The Class Action Fairness Act of 2005:
Navigating Through Its Sea of Uncertainty

A resource brought to you by the Business Litigation Group of Hinshaw & Culbertson LLP

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Table of Contents

Executive Summary of the Class Action Fairness Act of 2005

The Class Action Fairness Act of 2005 is aimed at reducing frivolous class-action litigation, limiting class settlements that provide little or no benefit to class members but large fee awards to class counsel, and curtailing the practice of "forum shopping" class actions by filing them in favorable state-court jurisdictions. The Act attempts to accomplish this by expanding federal jurisdiction over most large class actions, easing removal procedures, mandating increased scrutiny of class-action settlements and by limiting fee awards involving coupon settlements.

Federal Jurisdiction Over Class Actions

The Act confers federal jurisdiction over any class action in which: (a) there are at least 100 potential class members; (b) the aggregate value of the class member's claims is at least $5 million; and (c) where one member of the plaintiff's class is a citizen of a state different from any defendant.

Specifically excluded from the Act's coverage are: (1) class actions where the primary defendants are governmental entities against whom the district court may be foreclosed from ordering relief; or (2) class actions exclusively involving: (a) the internal affairs or governance of a corporation; (b) a security defined under §16(f) of the Securities Act of 1933 and §28(f) of the Securities Exchange Act of 1934; or (c) actions involving rights, duties or obligations relating to or created by any security.

A federal court is permitted to decline the exercise of jurisdiction if more than one-third but less than two-thirds of the putative class members and the primary defendants are citizens of the forum state. The Act lists a series of factors to consider in making this jurisdictional determination which include whether the claims involve matters of national or state interest, whether the action will be governed by the law of the forum state or by the laws of other states, and whether the action was pleaded in a manner that seeks to avoid federal jurisdiction.

A federal court is required to decline jurisdiction under the Act over a class action in which more than two-thirds of the potential class members and the primary defendants are citizens of the forum state or where more than two-thirds of the class members are citizens of the forum state, the principal injuries caused by each defendant were incurred in the forum state, a defendant from whom significant relief is sought is also a citizen of the forum state and no other class actions involving similar allegations have been brought against any of the defendants during the preceding three-year period.

Revised Removal Procedures

Any defendant may remove a class action to federal court without the consent of other defendants regardless of whether any defendant is a citizen of the state in which the action was filed. The Act also eliminates the one-year limitation on the removal of class actions to federal court following commencement of the action in state court.

The Act provides a potential avenue for accelerated appellate review of orders granting or denying a motion to remand a putative class action to state court. Under the Act's accelerated review procedures, an application to appeal must be filed within seven (7) days of the removal order and a court of appeals must complete all activity including the rendering of its decision within sixty (60) days of the filing of an appeal unless an extension is granted.

Coupon Settlements

A court is required to hold a hearing in any class-action settlement which includes a coupon payment to class members and permits the approval of a settlement only after the court makes a written finding that the settlement is fair, reasonable and adequate to the class members. The court may also require that a portion of the unclaimed coupons be paid to charitable or governmental organizations as agreed to by the parties.

Class Counsel's Fees In Coupon Settlements

The Act requires that any fee award to class counsel which takes into consideration the value of coupons must be based upon the value of coupons that are redeemed rather than the value of the coupons that are issued.

Net Loss Settlements

Any settlement which obligates class members to pay their counsel's fees that would result in a "net loss" to the class members may only be approved where a federal court finds that the non-monetary benefits received by the class members substantially outweigh the net loss.

Geographic Discrimination In Settlements Prohibited

The Act prohibits the approval of a class-action settlement which provides for the payment of greater monetary benefits to class members based solely on their geographic proximity to the court.

Settlement Notices To Appropriate State And Federal Officials

Each defendant participating in a proposed settlement of a class action must provide notice of the settlement to an appropriate federal official and to an appropriate state official in each state in which a class member resides. Among the items required to be sent to those officials include the original complaint and any materials filed with it, notice of any scheduled judicial hearing, any proposed or final settlement of the class action, any proposed or final notification to the class members, any agreement contemporaneously made between class counsel and defense counsel as well as the names of class members who reside in each state and the estimated proportional share of their claims to the entire settlement or where that information cannot be feasibly provided, the reasonable estimate of the number of class members residing in each state and the estimated proportionate share of their claims to the entire settlement.

The penalty for non-compliance is that any class member who can demonstrate that the required notice under the Act was not provided may choose not to be bound by the settlement agreement or consent decree in that class action.

Effective Date

The Act applies to civil actions commenced on or after February 18, 2005, although a recent decision from the Seventh Circuit Court of Appeals suggests that amendments to pleadings which add new claims or new defendants may open a window of removal under the Act for class actions filed in state court prior to the Act's effective date.

The attached article covers in depth many of the issues and practice problems that are likely to be encountered under the Act. For more information about the Act, please contact the Hinshaw attorney with whom you work or Steve Puiszis at (312) 704-3243.

Introduction

The Class Action Fairness Act of 2005 is Congress' latest attempt to reduce several of the perceived abuses of the class-action vehicle occurring in state courts.[1] The Act impacts class-action litigation by:

I. Expanding federal diversity jurisdiction to cover large class actions (those having 100 or more class members) where the amount in controversy has an aggregate value in excess of $5,000,000, and the "primary defendants" are not states, state officials or governmental entities against whom a district court may be foreclosed from ordering relief or does not involve a claim involving a "covered security" as defined in the Securities Act of 1933 and the Securities Exchange Act of 1934.

II. Enhancing the ability to remove many state-court class actions and by authorizing an accelerated appellate review of orders granting or denying a motion to remand a class action to state court.

III. By treating certain "mass actions" as if they were a "class action" and by treating unincorporated associations as if they were a corporation for purposes of the Act's revised class-action diversity and removal rules.

IV. Revising the procedure for settling class actions in federal court by requiring that defendants send notice of any "proposed settlement" to the "appropriate State official of each State in which a class member resides" and to an "appropriate Federal official."

V. Limiting fee awards to class counsel in "coupon settlements" to the value of coupons actually redeemed and by attempting to regulate settlements that "result in a net loss" to class members by requiring that the "non-monetary benefits to the class member[s] substantially outweigh the monetary loss" resulting from a net-loss settlement. The Act also prohibits settlements where the amount paid to a class member varies depending upon the member's "geographic proximity to the court."

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[1] In 1995, the Private Securities Litigation Reform Act, 15 U.S.C. §78u-4, (PSLRA), was passed by Congress in an attempt to eliminate certain abusive practices that frequently arose in federal securities class action litigation. Among other things, the PSLRA imposed: heightened pleading standards, a stay of proceedings while a motion to dismiss was pending, mandatory sanctions under Rule 11 for abusive pleading practices, the elimination of joint and several liability in the absence of a finding of a knowing violation of the securities laws, a limitation on fees and expenses awarded to class counsel and disclosure requirements to class members. Subsequently, Congress enacted the Securities Litigation Uniform Standards Act of 1998 (SLUSA) after "considerable evidence" was presented to it, that securities fraud class actions were being shifted from federal to state courts following the passage of the PSLRA. SLUSA amended §16 of the Securities Act of 1933 and §28 of the Securities Exchange Act of 1934 so that any state-court class action encompassed by SLUSA involving a "covered security" was considered "preempted" and subject to SLUSA's mandatory removal provision. As a result of SLUSA, federal courts are now the primary forum for most class actions which involve nationally-traded securities. SLUSA's preemption rules do not apply however, to shareholder-derivative class actions or actions involving corporate governance issues.

Federal Rule of Civil Procedure 23 was substantially revised in 2003. The Class Action Fairness Act was initially drafted years before Rule 23 was amended which explains why Section 7 of the Act provides that Rule 23's amendments "shall take effect on the date of enactment of this Act or on December 1, 2003 . . . whichever occurs first."

