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# **Understanding the Class Action Fairness Act of 2005**

**Professor William B. Rubenstein  
UCLA Program on Class Actions**

## **UCLA Program on Class Actions**

Class action lawsuits are among the most prevalent and important forms of adjudication in the U.S. Class actions serve a critical function in enabling private parties to supplement public law enforcement. Yet the class action lawsuit can also be misused.

The UCLA Program on Class Actions is a center for the study and development of sound approaches to class action lawsuits. The Program's primary goals are (1) to further scholarship in the field of complex litigation; (2) to assist the bench and bar in developing effective and efficient practices for complex cases; and (3) to contribute to the public's comprehension of class action law and public policy. The Program pursues these goals through the publication of scholarship, educational materials, and opinion pieces; and by bringing together scholars, lawyers, judges, and the public to discuss and debate cutting-edge issues.

The Program is providing this continuing legal education program on the Class Action Fairness Act of 2005. In January 2006, the Program – in conjunction with the *UCLA Law Review* – will host a symposium on class action law.

### **Professor William B. Rubenstein**

Professor William B. Rubenstein founded and directs the UCLA Program on Class Actions. Professor Rubenstein is a nationally-recognized expert on class action law: he has litigated, served as an expert witness, and published in the field. Professor Rubenstein regularly provides consulting services to attorneys involved in complex procedural matters. In 2004, the American Law Institute selected Professor Rubenstein to be an Adviser on its current effort to re-think class action law, *The Project on Aggregate Litigation and Class Actions*.

A graduate of Yale College and Harvard Law School, Professor Rubenstein joined the UCLA faculty in 1997. He teaches courses on Civil Procedure, Complex Litigation, and Remedies. Professor Rubenstein has taught as an adjunct faculty member at Harvard, Yale, and Stanford Law Schools. He is a member of the bars of California, Pennsylvania (inactive), the District of Columbia, the United State Supreme Court, and numerous federal circuit and district courts.

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## **Class Action Fairness Act of 2005**

In February 2005, Congress enacted the Class Action Fairness Act of 2005 (CAFA). CAFA alters class action practice in state and federal courts throughout the United States. The law: changes the rules for federal diversity jurisdiction and removal, enabling most large class cases to be filed in, or removed to, federal court; restricts the practice of coupon settlements; and transforms the procedures for settling class actions in federal courts. CAFA contains a host of new, often complex, rules. This analysis explains CAFA and considers what impact CAFA will likely have on class action practice.

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## **I. CLASS ACTION LAW REFRESHER**

### **A. Conceptual**

Class action lawsuits are best conceptualized as representative, not group, litigation. While the rights of many people are resolved in one proceeding, the adjudication is done by representatives, not by the group getting together to go to the courthouse. In a class action, one or several representatives litigate or settle claims, with the judgment then binding everyone within the class. The practices and doctrinal requirements of class action lawsuits are most easily understood if the *representative* nature of the action is kept in mind.

### **B. Practical**

Class actions lawsuits rarely go to trial. Some are dismissed on legal motion, but the vast bulk are settled. These negotiated settlements in class action lawsuits are essentially large financial transactions. Defendants purchase a commodity – finality. They buy from the plaintiffs’ representatives the plaintiffs’ right to sue. The financial transaction is a transaction about legal rights, to be sure, but the buying and selling of those legal rights, not their likely adjudication, is the core purpose for coming together in an adjudicatory framework. I develop this way of thinking about class cases in more detail in *A Transactional Model of Adjudication*, 89 GEO. L. J. 371 (2001). For purposes of understanding CAFA and its potential impact, it is important to bear in mind these transactional components of class cases.

### **C. Doctrinal**

Federal law – copied in many states, though not exactly in California – has two essential sets of requirements for cases to be adjudicated as class actions. First, the case must be of a type that calls for representative treatment. Second, there must be a representative able to represent the absent class members. These requirements are codified in Rules 23(b) and 23(a) respectively.

