a hodgepodge of compromises which are sliced together for expediency, not legitimacy. For example, how will the $5 million amount in

controversy requirement be ascertained? Traditionally, plaintiffs allege in the complaint that "none of the plaintiffs or individual members of the class have damages, exclusive of interest and costs, equal to or greater than $75,000." The allegations of the complaint control for purposes of determining the jurisdictional amount. *St. Paul Mercury Indem. Co. v. Red Cab Co.*, 303 U.S. 283, 294 (1938) ("the status of the case as disclosed by the plaintiff's complaint is controlling in the case of removal . . . if plaintiff does not desire to try his case in the federal court he may resort to the expedient of suing for less than the jurisdictional amount, and though he would be justly entitled to more, the defendant cannot remove"). Do the allegations of the complaint still control or is more than 200 years worth of federal civil procedure law overturned?

Likewise, how will courts determine if more than two-thirds of the class members are from the home state? Often, class counsel himself or herself has no way of knowing

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where the class members are located, particularly at the time of filing. Is class counsel now entitled to expensive and *immediate* discovery on this issue? Moreover, what makes a defendant a "primary defendant" under 28 U.S.C. §1332 (d)(4)(A)? What legally qualifies as "significant relief" for application of the Local Controversy Exception? And, how long will class counsel have to wait to determine the redemption rate of the coupon settlement to obtain their attorney's fees? What if the coupons, by state law, cannot have an expiration date? Of course, lawyers will litigate these, and many more, issues for the next several years and the appellate courts will sort out and establish tests for all of these problems; but not without significant pain and predictable conflict between the federal circuits.

An Examination of the "Judicial Hellhole" Study

The American Tort Reform Association's "Judicial Hellholes" study reviewed over 3100 counties in the United States. It identified *only nine* counties which are "unfair" to defendants. But in only two of these "hellholes" did ATRA provide data to substantiate its claims. And in one of these counties, Madison County, Illinois, the courts have certified only one out of 188 class actions in the last two years—hardly a reason for change. It is important to keep in mind that class actions have been utilized effectively for social and economic change for years. *Brown v. Board of Education*, 347 U.S. 483 (1954), which mandated the desegregation of the nation's public school system, was a class action. Indeed, class actions are the only real vehicle to prevent corporate fraud that affects consumers a few dollars at a time. Who would individually prosecute a well-funded phone company for an improper late fee of a few dollars or a few dropped calls which marginally impact your monthly bill?

The 1995 Private Securities Litigation Reform Act was passed to make it more difficult for plaintiffs to get past defense motions to dismiss and therefore reduce the number of securities fraud class actions. A recent study by PricewaterhouseCoopers found that the number of securities class action suits actually *increased* by an incredible 16% from 2003 to 2004. While the Sarbanes-Oxley corporate reform law accounts for some of this change, the fact remains that drastic changes in the law almost always have unintended consequences. The CAFA is no different.

The Hypothetical "Benefit" for Corporations

The real "benefit" for corporations, that lobbied for almost seven years for this legislation, is the notion that federal courts are reluctant to certify class action disputes, thereby thwarting nationwide class actions altogether. This premise has two problems. First, most people assume that federal courts are unlikely to certify such cases. But empirical evidence suggests otherwise. On average, federal courts are just as likely to certify a class action as state courts. Tomas E. Eillging & Shannon R. Wheatman, *An Empirical Examination of Attorneys' Choice of Forum in Class Action Litigation*, Federal Judicial Center (2005). Second, even if federal courts do not certify nationwide class actions, they will not automatically or magically disappear.

Class action lawyers are, relatively speaking, a small and unique bread. They build

relationships with each other from many different states and share ideas, pleadings, resources, and ultimately cases. If the federal courts deny nationwide certification, this network will surely go into high gear. The likely, and unintended, result of the CAFA may be an overall *increase* in multiple state-wide actions, coordinated by informal agreement.

For its part, the corporation will have to hire defense counsel, at silk-stocking firm rates, in each jurisdiction, who, in turn, will undoubtedly have to spend vast amounts of time and money coordinating and refining their litigation efforts and strategy. Different courts may reach opposite, or somewhat conflicting, results on discovery, class certification, damages, coordination, and trial. The appeals from different jurisdictions on various unfavorable legal decisions may further complicate matters, and settlements will likely involve monumental efforts between the various states and their team of class counsel, that each may have veto power over the terms of any settlement. To add insult to injury, "fees as a percentage of class recovery were found to be *higher* in federal than state court." Profs. Theodore Eisenberg and Geoffrey Miller, *Journal of Empirical Legal Studies*, Volume 1, Issue 1, 27-78.

The classic shark attack versus the school of piranha (a small South American freshwater fish that has extremely sharp teeth, strong jaws, and is as dangerous a predator as any when attacking in large numbers)... While one routinely hears of the surfer who survived a shark attack with only a few scares, how many people survive an attack by a school of piranha?

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