A number of the Act's terms and phrases were left undefined. Thus, court and counsel are left with the difficult task of reconciling the interplay of the Act's various jurisdictional provisions in light of its intended purpose of directing class-action litigation into federal court with prior court decisions addressing the scope of diversity jurisdiction. The full scope of the Act's reach will require clarification by future court decision. As discussed below in Section VI of this article, the Act has already spawned several decisions addressing whether and under what circumstances the Act might apply to class-actions filed before its effective date. Several of the Act's jurisdictional provisions will likely trigger evidentiary hearings requiring the use of expert or opinion testimony.

Where a statute "is plain and unambiguous on its face," courts have been instructed "not to look to legislative history as a guide to its meaning." *TVA v. Hill*, 437 U.S. 153, 184 n. 29 (1978). However, in view of the uncertainties created by the Act's use of undefined terms and its silence on many issues, this article refers to the Senate Committee Report regarding the Act in an attempt to close several of the Act's gaps. Committee Reports "represen[t] the considered and collective understanding of those [legislators] involved in drafting and studying proposed legislation." *Zuber v. Allen*, 396 U.S. 168, 186 (1969). To the extent it is appropriate to consider legislative history when engaged in statutory interpretation, the Supreme Court views Committee Reports as the "authoritative source" for determining legislative intent. *Garcia v. United States*, 469 U.S. 70, 76 (1984). However, as the Court itself recognized in *Exxon Mobil Corp. v. Allapattah Services, Inc.*, ___ U.S. ____, 125 S.Ct. 2611 (2005), even Committee Reports can be abused, and should not be employed in the absence of ambiguity. *Id.* at 2625-2627.

The following sections address the Act's salient provisions and will alert you to a number of the legal issues and practical problems you will likely encounter when navigating its uncharted shoals.

I. Expansion Of Diversity Jurisdiction For Class Actions Covered By The Act

Section 4 of the Act expands federal diversity jurisdiction to potentially include (with certain limitations discussed below), any class action[2] having 100 or more class members where the "matter in controversy exceeds the sum or value of $5,000,000, exclusive of interest and costs," and any plaintiff class member is diverse from any defendant. 28 U.S.C. §1332(d)(2).

A. Aggregation Of Value Now Permitted For Class Actions

Zahn v International Paper Co., 414 U.S. 291 (1973), held that all members of a federal class action brought pursuant to diversity jurisdiction must meet §1332's jurisdictional amount-in-controversy requirement. *Id.* at 300-02. In *Zahn*, each of the named class representatives' claims met the required jurisdictional amount. However, not all of the individual class member's claims reached that jurisdictional threshold. Therefore, the district court refused to certify a

[2] The term "class action" is defined under the Act to include "*any* civil action filed under Rule 23 of the Federal Rules of Civil Procedure" or a "similar State statute or rule of judicial procedure" which authorizes the filing of a class action. The term "class member" is defined to include those "persons (named or unnamed) who fall within the definition of the proposed or certified class." See 28 U.S.C. §1332(d)(1)(B),(D) (emphasis added). The Act's provisions are generally applicable to actions before a class is certified under 28 U.S.C. §1332(d)(8).

class, concluding it would not be feasible to define a class of persons whose individual claims failed to meet §1332's amount-in-controversy requirement. *Id.* at 292. *Zahn* reaffirmed the Court's prior holding in *Snyder v. Harris*, 394 U.S. 332 (1969), to the effect "that there may be no aggregation and that the entire case must be dismissed where none of the plaintiffs' claims" meet the jurisdictional amount-in-controversy threshold. *Zahn*, 414 U.S. at 300. *Zahn* further elaborated that "any plaintiff without the jurisdictional amount must be dismissed from the case, even though others allege jurisdictionally sufficient claims." *Id.*

Zahn's jurisdictional holding and the corresponding notion that the value of the putative class member's claims could not be aggregated to meet §1332's jurisdictional requirement have been eliminated by Section 4 of the Act where it is applicable. Section 1332(d)(6) now specifically provides: "In any class action, the claims of the individual class members shall be aggregated to determine whether the amount in controversy exceeds the sum or value of $5,000,000 exclusive of interest and costs."

Additionally, in *Exxon Mobil Corp. v. Allapattah Services, Inc.*, ___ U.S. ___, 125 S.Ct. 2611 (2005), the Supreme Court significantly expanded the scope of a district court's supplemental jurisdiction under 28 U.S.C. §1367. *Exxon Mobil* held in the context of a class action based upon diversity jurisdiction, where at least one plaintiff meets the jurisdictional amount-in-controversy requirement and the other elements of diversity jurisdiction are met, a district court has supplemental jurisdiction over the claims of other parties whose claims do not meet §1332's amount-in-controversy requirement, essentially overruling *Zahn*. *Id.* at 2620. While the Act had no bearing on the Court's analysis in *Exxon Mobil*, the Court did recognize that the Act "abrogates the rule against aggregating claims." *Id.* at 2627-2628.

Where purely injunctive relief is sought, the Seventh Circuit has explained "that the jurisdictional amount should be accessed [by] looking at either the benefit to the plaintiff or the cost to the defendant" in complying with the requested injunctive relief. *Uhl v. Thoroughbred Tech. & Telecomm., Inc.*, 309 F.3d 978, 983 (7th Cir. 2002). The Seventh Circuit refers to this as the "either viewpoint" rule. *Id.* The Senate Committee Reports endorses the "either viewpoint" approach when assessing the aggregate value of the class members claims. S. Rep. No. 14, 109th Cong., 1st Sess. (2005) *reprinted in* U.S.C.C.A.N. 3, p. 42 ("S. Rep. 109-14").

Where injunctive relief is the sole relief sought in a class action, the Seventh Circuit has instructed courts to look "separately at each named plaintiff's claim and the cost to the defendant of complying with an injunction directed to that plaintiff." *Uhl*, 309 F.3d at 983. The required analysis of each plaintiff's claim was to ensure that courts would not undermine "the non-aggregation rule that still applies to class actions where the named plaintiff's claim does not satisfy the jurisdictional amount." *Id.* However, the aggregation rule found in Section 4 of the Act and the Supreme Court's recent *Exxon Mobil* decision have implicitly rejected *Uhl's* approach for class actions involving injunctive relief. Even without the Act's value-aggregation rule, so long as one of the named plaintiffs alleges a jurisdictionally sufficient claim when examined from "either viewpoint," the court should have supplemental jurisdiction over the remaining claims following *Exxon Mobil*.

The Senate Committee Report on the Act recognized the potential difficulties that can occur in attempting to place a value on non-monetary relief sought in a class action. That Report indicates that it was the Committee's intent that this provision should be "interpreted

expansively," that any assessment include "the value of all relief and benefits that would logically flow" from the relief sought and that where there exists any doubt as to whether the class members' claims reach the Act's aggregate threshold, "the court should err in favor of exercising jurisdiction over the case." S. Rep. No. 109-14, pp. 42-43. For example, a declaration that a product is defective could easily meet the Act's aggregate value threshold depending upon the number that have been sold and the costs associated with a recall and repair of the product.

B. Only Minimal Diversity Now Required For Class Actions

While the requirement of complete diversity was neither constitutionally mandated nor specifically required by the text of §1332, *Exxon Mobil Corp. v. Allapattah Services, Inc.*, __U.S. __, 125 S.Ct. 2611, 2617 (2005), the Supreme Court "has consistently interpreted §1332 as requiring complete diversity." *Id.* The requirement of complete diversity has been abandoned for class actions encompassed by the Act. All that is now required for a class action is minimal diversity – that "any member of a class of plaintiffs is a citizen of a State different from any defendant." 28 U.S.C. §1332(d)(2)(A).[3] For class actions, this should elevate concerns over the possibility of the "fraudulent joinder" of a defendant to defeat diversity jurisdiction.

Additionally, Section 4 of the Act provides that diversity jurisdiction for a class action can be met where either "any member of a class of plaintiffs is a foreign state or a citizen or subject of a foreign state," or where "any defendant is a foreign state or a citizen or subject of a foreign state." See 28 U.S.C. §1332(d)(2)(B), (C).