Rule 23(b) sets for four situations in which representative litigation is appropriate:

1. **Risk of Inconsistent Adjudications.** Rule 23(b)(1)(A).
2. **Limited Funds.** Rule 23(b)(1)(B).
3. **Injunctive Cases.** Rule 23(b)(2).
4. **Money Damages (particularly small claims).** Rule 23(b)(3). (B)(3) class actions have two additional doctrinal requirements – common issues must *predominate* and class adjudication must be *superior* to other forms of resolution.

Rule 23(a) sets for four requirements concerning the class and its representative:

1. **Numerosity.** The class must be so numerous that joinder of all members as individual parties is impracticable. Rule 23(a)(1).
2. **Commonality.** There are questions of law or fact common to the class. Rule 23(a)(2).
3. **Typicality.** The class representative's claims must be typical of those of the class members she seeks to represent. Rule 23(a)(3)
4. **Adequacy.** The class representatives – and typically their counsel – must be able to represent the class adequately. Rule 23(a)(4)

To be certified as a class action, a case must fit within one of the 23(b) categories and meet all four of the requirements of Rule 23(a).

While these are the requirements of the *certification*, a federal court must also have *subject matter jurisdiction* over the case.

## II. CAFA'S NEW JURISDICTIONAL RULES

### A. New Diversity Rules

#### 1. *Conventional Jurisdictional Rules*

Class actions can proceed in federal court if the claims of the class arise under federal law, regardless of the citizenship of the parties.

If the claims of the class do not arise under federal law, class action cases must meet these requirements of diversity jurisdiction:

- \* all of the class *representatives* must be of diverse citizenship from all of the defendants, see *Supreme Tribe of Ben-Hur v. Cauble*, 255 U.S. 356 (1921); and
- \* traditionally, each and every class *member* had to meet the minimal amount in controversy requirement (currently, more than \$75,000). See *Zahn v. International Paper Co.*, 414 U.S. 291 (1973). This past summer, the Supreme Court held that the supplemental jurisdiction statute, 28 U.S.C. § 1367, overruled *Zahn*: if – but only if – at least *one named plaintiff* has more than the jurisdictional amount in controversy, the other class members' claims can be joined via supplement jurisdiction. *Exxon Mobil, Inc. v. Allapattah Services, Inc.*, 125 Sup. Ct. 2511 (2005).

#### 2. *CAFA'S New Jurisdictional Rule* – 28 U.S.C. §1332(d)(2)

CAFA makes no changes to federal question class actions.

CAFA *expands* jurisdiction for diversity class actions by creating jurisdiction for classes with *more than 100 class members if*:

- \* at least one class member is diverse from at least one defendant; and
- \* more than \$5 million in total is in controversy, exclusive of interest and costs.

### 3. *Jurisdictional Rules Compared*

#### FEDERAL JURISDICTION IN DIVERSITY CLASS ACTIONS

	REGULAR	CAFA
Numerosity	23(a)(1) requirement – usually met with 40 or more class members	23(a)(1) requirement must be met <i>and</i> there must be more than 100 class members
Citizenship	<i>All</i> class <i>representatives</i> and <i>all</i> defendants must be <i>completely</i> diverse	<i>Any</i> class <i>member</i> must be diverse from <i>any</i> defendant
Amount in Controversy	If at least <i>one named plaintiff has more than \$75,000</i> in controversy, the judge has the discretion to accept all class members' claims via supplemental jurisdiction.	A total of more than \$5 million total, exclusive of interests and costs, must be in controversy

### 4. *Coexistence*

CAFA does not displace conventional diversity class action rules, it augments them. Therefore, a class action may be sustained either under the conventional rules or under CAFA. While cases meeting the conventional requirements will almost always comply with CAFA, if filed based on CAFA, CAFA's exceptions (discussed below) will apply; if filed under the conventional rules, CAFA's exceptions seemingly will not apply.

