

BY MARK B. SEIGER AND
CHRISTOPHER W. HEALY

ACCLASS REACTION REFORM:

WILL PERCEPTION
BECOME REALITY



JUSTICE

After several failed attempts, the 109th Congress enacted class action reform legislation on February 17, 2005, which President George W. Bush signed into law the very next day. At the White House signing ceremony, President Bush stated “[t]he Class Action Fairness Act of 2005 marks a critical step toward ending the lawsuit culture in our country. The bill will ease the needless burden of litigation on every American worker, business and family. By beginning the important work of legal reform, we are meeting our duty to solve problems now and not to pass them on to future generations.”

This legislation, known as the Class Action Fairness Act of 2005 (the “Act” or “S.5”), is being hailed by many as a significant stride forward in controlling the perceived abuses in class action litigation and a major first step in the much-needed area of tort reform. The GOP has positioned the Act as court reform, not tort reform since it does not affect substantive legal rights of claimants.

Big business overwhelmingly supported the Act because of the ease with which it allows class action lawsuits to be transferred from more lenient state courts to federal courts, which tend to more rigorously apply the certification standards, thus hopefully bringing uniformity and evenhandedness to class action certification. According to big business, consumers will ultimately benefit through lower consumer prices and more innovative products if illegitimate and ill conceived class actions are deterred and businesses are freed from fighting these very cases in court.

From the insurance industry’s perspective, the Act’s impact will hopefully arise from its chilling effect on the class action plaintiffs’ bar. It is hoped that the class action plaintiffs’ bar will perceive the Act as a significant hurdle, or even as a deterrent, to

the filing of class action lawsuits, resulting in a significant decrease in the number of such suits and a reduction in forum shopping. However, if the Act does not create an incentive for the class action plaintiffs’ bar to more carefully pre-screen potential class action cases, then it will likely have failed in its intended purpose.

A Bit of History

In 1938, Congress promulgated the first Federal Rules of Civil Procedure (FRCP). The FRCP included Rule 23, which for the first time made class-action suits for damages available in the United States.

(The modern-day class action suit in the United States developed from the English Bill of Peace, which created an opportunity for one person, referred to as the “adversary,” to sue multiple per-



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sons with separate but similar interests, referred to as the “multitude,” or for the multitude to bring a single suit against the adversary. It was first codified as a rule of equity in the United States in 1842 as Federal Equity Rule 48. However, Rule 48 missed the mark in several ways, not the least of which was the fact that judgments in cases brought under Rule 48 were not binding on absent parties. This was corrected when the rule was re-cast in 1912 as Federal Equity Rule 38. Even under Rule 38, however, the class action continued to be available only in courts of equity, and thus could not be relied upon in a suit for damages.)

Since its adoption, Rule 23 has been the subject of significant criticism on a number of fronts. For example, although absent members of a class in a spurious class action were

clearly not subject to an unfavorable decision, it was far less clear as to whether such persons could reap the benefits of a favorable decision. To address the concerns raised with respect to Rule 23, Congress completely rewrote the Rule in 1966. The amended Rule established four elements as a prerequisite to all categories of class actions. First, the class must be so large that it is impracticable to join the members in court. Second, there must be one or more questions of law or fact common to the class. Third, the claims or defenses of the representatives must be typical of the class. And fourth, the representatives must fairly and adequately represent the class. The amended Rule did address certain shortcomings of its predecessor, and has, for the most part, remained unchanged since the 1966 amendments.

(Despite revisions to Rule 23 throughout the years, a major problem has persisted. This problem stems not from the rule itself, but rather from its application. Federal courts have in many instances lacked the power to adjudicate many class action lawsuits because personal jurisdiction was lacking.)

The Primary Problem

1. Diversity jurisdiction. A Federal court can only hear those actions over which it has jurisdiction. In other words, absent jurisdiction, a federal court is without the power to adjudicate a dispute. One of the primary powers granted by Congress to the federal courts was the power to adjudicate actions involving diversity jurisdiction. This grant of power is found in 28 USC § 1332, which provides district courts with “original jurisdiction of all civil actions where the matter in controversy exceeds the sum or value of \$75,000, exclusive of interest and cost, and is between citizens of different States; citizens of a State and citizens or subjects of a foreign state; citizens of different States and in which citizens or subjects of a foreign state are additional parties; and a for-

eign state, defined in section 1603(a) of this title, as plaintiff and citizens of a state or of different states.”