C. Timing Of The Determination Of Diversity

Whether diversity exists is determined as of the date a complaint is filed. *See, e.g., Navarro Savings Assn. v. Lee*, 446 U.S. 458, 459 (1980). While that rule remains true for defendants under the Act, §1332(d)(7) requires diversity determinations involving "members of the proposed plaintiff classes," be made at several other stages of a class-action proceeding. Section 1332(d)(7) provides that for class actions potentially encompassed by the Act, diversity: "*shall* be determined . . . as of the date of filing of the complaint or amended complaint, or if the case stated by the initial pleadings is not subject to federal jurisdiction, as of the date of service by plaintiffs of an amended pleading, motion or other paper, indicating the existence of federal jurisdiction." Section 1332(d)(7) contains no time limitation. Thus, it is possible that a diversity determination and a right of removal could be triggered immediately prior to the trial of a state-court action by the filing of a pleading or paper which provides the initial indication that diversity jurisdiction over the action is available.

When §1332(d)(7) is potentially applicable to a class action you are defending, several issues are of immediate concern. First, can a defendant forfeit the right to invoke federal-court

[3] The long-standing rule for determining diversity of citizenship in class actions was that a court looked to the domicile of the named class representatives rather than the putative class members. *Supreme Tribe of Ben Hur v. Cauble*, 255 U.S. 356 (1929). Complete diversity was only required between the named plaintiffs and the named defendants in a federal class action based upon diversity jurisdiction. *In re Agent Orange Product Liability Litigation*, 818 F.2d 145 (2d Cir. 1987). The Act's directive that the citizenship of plaintiff class members be examined changes that rule and should eliminate any attempt to collusively name a class representative in order to either dodge or invoke federal diversity jurisdiction.

jurisdiction by not immediately removing the case when federal jurisdiction first appeared in an original or amended pleading, motion or other paper in view of the Act's intent to broadly expand diversity jurisdiction over class actions? The short answer is yes. As explained below, while Section 5 of the Act eliminates 28 U.S.C. §1446(b)'s one year absolute time limitation on removal – currently, a notice of removal must be filed within one year of the commencement of the action – it leaves undisturbed §1446(b)'s requirement that a notice of removal must be filed within 30 days of receiving a pleading or paper which provides the initial basis for removal. A contrary rule would permit a defendant to sit back, assess a state-court judge's rulings, and if those rulings were unfavorable remove the action to federal court at a later time. The Act was intended to expand federal jurisdiction over class actions, not forum shopping.

Second, §1332(d)(7) is not expressly limited to proceedings prior to removal. As explained below in Section I F of this article, the Act's revised diversity rules permit a district court to decline jurisdiction based upon certain enumerated factors including the number of putative class members who reside in the forum state. See, 28 U.S.C. §1332(d)(3),(4). Theoretically, the citizenship of plaintiff class members can be reassessed even after removal and federal jurisdiction could be lost by the filing of an amended pleading which triggers the Act's one-third and two-thirds rules.[4]

Third, can the citizenship of a *defendant* or group of defendants be reconsidered at other stages of a class-action proceeding when §1332(d)(7) only specifies subsequent consideration of the citizenship of putative plaintiff class members? Under the Act, there is no statutory basis for reconsideration of a defendant's citizenship after minimal diversity has been established. Had Congress so intended, it could have readily indicated that the defendants' citizenship should also be considered as it did with the citizenship of the proposed plaintiff class members. By specifying that only the citizenship of the proposed plaintiff class members is to be considered, a valid argument can be made that subsequent amendments to a pleading which merely add or subtract a significant or target defendant from a class action should not provide a basis for a federal court to decline the exercise of diversity jurisdiction under §§1332(d)(3) or(d)(4), and remand a case to state court.[5]

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[4] Section 1332(d)(7) *requires* diversity be determined at various times during the life of class action – as of the date of filing of either: (1) the complaint; (2) an amended complaint; or (3) where the initial pleading is not subject to federal jurisdiction, "as of the date of service" of an "amended pleading, motion or other paper indicating the existence of federal jurisdiction." Perhaps the drafters of the Class Action Fairness Act did not intend this result, but its reference to the "amended complaint" (item 2) is not necessarily same as an amended pleading that "indicate[s] the existence of federal jurisdiction" (item 3). Otherwise, the timing triggers created by items (2) and (3) would be redundant. Thus, the amended complaint (item 2) referenced in §1332(d)(7) by definition appears to be one which does not "indicat[e] the existence of federal jurisdiction," otherwise there would be no need to refer to an amended pleading in item 3. Accordingly, the filing of an amended complaint following removal would seemingly trigger another diversity determination because §1332(d)(7)'s reassessment requirement is mandatory in nature and could result in a subsequent determination that the court should decline jurisdiction over the action. The filing of an amended complaint following removal could trigger a reexamination of the citizenship of the plaintiff class members and could result in a court declining to exercise jurisdiction in the event the Act's one-third or two-thirds jurisdictional rules are met. However where the amended pleading merely eliminates a diverse "target" or significant defendant, as explained in the text above, that should not trigger a reexamination of jurisdiction.

[5] Perhaps this is of little significance in light of the Act's minimal diversity rule, however if this approach is followed, it would impact existing procedure in federal court. Currently, the mere substitution of a non-diverse party

D. Unincorporated Associations Are Treated Like Corporations

For diversity purposes, unincorporated business entities and membership associations assume the citizenship of each of its members. See, e.g., *Indiana Gas Co. Inc. v. Home Ins. Co.,* 141 F.3d 314, 316 (7th Cir. 1998). However, under the Act's revised class-action diversity and removal rules, "an unincorporated association is deemed to be a citizen of the State in which it has its principal place of business and the State under whose laws it is organized." 28 U.S.C. § 1332(d)(10). An unincorporated association is treated like a corporation for diversity purposes under the Act. See 28 U.S.C. §1332(c)(1).

Traditionally, limited liability companies, labor unions, worker's compensation insurance pools and even religious organizations were treated like an unincorporated association for diversity purposes – the court considered the citizenship of all of their respective members. See, e.g., *Cosgrove v. Bartolotta*, 150 F.3d 729, 731 (7th Cir. 1998) (limited liability company); *United Steelworkers of America, AFL-CIO v. R.H. Bouligny, Inc.*, 382 U.S. 145, 153 (1965) (unincorporated labor union); *U.S. Fire Ins. Co. v. United Church of Christ*, 2005 WL 1668517, *2 (N.D. Ohio July 18, 2005) (religious organization); *Aetna Cas. & Sur. Co. v. Landry Enterprises, Inc.*, 1995 WL 217468, *3 (E.D. La. April 12, 1995) (worker's compensation insurance pool). While the Act does not specifically address how those entities are to be treated for diversity purposes on a going forward basis when named in a class action complaint, given the Act's intended purpose of enlarging federal jurisdiction over class actions, one can expect that any entity which can loosely be described as an unincorporated association will fall within the scope of §1332(d)(10)'s coverage.

E. Jurisdictional Exemptions To Minimal Diversity Rule

1. Governmental Defendants

Section 1332(d)(5)(A) provides that the Act's diversity rules applicable to class actions do not apply to any action in which, "*the primary defendants* are States, State officials, or other governmental entities *against whom the district court may be foreclosed from ordering relief.*"

The Act does not define the term "primary defendants." However, another section of the Act which requires a district court to decline jurisdiction over a class action, 28 U.S.C. §1332(d)(4), employs the phrase "primary defendants" while also referring to defendants from whom "significant relief is sought" and "whose alleged conduct forms a significant basis for the claims asserted by the proposed plaintiffs' class." Compare 28 U.S.C. §1332(d)(4)(A)(i)(II) and §1332(d)(4)(B). Thus, it would seem that a "primary defendant" must be someone or something different than a party from whom "significant relief is sought" and whose alleged conduct "forms a significant basis for the claims asserted." Otherwise, §1332(d)(4)(B)'s use of the term "primary defendants" would be rendered redundant by §1332(d)(4)(A)(i)(II)'s reference to significant defendants. Accordingly, it would appear that the governmental entity or official

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does not necessarily deprive a district court of diversity jurisdiction. *Freeport-McMoRan, Inc. v. K N Energy*, 498 U.S. 426, 428 (1991) (*per curiam*). In *Freeport-McMoRan*, the defendant that was added to the case was not an indispensable party at the time the complaint was filed. *Id.* However, the Seventh Circuit has held that the subsequent addition of non-diverse indispensable parties under Rule 19(b) can destroy diversity jurisdiction warranting dismissal of a federal action. See *Estate of Alvarez v. Donaldson Co., Inc.*, 213 F.3d 993, 995 (7th Cir. 2000).

must be a "target defendant" for the vast majority of the putative class members in order for this jurisdictional exemption to have any meaning.