**B. New Removal Rules****1. Conventional Removal Rule**

Four attributes characterize removal of diversity cases:

- a. only out-of-state defendants can remove a diversity case from state to federal court, 28 U.S.C. §1441(b);
- b. if there are multiple defendants, all must agree to the removal, see, e.g., *Brierly v. Alusuisse Flexible Packaging, Inc.*, 184 F.3d 527, 533-34 n. 3 (6th Cir. 1999) (“[I]n order for a notice of removal to be properly before the court, all defendants who have been served or otherwise properly joined in the action must either join in the removal, or file a written consent to the removal”);
- c. the removal petition must be filed within 30 days of receipt of a removable complaint, but never later than 1 year after commencement, 28 U.S.C. 1446(b);
- d. district court decisions to remand to state court are not reviewable, 28 U.S.C. 1447(d).

**2. CAFA’S New Removal Rule – 28 U.S.C. § 1453**

Under CAFA, each of these requirements is loosened:

- a. in diversity cases that fit within the jurisdictional requirements of CAFA, any defendant, including in-state defendants can remove;
- b. any defendant can remove even if all defendants do not consent;
- c. there is no 1 year limit on the timing of removal; *and*
- d. district court decisions to remand are reviewable if review is sought within 7 days, and must be decided within 60 days of acceptance (with a possible 10 day extension).

**3. Removal Rules Compared****REMOVAL OF DIVERSITY CLASS ACTIONS**

	<b>CONVENTIONAL</b>	<b>CAFA</b>
<b>Citizenship</b>	Only out-of-state defendants can remove diversity cases	Any defendant can remove
<b>Consent</b>	All defendants must consent to the removal	Consent of all defendants not required
<b>Deadline</b>	Defendant must remove within 30 days of receiving a removable pleading – but in no case beyond 1 year of the commencement of the action	No 1 year time limit on removal
<b>Appellate Review</b>	No appellate review of district court decisions to remand	Appellate review of decisions granting or denying motions to remand.

**C. Four Exceptions**

While CAFA essentially makes the resolution of large class actions with minimal diversity a federal court matter, it reserves for the states certain types of large class actions arguably more local in nature. Four key exceptions to CAFA's jurisdictional expansion accomplish this reservation of state authority.

**1. Local Controversies – 28 U.S.C. §1332(d)(4)**

Federal courts **must** decline federal subject matter jurisdiction when:

- a. more than 2/3 of the class members are from the forum state; and
- b. *either*
  - i. the primary defendant is from that state *or*
  - ii. (A) a significant defendant is from that state;  
(B) the principal injuries were incurred in-state;  
*and*  
(C) no other class action on the issue has been filed in the preceding 3 years.

**2. Defendant's Home State – 28 U.S.C. §1332(d)(3)**

Federal courts **may** decline federal subject matter jurisdiction (based on consideration of six enumerated factors and a totality of the circumstances) when:

- a. between 1/3 and 2/3 of the class members are from the forum state;
- b. and the primary defendants are from that state.

Read together, these exceptions aim to provide a state forum for at-home defendants, particularly if the class is largely composed of in-state plaintiffs. Where the defendant is sued its home state court, as the percentage of in-state class members increases, the likelihood of federal jurisdiction decreases.

3. ***The Delaware Carve-Out*** – 28 U.S.C. §1332(d)(9)

CAFA reserves Delaware’s jurisdiction over most corporate cases by stating that it (CAFA) will *not* apply to class actions solely involving claims:

- a. that concern a covered security as defined by certain federal securities laws, 28 U.S.C. §1332(d)(9)(A);
- b. that relate to “the internal affairs or governance of a corporation . . . that arise under or by virtue of the laws of the State in which such corporation . . . is incorporated or organized,” 28 U.S.C. §1332(d)(9)(B); *or*
- c. that concern fiduciary duties created by securities laws, 28 U.S.C. §1332(d)(9)(C).