In order to satisfy the requirements of 28 USC § 1332, each proposed class member’s individual claim must exceed the sum or value of \$75,000, exclusive of interest and costs, plus complete diversity must exist between each proposed class member and each defendant. (Typically, the plaintiffs’ class action bar files class actions in lenient and plaintiff friendly state courts. These cases usually cannot be removed to federal court because certain parties are purposefully added so as to destroy diversity. Absent jurisdiction based upon a federal question, such as a violation of the United States securities laws, jurisdiction based on diversity of citizenship is destroyed.)

Aggregation of claims is not permitted to arrive at the \$75,000 threshold. In most federal class action litigation, the \$75,000 threshold and complete diversity of citizenship requirements are impossible to meet. As such, despite the legal significance of a claim and its potential impact on interstate commerce, federal courts often lack jurisdiction, allowing the class action plaintiffs’ bar to forum shop for a more lenient state court. This situation has drawn substantial criticism over the years since the adoption of FRCP 23. The Act is designed to remedy this concern as well as other perceived flaws in Rule 23.

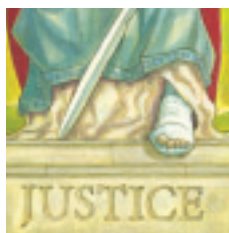
2. *Coupon Settlements.* Coupon settlements have been prevalent and for the most part permitted by state court judges. Many state court class actions are settled early on with the defendants providing the class members with coupons that, in their aggregate, add up to hundreds of millions of dollars. Attorneys’ fees are then awarded based on the full-face amount of the aggregate dollar amount of the coupons issued, rather than on the actual value of those coupons redeemed by the class members. As such, attorneys’ fee

awards end up being disproportional to the benefit provided to the class. This result clearly benefits the plaintiffs’ class attorneys, not the class members themselves. Moreover, coupon settlements have provided defendants with a facilitative solution that may not cost them much in the way of up-front dollars, other than the payment of attorneys’ fees along with those few coupons that are actually redeemed. The Act contains a provision that addresses this issue, thereby hopefully eliminating many coupon settlements. Increased judicial scrutiny of coupon settlements should also result in a decreased number of class action lawsuits

since defendants are less likely to settle spurious claims for real dollars.

The Act’s Findings and Purpose

Congress’ stated intent in passing S.5 is “[t]o amend



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the procedures that apply to consideration of interstate class actions to assure fairer outcomes for class members and defendants, and for other purposes.” It is important to note that Congress is seeking to provide a mechanism to produce fairer outcomes to class members and defendants. This statement of intent flows naturally from Congress’ findings. Through this legislation, Congress is not attempting to eliminate class action litigation, but merely to make the system fairer to all of the parties to such litigation, and to society as a whole.

This last component is especially important, as the public typically sees the lawyers, both the defense counsel who work for hourly fees regardless of the outcome and plaintiffs’ counsel who stand to obtain contingency fees if the class prevails,

as the only winners in such a system.

In Section 2 of the Act, Congress acknowledges the importance of class action lawsuits to our system of jurisprudence, while at the same time recognizing the abuses that have previously occurred, when it states that over the past decade, there have been abuses of the class action device that have harmed class members with legitimate claims and defendants that have acted responsibly; adversely affected interstate commerce; and undermined public respect for the judicial system.

S.5, Sec. 2 (a)(2). Section 2 of the Act further points out the impact of class action abuses by finding that abuses in class actions undermine the national judicial system, the free flow of interstate commerce, and the concept of diversity jurisdiction as intended by the framers of the United States Constitution. It backs up the point by noting that State and local courts are

keeping cases of national importance out of Federal court; sometimes acting in ways that demonstrate bias against out-of-State defendants; and making judgments that impose their view of the law on other

States and bind the rights of the residents of those States.

After making its case for the Act, Congress succinctly states the purpose of the Act as threefold: 1) to assure fair and prompt recoveries for class members with legitimate claims; 2) to restore the intent of the framers of the United States Constitution by providing for Federal court consideration of interstate cases of national importance under diversity jurisdiction; and 3) to benefit society by encouraging innovation and lower consumer prices.

Key Provisions of the Act

While there are numerous provisions in the Act, many of which will likely spawn significant procedural litigation over the next several years for clarification, the salient points of the Act are as follows:

- Federal jurisdiction is generally granted over class actions in which the aggregate amount in controversy exceeds \$5 million, exclusive of interest and costs, and is between citizens of different states; however, complete diversity is no longer required. The importance of this provision is that it eliminates the requirement for complete diversity between each class member and each defendant, thus eliminating the problem of Rule 23's application as described previously and thereby permitting defendant corporations to remove virtually all class action lawsuits to federal courts.