Additionally, this exemption is not directed merely at governmental entities generally, but rather against those governmental entities from "whom the district court may be foreclosed from ordering relief." 28 U.S.C. §1332(d)(5)(A). The Senate Committee Report explains that the purpose of this exemption is to prevent "governmental entities from dodging legitimate claims and then arguing that the federal courts are constitutionally prohibited from granting the requested relief." S. Rep. 109-14, p. 42. However, in *Lapides v. Board of Regents of Univ. System of Georgia*, 535 U.S. 613, 619 (2002), the Court concluded that the protection of the Eleventh Amendment which is otherwise potentially available to states and state officials in a federal-court action had been waived by the defendant's invocation of federal jurisdiction by removing the case from state court. If *Lapides'* holding is applied in this scenario, states and state officials may still be able to invoke §1332(d)'s minimal jurisdictional rules if they seek to remove a case to federal court even when they are the "primary defendant," because the Eleventh Amendment's protection would not necessarily foreclose a district court from ordering relief under those circumstances. Because the Eleventh Amendment is not applicable to actions filed in state court, a state defendant is not forfeiting a defense otherwise available to it in state court by removing the action to federal district court.

Section 1332(d)(5) applies where "*the* primary defendants," are governmental entities. It does not apply where *a* governmental entity or where *one or more* governmental entities are primary defendants. Thus, this exception seemingly requires that *all* of the target defendants be governmental entities. Where one or more target defendants are non-governmental entities, this exemption should not be triggered. Finally, applying this same logic, unless it appears from the face of a pleading that a common-law defense or immunity would bar the action against all the named governmental defendants, in which case the action should probably not been brought against them in the first place, §1332(d)(5)'s exemption should not bar removing the action to federal court. The fact that a common-law defense or immunity might preclude relief from being entered against one (but not all) of the governmental defendants should not suffice.

2. Small Class Actions

Section 1332(d)'s diversity rules do not apply to class actions where the total number of class members for all proposed plaintiff classes is less than 100. 28 U.S.C. §1332(d)(5)(B). Where it is unclear whether the total number of potential class members is less than 100, the Senate Committee Report indicates that a district court "should err in favor of exercising jurisdiction over the matter." S. Rep. 109-14, p. 42.

3. Class Actions Involving Securities

Section 1332(d)'s diversity rules do not apply to class actions *solely* involving a "security" defined under §16(f)(3) of the Securities Act of 1933 and Section 28 (f)(5)(E) of the Securities Exchange Act of 1934. See 28 U.S.C. §1332(d)(9)(A). State-court class actions involving "covered securities" are already subject to the SLUSA's (Securities Litigation Uniform Standards Act of 1998) mandatory preemption and removal provisions. Thus, by this exemption, Congress was obviously attempting to draw a clear line of demarcation between the two Acts and not to disturb SLUSA's jurisdictional boundary lines.

4. Class Actions Directed At Internal Corporate Affairs

Section 1332(d)'s diversity rules do not apply to class actions solely involving "the internal affairs or governance of a corporation" or some other form of "business enterprise and that arises under or by virtue of the laws of the State in which such corporation or business enterprise is incorporated or organized." See 28 U.S.C. §1332(d)(9)(B). The Senate Committee Report indicates that this exemption is directed at the "internal affairs doctrine" which was described by the Supreme Court in *Edgar v. MITE Corp.*, 457 U.S. 624 (1982), as "matters peculiar to the relationships among or between the corporation and its current officers, directions and shareholders." S. Rep. 109-14, p. 45, quoting *Edgar*, 457 U.S. at 645.

5. Class Actions Relating To The Rights, Duties Or Obligations Associated With A Security

Section 1332(d)'s diversity rules do not apply to class actions solely involving a right, duty or obligation, including a fiduciary duty "relating to or created by or pursuant to any security" as defined in Section 2(a)(1) of the Securities Act of 1933. See 28 U.S.C. §1332(d)(9)(C).

To state the obvious, the three (3) exemptions provided by §1332(9), items 3, 4, and 5 above, do not close the door to diversity jurisdiction where the class-action complaint raises multiple liability issues or involves claims or theories other than one of those exempted by §1332(d)(9).

F. Permissible And Mandatory Grounds To Decline Diversity Jurisdiction – The One-Third And Two-Third Rules

While §1332(d)(2) may open the door to federal diversity jurisdiction for many class actions, §§1332(d)(3) and (4) provide a means to close that door. Section 1332(d)(3) provides a district court with a discretionary basis to decline the exercise of diversity jurisdiction over a class action. Additionally, where the factors enumerated by §1332(d)(4) are met, the district court is mandated to decline jurisdiction. However, please bear in mind that where *one-third or less* of all putative class members reside in the forum state, the exemptions to class-action diversity discussed below are not triggered.

1. Discretionary Grounds To Decline Jurisdiction – The Greater Than One-Third But Less Than Two-Thirds Rule

28 U.S.C. §1332(d)(3) provides that "in the interests of justice and looking at the totality of the circumstances," a court may decline to exercise jurisdiction "over a class action in which greater than one-third but less than two-thirds of the members of all proposed plaintiff classes" and "the primary defendants are citizens of the State in which the action was originally filed." Factors that a district court has to consider in making this determination include:

(a) whether the claims involve matters of national or state interest;

(b) whether the claims asserted will be governed by the laws of the State in which the action was originally filed or by the laws of other States;

(c) whether the action was pleaded in a manner that seeks to avoid federal jurisdiction;

(d) whether the action was brought in a forum with a distinct nexus with the class members, the alleged harm or the defendants;

(e) whether the number of citizens of the State in which the action was originally filed who are proposed class members is substantially larger than the number of citizens from any other State and whether the citizenship of the other proposed class members is dispersed among a substantial number of States; and

(f) whether during the preceding 3-year period any other class actions asserting the same or similar claims have been filed.

28 U.S.C. §1332(d)(3)(A) – (F).

Sections 1332(d)(3)'s use of the phrase "*the* primary defendants" would again seemingly require that *all* of the target defendants be from the forum state. If one or more of the target defendants are citizens of a different state, this exception should not then apply.

The definition of a proposed class will have a major impact on the Act's one-third and two-third rules. It sets the stage for the district court's required analysis. The proposed class definition will likely be the focus of heated jurisdictional disputes. Anticipate that class counsel who seek to dodge federal-court jurisdiction will draft proposed class definitions in a fashion to maximize the number of in-state class members. It also appears the Act has potentially created a new cottage industry for experts addressing the situs and number of the proposed class members.

Another issue sure to be litigated is whether class counsel can attempt to trigger this exception by intentionally not naming a target defendant from a different state. New jurisdictional battles implicating the potential joinder of necessary parties under Rule 19 loom on the horizon. Therefore, an issue that will have to be resolved is whether a defendant can be a "necessary party" under Rule 19, because in its absence complete relief could not be afforded, and if so, still not be a "target defendant" under the Act?

2. Mandatory Grounds To Decline Jurisdiction – The Greater Than Two-Thirds Or More Rule

Section 1332(d)(4) sets forth two alternative tests which mandate a court to decline diversity jurisdiction over a class action where "two-thirds or more" of all proposed plaintiff class members are citizens of the forum state. "The first is where two-thirds of the potential class members and *the* primary defendants" are citizens of the State in which the action is filed. 28 U.S.C. §1332(d)(4)(D).