This section also appears to carve out of CAFA those securities class actions already addressed by Congress’ promulgation of the Private Securities Litigation Reform Act of 1995 (PSLRA), 15 U.S.C. §§ 77z-1 - 78j-1; and the Securities Litigation Uniform Standards Act of 1998 (SLUSA), Pub. L. No. 105-353, 112 Stat. 3227 (1998).

4. ***Civil Rights Exception*** – 28 U.S.C. §1332(d)(5)

In enacting CAFA, Congress demonstrated no intention to create federal jurisdiction that would strip states of existing sovereign immunity defenses. Hence CAFA rejects jurisdiction in cases against states, state officials, or other governmental entities over whom “the district court may be foreclosed from ordering relief.” The impact of this exception is largely to carve many civil rights class actions out of CAFA. As most such cases arise under federal law anyway, this carve out is probably extraneous.

## CAFA'S CONSUMER CLASS ACTION BILL OF RIGHTS

The heart of CAFA is the *Consumer Class Action Bill of Rights*, a series of provisions meant to rein in coupon settlements and to alter other settlement processes. These new rules apply not only to CAFA-enabled class actions, but to *all* federal class actions, including those arising under federal law.

### III. CAFA'S NEW COUPON RULES

In coupon settlements – sometimes called script or voucher or non-pecuniary settlements – class members are awarded a coupon for use with future purchases of particular products. Often the future product that can be purchased is a product manufactured by the defendant. Congress was understandably critical of settlements which appear to benefit the very party charged with wrongdoing by heightening its future sales; while these sales are discounted by the value of the redeemed coupons, the consumer remains tethered to the wrongdoer. A related attack on coupon settlements is that the plaintiff attorneys are paid in cash while the plaintiffs receive only script.

#### A. Substantive Coupon Settlement Provisions

1. **Expert Testimony.** – 28 U.S.C. §1712(d)

CAFA authorizes federal judges to receive testimony from experts as to the actual value of coupons to the class members. Nothing barred courts from receiving such testimony pre-CAFA, except that when coupon settlements are presented by class and defense counsel, there is typically no party present to hire and pay such an expert. CAFA does not change that dynamic, though perhaps by authorizing courts to accept this testimony, federal judges will appoint experts as special masters.

2. **Hearings and Findings.** – 28 U.S.C. §1712(e)

CAFA requires that before approving a coupon settlement, a judge must hold a fairness hearing and make a written finding that the settlement is fair, reasonable, and adequate. This provision restates the requirements of Rule 23(e)(1)(C), while adding the requirement that the court's finding be *written*.

3. **Cy Pres Redistributions.** – 28 U.S.C. §1712(e)

CAFA authorizes federal courts to redirect funds unclaimed by class members to charity or to the government. This “*cy pres*” approach to unclaimed funds is already standard practice in class action settlements. CAFA also prohibits the attorney's fee calculation to be based on these *cy pres* funds.

## B. Coupon Settlement Attorney's Fee Provisions

CAFA's major change to coupon settlements concerns how plaintiffs' attorneys are awarded for such settlements. Often, though not always, plaintiffs' attorneys take a fee (on top of, not out of, the coupon award) calculated as a percentage of the total value of coupons theoretically available to the class. Thus, in the recent Microsoft anti-trust settlement in California, Microsoft agreed to make up to \$1.1 billion worth of vouchers available to class members. Had the plaintiffs' attorney used a percentage method to calculate a fee (they used an hourly method in the Microsoft case), they might, for example, have asked for 20% of this \$1.1 billion, or \$220 million.

In practice, however, it's extremely unlikely that anywhere near \$1.1 billion worth of coupons will be redeemed by the class members. This is true for two reasons: first, the coupons are for very small amount of money (\$5 for Microsoft Word purchasers, for example); and second, the process of acquiring a voucher and then redeeming it for cash is rather complicated and multi-staged, yet time-limited. Thus, if we assume that only \$100 million will actually be redeemed by the class, the attorneys' 20% would be \$20 million, not \$220 million.