- Mass tort actions in which there are 100 or more plaintiffs that are proposed to be tried jointly on the ground that the plaintiffs' claims involve common questions of law or fact, shall be treated as class actions under the act for purposes of federal jurisdiction, but only with respect to those plaintiffs' whose individual claims exceed \$75,000, exclusive of interest and costs.



The fact that aggregation of the value of each class member's claim is now permitted and that complete diversity is no longer required will inevitably open the doors

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- Keeps in state courts any class actions filed in a defendant's home state when two-thirds or more of the class members are from that state.
- Requires that class counsel's attorneys' fee award be based on the value of the settlement to the class members if a proposed class action settlement provides for the payment of coupons or non-monetary awards to class members. For those settlements where coupons comprise at least a portion of the proposed settlement, the attorney's fee must be based on the value of the coupons actually redeemed (as opposed to the value of the coupons issued) or the amount of time counsel actually worked on the case.
- Requires careful judicial scrutiny, including a hearing on the adequacy

and fairness of the proposed settlement to class members, of any proposed class action settlement where the class members' award is de minimus (such as coupon settlements).

- Bars settlements that favor some class members over others based solely on their geographic proximity to the court in which the lawsuit is pending.
- Requires defendants to provide notice to a responsible state and/or federal official about any proposed class settlement.

to the federal courts. Once inside those doors, cases will hopefully be more fully and fairly litigated, resulting in what Congress believes will be a fair result to both class members and defendants.

The additional scrutiny imposed on coupon settlements will likely cause the plaintiffs' class action bar to be more concerned with the resolutions that they promote on behalf of class members. Absent real value being provided to the class members in coupon settlements, the class action plaintiffs' bar stands to receive little in the way of attorneys' fees. In essence, the Act federalizes class action litigation, removing many of the reported abuses that have occurred in class action lawsuits filed in extremely lenient and well-known state courts.

CAFA's Impact

Since its passage almost one year ago, litigation involving the Act has focused largely on retroactivity of the Act insofar as it applies to complaints filed in state court prior to enactment. Section 9 of the Act provides that "[t]he amendments made by this Act shall apply to any civil action commenced on or after the date of enactment of this Act." Defendants have vigorously argued that the term commenced means when the action is removed to federal court. Conversely, plaintiffs have argued that commencement occurs when the action is first filed in a court of appropriate jurisdiction. For the most part defendants have been largely unsuccessful, with several circuits holding that for purposes of the Act, the action is commenced when filed in the court of proper jurisdiction. [*Natale v. Pfizer, Inc.*, 424 F.3d 43, 44 (1st Cir. 2005) (holding state law suit commences when it begins in state court); *Bush v. Cheaptickets*, 425 F.3d 683, 686 (9th Cir. 2005) ("CAFA's 'commenced' language surely refers to when the action originally commenced in state court"); *Schorsch v.*

Hewlett-Packard Co., 417 F.3d 748, 751 (7th Cir. 2005) (holding that amendments to class definitions do not commence new suits, so as to permit removal); *Knudsen v. Liberty Mut. Ins. Co.*, 411 F.3d 805, 808 (7th Cir. 2005) (holding same); *Pritchett v. Office Depot, Inc.*, 420 F.3d 1090, 1094 (10th Cir. 2005) (holding that the term commenced in the Act refers to the initial filing date and not the removal date).]

Other courts have recognized a caveat to this rule, however, in the case where an amendment to the complaint is made after the Act's enactment, or where additional defendants are served after enactment. [*Weekley v. Guidant Corp.*, 392 F. Supp.2d 1066, 1068 (E.D. Ark. 2005) ("Pleadings may be amended, but amending pleadings does not commence a civil action. By definition, a

civil action must already have been commenced before a pleading can be amended.”); *Richina v. Maytag Corp.*, No. Civ. S05-1281, 2005 WL 2810100 *3 (E.D. Cal. Oct. 25, 2005) (second amended complaint filed after the effective date of CAFA in action where initial complaint was filed prior to effective date was not removable due to commencement of action before CAFA’s enactment); but see *Plummer v. Farmers Group, Inc.*, 388 F. Supp. 2d 1310, 1316 (E.D. Okla. 2005) (post-CAFA amendment of complaint filed prior to CAFA enactment was de facto commencement of new suit and therefore removable). See also *Dinkel v. General Motors Corp.*, No. Civ. 05-190, 2005 WL 3006728 (D. Me. 2005) (interpreting Kansas procedural law to conclude that the lawsuit commenced after service of process on all defendants, and plaintiffs subsequent dismissal of later served defendants did not remove federal jurisdiction.)]