The second is where the principal injuries caused by "each defendant" were *incurred* in the state in which the action was originally filed, more than two-thirds of all proposed plaintiff class members and a "significant defendant" are citizens of the forum state, and that during the immediately preceding three-year period, no other class actions involving the same or similar allegations were brought against any of the defendants. Under this second test, a significant defendant is one from whom "significant relief is sought" and whose conduct "forms a

significant basis for the claims asserted" by the proposed plaintiff class. 28 U.S.C. §1332(d)(4)(A).

Under these alternative tests, the "primary" defendants and a "significant" defendant are clearly treated as separate and distinct entities. The Act does not define what constitutes "significant relief" or what amounts to a "significant basis for the claims asserted." In light of traditional rules on joint and several liability, any defendant theoretically could qualify as one from whom significant relief is sought. Whether the defendant's alleged conduct forms a significant basis for the claim asserted could likely turn on the legal theory under which the action is being brought. It is unclear whether traditional state-law concepts such as active vs. passive fault or direct vs. vicarious liability will play any role or impact a court's analysis when addressing this issue.

Note that under §1332(d)(4)'s first test, *all* target defendants must be from the forum state. Under its second test, only one "significant" defendant must be from that state. However, under the second test, the principal injuries from each of the defendant's misconduct must have been incurred (not occurred) in the state in which the action was filed. The term "principal injuries" is also not defined under the Act. In many scenarios, what constitutes the principal injury may be far from clear. In a ground-water contamination case which allegedly results in physical illness or injuries to multiple persons, is the principal injury the contamination of the ground water or the subsequent physical illness? Where multiple parties from different states are suing to recover for monetary losses or lost profits, will the size of an individual's loss or the number of plaintiffs in a given state be the determinative factor for assessing in which state the principal injuries were incurred? As with several of the Act's other class-action diversity rules, until guidance is provided by court decision, these issues have to be carefully addressed by counsel. The one-third and two-third rules create some "room to play" for a creative pleader who desires to dodge federal-court jurisdiction.

For purposes of the one-third and two-third rules, the existence of other class actions involving the same or similar allegations would seemingly favor the assertion of federal jurisdiction, especially in view of the "multidistrict litigation process" in which all of the proposed actions "could be handled efficiently on a coordinated basis." S. Rep. 109-14, p. 38. The Committee Report explains that this factor should be liberally interpreted so that "plaintiffs not be able to plead around it with creative legal theories." *Id.* In other words, where the subject matter of a prior class action is essentially the same, a party should not be able to trigger §1332(d)(4)'s jurisdictional exemption merely by changing legal theories. Finally, while the Act itself is silent on the issue, the Committee Report indicates that "the party opposing federal jurisdiction shall have the burden of demonstrating the applicability of an exemption." S. Rep. 109-14, p. 44.

II. Revisions To Removal Procedure And Expanded Appellate Review

Through its expansion of diversity jurisdiction for class actions, Section 4 of the Act has enhanced the ability to remove a class action to federal court. Section 5 of the Act, 28 U.S.C. §1453, makes several additional significant changes to the removal procedures for class actions based upon diversity jurisdiction.

A. One-Year Limitation On Removal Eliminated For Class Actions

28 U.S.C. §1446(b) recognizes that federal jurisdiction may not be triggered by an initial pleading filed in state court. It can arise through the filing of "an amended pleading, motion, order or other paper," and permits a party to file a notice of removal within thirty (30) days after receipt thereof. Section §1446(b) contains its own limitations period. "No case, however, may be removed from state to federal court based on diversity of citizenship 'more than 1 year after commencement of the action.'" *Caterpillar, Inc. v. Lewis*, 519 U.S. 61, 69 (1996), quoting 28 U.S.C. §1446(b). Section 5 of the Act eliminates §1446(b)'s one-year limitation period for removal of class actions. See 28 U.S.C. §1453(b).

B. Removal By Defendants Who Are Citizens Of The Forum State

Where diversity provides the basis for federal-court jurisdiction, a case cannot be removed where one of the defendants is a citizen of the state in which the action is brought. 28 U.S.C. §1441(b)("any other such action shall be removable only if none of the parties in interest properly joined and served as defendants is a citizen of the State in which such action is brought").[6] Section 5 of the Act also does away with that prohibition for class actions encompassed by the Act. See 28 U.S.C. §1453(b) ("A class action may be removed to a district court of the United States . . . without regard to whether any defendant is a citizen of the State in which the action is brought").

C. Consent Of All Defendants Not Required

Where a cause of action is brought against multiple defendants, the defendants are treated collectively for removal purposes. All defendants who have been served must either join in the removal petition or indicate their consent to removal. *Phoenix Container, L.P. v. Sokoloff*, 235 F.3d 352, 353-54 (7th Cir. 2000). A petition for removal is defective where it fails to demonstrate that all defendants who have been served have either joined or consented to removal. *Shaw v. Dow Brands, Inc.*, 994 F.2d 364, 368-69 (7th Cir. 1993). Section 3 of the Act eliminates this requirement for class actions. Section 1453(b) specifically provides that a class action "may be removed by any defendant without the consent of all defendants."

D. Burden Of Proof When Remand Is Sought

Historically, when a motion to remand has been filed, the party seeking to preserve the removal bears the burden of demonstrating the existence of federal jurisdiction and that the procedural requirements for removal have been met. *Doe v. Allied Signal*, 985 F.2d 908, 911 (7th Cir. 1993). A court will "resolve all contested issues of substantive fact in favor of the plaintiff," *Boyer v. Snap On Tools Corp.*, 913 F.2d 108, 111 (3rd Cir. 1990), and a case will be remanded "if there is doubt as to the right of removal in the first instance." *Jones v. General Tire & Rubber Co.*, 541 F.2d 660, 664 (7th Cir. 1976).

The Senate Committee Report clearly indicates that under the Act "the named plaintiffs should bear the burden of demonstrating that a case should be remanded to state court." S. Rep.

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[6] One of the theoretical grounds supporting federal diversity jurisdiction was to provide an out-of-state defendant who might be the subject of local prejudice in a state-court proceeding with an independent tribunal to fairly resolve a dispute with local residents. That concern is thought to be lessened where the defendant is a resident of the forum state in which the action is brought.

109-14, p. 43. However, the Act does not itself specifically address the issue. Thus, in light of the Act's silence on the point, once its revised jurisdictional and removal rules have been invoked, a question certain to arise is who bears the burden of proof on remand, the defendant who removed the case or the plaintiff seeking remand?

Recently one federal district court addressed that issue and concluded that the Act shifts the burden of proof to the party seeking remand. *Berry v. American Express Publishing Corp.*, 2005 U.S. Dist. LEXIS 15514 (C.D. Cal., June 15, 2005). In reaching that conclusion, the district court relied on statements in the Senate Committee Report addressing the burden of proof issue in light of the Act's intended purpose of expanding federal jurisdiction over class actions. It also observed that the original diversity statute, just like the Act, does not contain any references to burden of proof issues.

In determining that it could rely on the Committee Report to decipher legislative intent, the district court observed that "where the statute does not squarely address the issue, legislative history is an essential tool for statutory interpretation. To this end, committee reports are 'the authoritative source for finding the Legislature's intent, and may be consulted as one important resource in the quest for faithful statutory interpretation." *Berry*, 2005 U.S. Dist. LEXIS 15514 at * 7, quoting *Garcia v. United States*, 469 U.S. 70, 76 (1984). Burden of proof skirmishes are likely to be a part of many larger jurisdictional battles triggered by the Act and could prove to be outcome determinative, although in *Berry* it was not.

E. Accelerated Appellate Review Of Remand Orders

A plaintiff objecting to removal can file a motion to remand the case to state court. Where the basis of the motion to remand is a "defect in removal procedure," the motion to remand must be brought within thirty (30) days after the filing of the Notice of Removal. Where a jurisdictional defect provides the basis for remand, the motion may be brought "at any time before final judgment." 28 U.S.C. §1447(c).