CAFA compels this latter approach. It requires federal judge to assess percentage fees attributable to coupon settlements based on the value of the coupons *actually redeemed*, not the value of the coupons *arguably available*. 28 U.S.C. §1712(a).

Parties interested in coupon settlements can apparently avoid this provision by basing the attorney's fee on an hourly rate, not a percentage. CAFA states that fees not based on a percentage should be based on the amount of time class counsel "reasonably expended." 28 U.S.C. §1712(b)(1). In cases that end with both coupons and injunctions, CAFA directs that the fees for the coupon work be a percentage of coupons redeemed, while fees for the injunctive work be hourly. 28 U.S.C. §1712(c). This implies that coupon-related fees *must* always be calculated on the percentage method. However, the rest of the section can be read more liberally to suggest that fees can be determined either way, insisting only that *if* a percentage method is employed, *then* it must track the value of redeemed, not available, coupons.

## **IV. CAFA'S NEW SETTLEMENT REQUIREMENTS**

### **A. New Settlement Rules**

CAFA enacts two new limits on the substance of class action settlements.

First, settlements cannot constitute a net financial loss to individual plaintiffs, unless the court makes a “written finding that non-monetary benefits to the class member substantially outweigh the monetary loss.” 28 U.S.C. §1713.

This provision responds to an infamous class action settlement concerning escrow fee overcharges by the Bank of Boston. Plaintiffs’ attorneys secured a nationwide settlement that yielded the 700,000 class members small amounts of money; the attorneys’ fee for accomplishing this was then deducted from the same escrow accounts, pro rata, yielding a net loss for many class members. One – who paid \$91.33 in fees to secure a \$2.19 settlement – sued the plaintiffs’ attorneys, but the case was dismissed under the *Rooker-Feldman* doctrine. See *Kamilewicz v. Bank of Boston*, 92 F.3d 506 (7<sup>th</sup> Cir. 1996).

CAFA does not preclude such a settlement, but requires that a federal judge approving it make a written finding that the class sustained some non-monetary benefit that outweighed the monetary loss. 28 U.S.C. §1713.

Second, CAFA bans settlements that accord extra monies to in-state, or local, plaintiffs as opposed to out of state plaintiffs. 28 U.S.C. §1714.

## **B. New Settlement Process**

One of CAFA's most significant provisions requires that governmental officials be notified of pending class action settlements and be given time to comment upon them before the settlement is finalized. 28 U.S.C. §1715.

Within 10 days of filing a proposed class action settlement, *each defendant* must serve "appropriate" federal officials and state officials in any state where one class members resides. Service is generally directed to the Attorney General of the United States and the state's attorney general, or to the most obvious state regulatory official; in cases involving banks, the banking regulators must be served instead. 28 U.S.C. §1715(a).

The government officials must be given a notice of the proposed settlement and copies of: (1) the complaint; (2) notice of pending hearings; (3) the proposed or final notification to class members of their rights to opt out or a statement that no such right exists; (4) the proposed or final settlement; (5) details of any side agreements between class counsel and defendants; (6) any final judgment or notice of dismissal; (7) the names of the class members residing in each State and that state's percentage share of the settlement; and (8) any relevant judicial opinions. 28 U.S.C. §1715(b).

CAFA does not require that these government officials to do anything; indeed, the law explicitly states that it "shall not be construed to expand the authority of, or impose any obligations, duties, or responsibilities upon, Federal or state officials." 28 U.S.C. §1715(f). However, the federal court may not enter final approval of the proposed settlement earlier than 90 days after the last date of service on a government official. 28 U.S.C. §1715(d).

CAFA authorizes class members to refuse to comply with or chose not to be bound by a settlement that does not comply with these notice provisions. 28 U.S.C. §1715(e).