Another contentious issue, which still remains unsettled in the courts, is the question of which party bears the burden of proving that federal jurisdiction is lacking once removal has been sought. While it is traditionally the proponent’s burden to establish federal jurisdiction, legislative history published by the Senate Judiciary Committee has caused some courts to decidedly shift that burden. The committee report states: “If a purported class action is removed pursuant to these jurisdictional provisions, the named plaintiff(s) shall bear the burden of demonstrating that the removal was improvident (i.e., that the applicable jurisdictional provisions are not satisfied.)” [11 S. Rep. 14, 109th Cong. 1st Sess. 42 (2005).]

And while the Seventh Circuit has upheld the traditional rule in the post-CAFA environment, many district courts have relied on this language in concluding that the plaintiff, and not the defendant, maintains the burden of proving removal is improper. [12 *Brill v. Countrywide Home Loans, Inc.*, 427 F.3d 446,447-448 (7th Cir. 2005) (“That the proponent of jurisdiction bears the risk of non-persuasion is well established.”). But see

Berry v. American Express Publishing Corp., 381 F. Supp. 2d 1118, 1122 (C.D. Cal. 2005) (“the Committee report expresses a clear intention to place the burden of removal on the party opposing removal to demonstrate that an interstate class action should be remanded to state court.”); *Natale v. Pfizer, Inc.*, 379 F. Supp. 2d 161, 168 (D. Mass 2005) affirmed on other grounds, 424 F.3d 43 (1st Cir. 2005) (relying on Committee Report to shift burden to opposing party).]

Due to the Act’s recent passage, there will likely be increased litigation regarding the interpretation of other sections of the Act in coming months.

Reducing Caseload

From the perspective of big business, the significant benefit of the Act is that it creates federal jurisdiction for many class action claims that previously would have been filed in state courts favorable to the plaintiffs’ bar. Federal courts are perceived to be more neutral and less willing to certify class actions brought on questionable grounds since federal judges are tenured and need not pander to any constituencies or the plaintiffs’ bar. As such, federal judges tend to apply the class action criteria more evenly. More importantly, class action plaintiffs’ attorneys typically and historically filed class actions with the hope that there would be an early settlement utilizing coupons that may cost the defendant very little in terms of actual settlement dollars, but the total value of which will serve as the basis of their attorney’s fee.

As noted above, the Act requires the federal court to award attorney’s fees to class counsel based upon the actual value of the coupons redeemed, rather than the total face amount of all coupons issued or, alternatively, based upon the actual value of the time spent on the litigation by class counsel. This provision alone will force class counsel to properly evaluate cases before filing them and, as such, should result in a significant reduction in the number of such cases. From the perspective of the insurance industry, the anticipated result of this reduction in the number of class action lawsuits

should result in a significant savings for the insurance companies whose policies may have otherwise been called upon to defend and indemnify class action claims. The Class Action Fairness Act should open courthouse doors to the federal courts for defendants that have long suffered the abuses of lenient and plaintiffs’ friendly state court judges. The Act will hopefully force plaintiffs’ class counsel to properly pre-screen punitive class actions, which should result ultimately in a reduction of class certification. Both the insurance industry and big business, as well as society as a whole, should be the beneficiaries of the Act. ■

Mark B. Seiger is a partner in Edwards Angell Palmer & Dodge, LLP resident in the firm’s Hartford, Connecticut office. Mark is a member of both Litigation and Insurance and Reinsurance Departments. **Christopher W. Healy** is a partner in Edwards Angell Palmer & Dodge, LLP resident in the firm’s New York City office. Chris is a member of the firm’s Litigation Department and is also in that department’s Class Action and Mass Litigation practice group. His practice focuses on insurance, products liability and mass/toxic torts. He has extensive experience in defending, managing and litigating mass tort and insurance related litigations, including commercial insurance and reinsurance coverage disputes, toxic tort actions and consumer class actions. Chris can be reached at (212) 756-0326, or you can email him at chealy@eapdlaw.com.

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