Generally, an order remanding a case to state court is not reviewable on appeal. See 28 U.S.C. §1447(d).[7] While Section 5 of the Act provides that §1447 applies to the removal of a putative class action, it permits a discretionary appeal from an order *granting or denying* a motion to remand the action. 28 U.S.C. §1453(c) (emphasis added). The Act permits a court of appeals to decline the application made to it. See 28 U.S.C. §1453(c)(2) ("if the Court of Appeals accepts an appeal under paragraph (1)"). The Act is silent as to those factors which an appellate court should consider in its decision to accept or decline an application for appellate review under these circumstances.

The initial application to appeal must be made within seven (7) days of a ruling on a motion to remand. See 28 U.S.C. §1453(c)(1). If the appeal is accepted, the Act requires that the appellate court complete all action on the appeal, including the rendering of a judgment within

[7] In *Quackenbush v. Allstate Ins. Co.*, 517 U.S. 706 (1996), the Court held that a remand based on grounds specified in §1447(c) is immune from review under §1447(d). Where the order remanding the case is not based on a lack of subject matter jurisdiction or defects in the removal procedure, appellate review may be permitted under 28 U.S.C. §1291 which confers jurisdiction over appeals from final decisions. In *Quackenbush*, the Court held that an order remanding a case based on abstention grounds was appealable under §1291.

sixty (60) days of the appeal having been filed unless an extension is granted. 28 U.S.C. §1453(c)(2).

The Act permits an extension "for any period of time" where "all parties to the proceedings agree." In the event that all parties cannot reach an agreement, an extension "for a period not to exceed 10 days" is permitted where good cause is shown and "the interests of justice warrant the extension." 28 U.S.C. §1453(c)(3). The Act provides that if the court of appeals does not issue its final judgment within the time frame noted above, the appeal shall be considered denied. 28 U.S.C. §1453(c)(4).

F. Coordination Of The Act's Removal And Jurisdictional Changes

The Act attempts to coordinate its revised removal and appellate procedures with its revisions to diversity jurisdiction. Section 1453(e) provides that the terms "class," "class action," "class certification order" and "class member" shall have the same meanings as given those terms in Section 4 of the Act (28 U.S.C. §1332(d)(1)). Additionally, the exemptions to diversity jurisdiction applicable to securities, the internal affairs or governance of a corporation and claims relating to the rights, duties and obligations involving or created by a security which are referred to in Section 4 of the Act (28 U.S.C. §1332(d)(9)(A), (B) and (C)) also apply to the Act's revised removal and appellate procedures applicable to class actions under the Act.

III. "Mass Actions" Subject To Revised Diversity And Removal Rules

Section 4 of the Act, 28 U.S.C. §1332(d)(11)(A), provides that "a mass action shall be deemed to be a class action removable under [§1332(d)(2) through (d)(10)] if it otherwise meets the provisions of those paragraphs." In other words, the minimal diversity rules and their exemptions as well as the revised removal rules apply to mass actions defined in the Act.

A "mass action" is defined as "any civil action" (other than a class action), in which monetary relief (as opposed to injunctive or equitable relief) is sought "in claims of 100 or more persons proposed to be tried jointly on the ground that the plaintiffs' claims involve common questions of law or fact." 28 U.S.C. §1332(d)(11)(B)(i). However, this section provides that "jurisdiction shall only exist over those plaintiffs whose claims in a mass action satisfy the jurisdictional amount requirements under subsection (a)." *Id.* In other words, the value of each plaintiff's claim must meet diversity's $75,000 threshold or the claim will be rejected.[8]

Just as with class actions, the Act contains several exemptions for mass actions. Where one of the following exemptions are triggered, traditional diversity and removal rules apply:

(a) Where all claims arise from an event or occurrence in the State where the action was filed which allegedly resulted in injuries in that state or in contiguous states;

(b) Where the claims were joined on defendant's motion;

[8] This particular section of the Act codifies *Zahn's* non-aggregation rule regarding diversity's traditional amount-in-controversy requirement. However, as discussed above in Section I A of this article, *Zahn* was recently overturned by the Court in *Exxon Mobil*. Thus, for mass actions as defined by the Act, §1332(d)(11)(B)(i) actually retracts the scope of a district court's supplemental jurisdiction as provided in *Exxon Mobil*.

(c) Where all of the claims are asserted on behalf of the general public and not on behalf of individual claimants or members of a purported class pursuant to a state statute authorizing the action;

(d) Where the claims have been consolidated or coordinated solely for pretrial proceedings or discovery.

28 U.S.C. §1332(d)(11)(B)(ii).

Where a "mass action" is encompassed by the Act, §1332(d)(11)(C)(i) prohibits any subsequent transfer of the action under the federal multi-district litigation rules unless a majority of the plaintiffs request such a transfer. This limitation on further transfers of the action does not apply where either a class has been certified under Rule 23 or where plaintiffs propose the action proceed as a class action. 28 U.S.C. §1332(d)(C)(ii).

Finally, the statute of limitations on any claims asserted in a "mass action" that are removed to federal court under §1332(d)(11) is tolled during the period of time the claims are pending in federal court. 28 U.S.C. §1332(d)(11)(D).

IV. Settlement Procedures For Federal Class Actions

Section 3 of the Act sets forth additional notification requirements applicable to the settlement of any federal-class action in which one or more classes have been certified. 28 U.S.C. §1715(b) now requires that "[n]ot later than 10 days after a proposed settlement of a class action is filed in court, *each defendant* that is participating in the proposed settlement shall serve upon the appropriate State official of *each* State in which a class member resides and the appropriate Federal official notice of the proposed settlement."(emphasis added).

The notice must include the following:

(1) the complaint, any materials filed with the complaint[9] and any amended complaints;

(2) notice of any scheduled judicial hearing;

(3) any proposed or final notification to class members of their right to opt out of the class action or that when applicable, no such right exists and about the proposed settlement;

(4) any proposed or final settlement of the class action;

(5) any agreement contemporaneously made between class counsel and defense counsel;

(6) any final judgment or notice of dismissal;

[9] 28 U.S.C. §1715(b)(1) provides that the materials filed with the complaint are "not required to be served" if they are available through the Internet and the notice explains how the materials can be accessed electronically.

(7) the names of class members who reside in each state and the estimated proportionate share of the claims of such members to the entire settlement – to that state's appropriate state official, or where this information cannot be feasibly provided a reasonable estimate of the number of class members residing in each state and the estimated proportionate share of the claims of such members to the entire settlement; and,

(8) any written judicial opinion relating to items (3) through (6) above.

28 U.S.C. §1715(b)(1) – (8). The Act further provides that "[a]n order giving final approval of a proposed settlement may not be issued [any] earlier than 90 days after the later of the dates on which the appropriate federal official and the appropriate State official" were served with this notice. 28 U.S.C. §1715(d).

The obvious purpose of this section is to provide federal or state officials with the opportunity to object to a proposed settlement that appears to be unfair to some or all class members or that might conflict with the regulatory policy, custom or practices of a state or federal agency.

In view of the Act's definition of a class action as "any civil action filed in a district court" or "that is removed to a district court," §1715's notice requirements apply to any federal class action commenced after the effective date of the Act and is not limited to those removed by a defendant to federal court. For a further discussion of decisions addressing the effective date of the Act, see Section VI of this article.

Normally, in the absence of an agreement between the parties to the contrary, the class representatives bear the expense of notifying class members about a proposed settlement. *Eisen v. Carlisle & Jacqueline*, 417 U.S. 156 (1974). The Act however, imposes upon the defendants the cost of notifying the required state and federal officials about a proposed class-action settlement. This could prove to be a time-consuming and a potentially expensive proposition, especially where a nationwide class has been certified which would require that notice be sent to the appropriate officials in all 50 states.