## V. CAFA'S GENERAL PROVISIONS

### A. Effective Date

CAFA applies to any civil action *commenced* on or after February 18, 2005. It does not apply to actions that were pending on that date. Several circuit decisions have rejected attempts to use CAFA to remove cases that were pending in state courts on Feb. 18. See *Schorsch v. Hewlett-Packard Co.*, 417 F.3d 748 (7<sup>th</sup> Cir. 2005); *Knudsen v. Liberty Mutual Insurance Co.*, 411 F.3d 805 (7<sup>th</sup> Cir. 2005); *Pfizer, Inc. v. Lott*, 2005 WL 1840046 (7<sup>th</sup> Cir. 2005); *Pritchett v. Office Depot, Inc.*, 2005 WL 1994020 (10<sup>th</sup> Cir. 2005).

### B. What Actions Covered

The new jurisdictional rules described above apply to “class action” cases whether or not they have been yet been certified as such. 28 U.S.C. §1332(d)(8). These new rules also apply to some “mass actions.” 28 U.S.C. §1332(d)(11). Mass actions are defined as cases, *not* brought as class actions, in which the “monetary relief claims of 100 or more persons are proposed to be tried jointly.” *Id.* Congress’ intent is to bring under CAFA super-joinder provisions that exist in certain states (the Senate Committee Report uses West Virginia as an example). The Senate Judiciary Committee Report states that these cases “are simply class actions in disguise.” Sen. Rep. at 47. The mass action provisions are complex, but most critically limit federal jurisdiction over mass actions to cases in which each plaintiff has more than \$75,000 in controversy, 28 U.S.C. 1332(d)(11)(B)(i), and bar jurisdiction where defendants made the joinder motion. 28 U.S.C. 1332(d)(11)(B)(ii)(II). Since plaintiffs can avoid this provision simply by joining only 99 plaintiffs, it is unlikely to matter much.

### C. Class Action Report

CAFA orders the Judicial Conference of the United States to prepare a report (within 12 months) for the House and Senate Judiciary Committees on class action settlements. The report must advise Congress of (1) the best practices that courts can use to ensure fair settlements; (2) the best practices that courts can use to set attorneys fees at levels reflecting the attorneys’ accomplishments and to ensure that class members are primary settlement beneficiaries; and (3) the actions the Conference will take to implement these practices.

## VI. CONCLUSION

Although CAFA is an ambitious, prodigious, and surprisingly complex law, it is difficult to predict what impact it will actually have on class action practice.

Taking each of its three primary elements in turn suggests that it may be more smoke than fire:

1. *Jurisdiction.* Those defending state court class actions definitely have a new weapon in their arsenal in the ability to remove these cases to federal court. If federal judges prove less likely to certify nationwide classes than some state judges have been, or more likely to dismiss on the merits, the removal power will be important. Of course, defendants facing multiple state court class actions take a risk in removing (and consolidating), for if the federal court does not dismiss, they could face significant liability. Moreover, with multiple actions pending, defendants are able to pit plaintiffs' attorneys against one another, creating a reverse auction that enables them to settle cheaply. Finally, in certain cases, plaintiffs attorneys may find the jurisdictional expansion helpful, particularly in states that limit attorneys fees or that have enacted limits on class cases.

2. *Coupon Settlements.* It is unlikely anything in CAFA will seriously curtail the use of coupon settlements. The fee provisions limiting plaintiffs' attorneys to a percentage of the redeemed, rather than offered, coupons will likely just shift fee calculations to a lodestar method, perhaps through the inclusion of an injunction in the settlement. The substantive provisions barely change current practice.

3. *Settlement Provisions.* CAFA's limits on net loss settlements and on in-state preferences will alter few settlements. However, CAFA's attempt to involve public officials in class action settlements has the potential to be the most important provision of the Act, since judges are likely to take government involvement quite seriously. Everything turns on whether public officials do get involved, though. CAFA provides no monies to public agencies for this task, nor requires them to undertake it. Thus, it will be somewhat surprising if federal and state agencies do follow through on the tasks that CAFA's notice provisions make possible.

CAFA is one of the most significant expansions of federal subject matter jurisdiction in many decades, perhaps since the Civil War. Whether it will have any effect on class action practice remains to be seen.