The penalty for noncompliance with these notice requirements is that a class member "may refuse to comply with and may choose not to be bound by a settlement agreement or consent decree in a class action." 28 U.S.C. §1715(e)(1). The class member bears the burden of proving the notice required under this rule was not provided. *Id*. Given the fact that each defendant must provide notice under this rule, a single defendant's failure to provide notice should not permit a class member to dodge the preclusive impact of a settlement where one or more of the other defendants furnished the required notice. So long as the appropriate state and federal officials received proper notice of the proposed settlement, the purpose of the Act's notification requirements were fulfilled and nothing useful can be gained by permitting a class member to "opt out" under those circumstances, other than the potential proliferation of related litigation.

The Senate Committee Report explains "that this provision is intended to address situations in which defendants have simply defaulted on their notification obligations" and "that a settlement should not be undermined because of a defendant's innocent error about which

federal or state official should have received the required notice in a particular case." S. Rep. 109-14, p. 35.

The Act does provide that a class member will be bound by a settlement agreement or consent decree where the notice required by §1715(b) was sent "to the appropriate Federal official and to either the state attorney general or the person that has primary regulatory, supervisory or licensing authority over the defendant." 28 U.S.C. §1715(e)(2). Thus, as explained below, notice should always be sent to the state attorney general for each state in which a class member resides.

A. Appropriate Federal Officials

The appropriate federal official to whom notice should be sent of a proposed class action settlement is the Attorney General of the United States – except where the defendant is a bank. 28 U.S.C. §1715(a)(1)(A).

Where the defendant is either a state or federal depository institution, a state or federal depository institution holding company, a foreign bank, or a "non-depository institution subsidiary of the foregoing" the appropriate federal official is the person who has the "primary federal regulatory or supervisory responsibility with respect to the defendant, if some or all of the matters alleged in the class action are subject to regulation or supervision by that person." 28 U.S.C. §1715(a)(1)(B), §17175(c).

B. Appropriate State Officials

The "appropriate state official" is "that person in the State" who either: (1) "has the primary regulatory or supervisory responsibility" over the defendant, or (2) "licenses or otherwise authorizes the defendant to conduct business in the State" so long as "some or all of the matters alleged in the class action are subject to regulation by that person." 28 U.S.C. §1715(a)(2). In the event "there is no primary regulator, or licensing authority," or where the issues involved in the class action "are not subject to regulation or supervision by that person," then a state's attorney general is considered the appropriate state official for receiving notice of the proposed settlement. *Id.*

Where the defendant is a state bank (depository institution), notice should be directed to "the State bank supervisor of the State in which the defendant is incorporated or charted" and upon the appropriate federal official, so long as "some or all" of the issues in the class action "are subject to regulation or supervision" by the state bank supervisor. 28 U.S.C. §1715(c)(2).

In light of §1715(e)(2)'s limitation on non-compliance when notice is sent to the state attorney general, a wise practice would be to always send the required notice to the state attorney general in each state in which a class member resides as well as to any other state official who arguably has supervisory, regulatory or licensing authority over the defendant. The Act imposes no penalty for sending notice to too many state officials. This will prevent class members from attempting to avoid the preclusive impact of a settlement by claiming notice was not sent to the person in their state who had the primary licensing, regulatory or supervisory responsibility over the defendant or that the issues raised in the settled class action were not subject to regulation or supervision by the state official to whom the notice was sent.

C. Rule 23's Settlement Hearing Requirement That Is Applicable Only To Certified Classes Is Unaffected By The Act

Rule 23(e)(1)(A) only requires court approval of a class action settlement where a class had been certified. The Advisory Committee notes to Rule 23(e)(1)(A) explain that: "The new rule requires approval only if the claims, issues or defenses of a *certified class* are resolved by a settlement, voluntary dismissal or compromise." (emphasis added). The Act does not impact or change this practice. 28 U.S.C. §§1712, 1713, 1714 and 1715 all employ the term "proposed settlement[s]," which is one of the few terms defined under the Act. Section 1711(6) defines a "proposed settlement" as "an agreement regarding a class action that is subject to court approval and that if approved, would be binding on some or all class members." Because under Rule 23(e) court approval is only required for certified classes, the Act's settlement hearing requirements do not apply to settlements that occur prior to certification of a class.

V. Coupon And Net-Loss Settlements

Section 3 of the Act, 28 U.S.C. §1712 *et. seq.*, limits the recovery of attorney's fees and requires a court hearing to address the reasonableness and adequacy of "coupon settlements." However, the Act fails to define what constitutes a "coupon" or what qualifies as a "coupon settlement." This omission was probably intentional in view of the wide variety of settlement options that might arguably be characterized as a coupon settlement.[10]

Section 1712's provisions limiting attorney's fees in "coupon settlements" provides some insight into the type of settlements the drafters were targeting. 28 U.S.C. §1712(a) essentially requires that for any portion of a fee award to class counsel based on coupons which are part of a class-action settlement, that the fee award be based on the value of "the coupons that are redeemed." This suggests that §1712 is targeting certificate or voucher settlements which require a class member to redeem a certificate or some type of paper in order to obtain the benefit of the proposed settlement. The Act's coupon provisions will likely extend to settlements which require class members to purchase additional services or benefits at a discounted amount through the use of a certificate or voucher system.[11] Whether it is extended to settlements that provide members with free additional services or benefits is less certain and may turn on other features of the settlement agreement. The full scope of the Act's protective shadow will be resolved by future court decisions.

Clarification of what constitutes a "couple settlement" is of primary importance to §1712's provisions limiting attorney's fees for class counsel because as explained below, the settlement-hearing procedures for coupon settlements are largely redundant of what is already required by Rule 23(e).

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[10] For a discussion of the wide-variety of settlement options that might constitute a coupon settlement under the Act, see Christopher R. Leslie, *A Market-Based Approach To Coupon Settlements In Antitrust And Consumer Class Action Litigation*, 49 UCLA L. Rev. 991, 994 (2002) (noting that "[s]ettlement coupons may resemble traditional promotional coupons, housing vouchers or discount contracts").

[11] Webster's Ninth New Collegiate Dictionary defines redeem as: "to buy back" or "repurchase." Thus, settlements which require the purchase of additional benefits or services are likely to fall under §1712's ambit.

A. Coupon Settlement Hearing Requirement

Rule 23(e)(1)(A) requires court approval of any "settlement, voluntary dismissal or compromise of the claims, issues or defenses of a *certified* class." Rule 23(e)(C) further provides that a court can approve a settlement or compromise of a class action "that would bind class members only after a hearing and on finding that the settlement, voluntary dismissal or compromise is fair, reasonable and adequate."

The Act's required judicial scrutiny of coupon settlements for the most part mirrors Rule 23(e)'s requirements. Section 1712(e) requires a hearing and a written finding by the court that "the settlement is fair, reasonable and adequate for class members." The Act does not list factors that a court should consider in evaluating reasonableness or fairness of a coupon settlement. In view of the wide array of terms or limitations that could potentially be included in a "coupon" itself, this omission was also probably deliberate. Factors that various courts have considered in evaluating the reasonableness of coupon settlements have included:

(a) the strength of plaintiffs' case weighed against the settlement offer;

(b) the complexity length and expense of further litigation;

(c) the presence of collusion between the parties;

(d) the opinion of competent counsel;

(e) the reaction of class members to the proposal; and

(f) the stage or proceedings and discovery completed.

In re Mexico Money Transfer Litigation, 164 F. Supp. 2d 1002, 1014 (N.D. Ill. 2000), *affd.* 267 F.3d 743 (7th Cir. 2001). See also *In re General Motor Corp. Pick-up Truck Fuel Tank Products Liability Litigation*, 55 F.3d 768, 785 (3d Cir. 1995) (identifying nine factors to use in evaluating a coupon settlement – (1) the complexity and duration of the litigation; (2) the reaction of the class to the settlement; (3) the stage of the proceedings; (4) the risks of establishing liability; (5) the risks of establishing damages; (6) the risks of maintaining a class action; (7) the ability of defendants to withstand a greater judgment; (8) the range of reasonableness of the settlement in light of the best recovery; and (9) the range of reasonableness of the settlement in light of all the attendant risks of litigation).

Section 1712(e) does authorize a district court to "require that a proposed settlement agreement provide for the distribution of a portion of the value of unclaimed coupons to one or more charitable or governmental organizations as agreed to by the parties." However, various courts including the Seventh Circuit have approved a cy pres distribution to a charitable, educational or public service entity or program that provides some benefit to the class members.[12] Additionally, §1712(d) permits a court to receive expert testimony from a

[12] See, e.g., *Keele v. Wexler*, 149 F.3d 589, 592 (7th Cir. 1998) (approving *cy pres* to legal aid foundation); *In re Three Mile Island Litigation*, 557 F. Supp. 96, 97 (M.D. Pa. 1982) (approving $5 million *cy pres* to finance public heath and evacuation planning).

qualified witness as to "the actual value to the class members of the coupons that are redeemed." Many district courts were generally following that practice even before the Act became effective. See, e.g., *In re Mexico Money Transfer Litigation*, 164 F. Supp. 2d 1002 (N.D. Ill. 2000), *affd*. 267 F.3d 743 (7th Cir. 2001). These provisions merely make explicit, procedures that were already being followed in many district courts.

B. Net-Loss Settlement Hearing Procedures

Section 3 of the Act does change the governing standard for approval of class action settlements in which "any class member is obligated to pay sums to class counsel that would result in a net loss to the class member." 28 U.S.C. §1713. In that scenario, the court approving a settlement must make a finding that the "non-monetary benefits to the class member substantially outweigh the monetary loss." *Id.* The Act makes no attempt to elaborate on what type of benefits may be considered by the court when engaging in this analysis or how those benefits are to be valued.

C. Prohibition Of Settlements Based On Geographic Location

28 U.S.C. §1714 prohibits a proposed settlement of any class action that provides for the payment of a greater sum to class members "*solely* on the basis that the class members to whom the greater sums are paid are located in closer geographic proximity to the court." However, §1714 does not for example, preclude geographic proximity to an environmental contamination site as a factor that can be considered in fixing the amount paid to those class members who live in close proximity to the site and are theoretically more likely to have suffered an exposure and an injury. See S. Rep. 109-14, p. 32. Rather, it targets settlements that have no legitimate basis to distinguish the amounts paid to various class members other than their geographic proximity to the courthouse.

D. Attorney Fee Provisions In Coupon Settlements

Rule 23(h) provides that in any action where a class has been certified, a court may award reasonable attorney fees and non-taxable costs as authorized by law or by agreement of the parties. That rule further requires that class counsel claiming attorney fees must do so pursuant to a motion under Rule 54(d)(2). Notice of the motion must be served on all parties and "directed to class members in a reasonable manner." See Rule 23(h)(1). The Act supplements Rule 23's hearing requirements for claims involving coupon settlements.

28 U.S.C. §1712(a) requires that in any proposed class-action settlement which "provides for a recovery of coupons to a class member, the portion of any attorney's fee award to class counsel that is attributable to the award of the coupons shall be based on the value to class members of the coupons that are redeemed."[13] Where "the recovery of coupons is not used to determine the attorney's fee" paid to class counsel, §1712(b)(1) provides that the fee award "shall be based on the amount of time class counsel reasonably expended working on the action." This is one the traditional criteria used in determining the appropriate amount of a fee award to class counsel involved in the creation of a common fund.

[13] This is consistent with the approach taken in the Private Securities Litigation Reform Act of 1995 which provides that attorney fees and expenses paid to class counsel shall not exceed a reasonable percentage of the amount of damages and interest paid to the class. 15 U.S.C. §78(u)-4(a)(6).

Section 1712(b)(2) specifies that in those cases where class counsel obtained equitable relief, any fee award shall include an appropriate fee for obtaining that relief. When a settlement involves a combination of equitable relief and coupons for the class members, §1713(c) is consistent in requiring that the portion of any fee award paid to class counsel based upon the inclusion of coupons must be calculated on the value of the redeemed coupons and that the remaining portion of the fee award should be based on the amount of time "reasonably expended" by class counsel.

These provisions were drafted to provide an economic incentive for class counsel to negotiate favorable terms for coupons that are part of any class-action settlement. Factors that limit the number of coupons that are ultimately redeemed include limits on transferability of the coupon, the timing of the coupon expiration date, restrictions on the aggregation of coupons, administrative obstacles to redemption and product restrictions which limit the items or services class members can acquire.[14]

As a result of §1712(a) and (c)'s requirement that the fee award be based on the value of redeemed coupons, class counsel's fees cannot be calculated until the time specified for redemption of those coupons has expired. Some courts had permitted a fee award to class counsel on the estimated likely rate of redemption of the coupons involved in a settlement. Now, §1712 prohibits that practice. The value which a coupon provides to a class member can be lessened by an increase in the price of the goods or services related to the coupon during its redemption period. *See In re Matter of Mexico Money Transfer Litigation*, 267 F. 3d 743, 748 (7th Cir. 2000). It is doubtful however, that a court would take that into consideration in calculating class counsel's fee award because counsel has no real ability to control a defendant's pricing strategies.

Section 1712 however, does not preclude the payment of class counsel's fees on a periodic installment basis where the amount paid is based upon the actual number of coupons redeemed during that installment period. See, e.g., *Duhaime v. John Hancock Mutual Life Ins. Co.*, 989 F. Supp. 375 (D. Mass 1997) (where that approach was followed). That would ensure that the fee award is proportionate to the actual value to the class, and minimize the economic disincentive for class counsel to negotiate a longer redemption period.

VI. Effective Date Of The Act

Section 9 of the Act provides that its amendments "shall apply to any civil action commenced on or after the date of enactment of this Act." The President signed the Act into law on February 18, 2005.

In *Pritchett v. Office Depot, Inc.*, 404 F.3d 1232 (10th Cir. 2005), the Tenth Circuit concluded that a cause of action is commenced for purposes of the Class Action Fairness Act when it is originally filed in state court, not when it is removed to federal district court. *Id.* at 1237-38. Therefore, the Act does not apply to state-court class actions that were pending prior to the effective date of the Act. *Id.* at 1233.

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[14] See *Leslie*, *supra.*, n. 11 at 1014-1029.

Recently, the Seventh Circuit agreed with Pritchett's conclusion that a civil action is commenced for purposes of the Act "when it is filed with the state court and not when some later step occurs in its prosecution." *Knudsen v. Liberty Mutual Insurance Co.*, 411 F.3d 805 (7th Cir. 2005). Knudsen held that a mere change in the definition of a class does not trigger the right to remove that action to federal court under the Act. However, Knudsen further explained that:

> [A] new claim for relief (a new "cause of action" in state practice), the addition of a new defendant, or any other step sufficiently distinct that courts would treat it as independent for limitations purposes, could well commence a new piece of litigation for federal purposes even if it bears an old docket number for state purposes.

Id. at 807. Knudsen explained that even under preexisting law, amendments to pleadings that add a federal claim where only state-law claims had preexisted or which add a new defendant open "a new window of removal." *Id.* The Court then "imagine[d]":

> [T]hat a similar approach will apply under the 2005 Act, perhaps modeled on Fed. R. Civ. P. 15(c), which specifies when a claim relates back to the original complaint (and hence is treated as part of the original suit) and when it is sufficiently independent of the original contentions that it must be treated as fresh litigation.

Id. In *Schorsch v. Hewlett-Packard Co.*, No 05-8017, 2005 1863412 (7th Cir., Aug. 8, 2005), the Seventh Circuit explained that it referred to Rule 15 (c) in *Knudsen* merely to "illustrate the difference between claims that relate back and those that do not,"and further elaborated that "state [law] rather than federal practice must supply the rule of decision." *Id.* at * 2. Under the Seventh Circuit's proposed approach, state law which governs whether a claim set forth in an amended pleading relates back to the original complaint for limitation purposes would also drive whether the action was removable under the Act. This presents an intriguing problem for court and counsel where either a multistate or nationwide class is sough to be assented. Theoretically, a new claim might relate back under one state's law and not another.

Additionally, the court in *Schorsch* suggested that an existing defendant may only be entitled to remove the newly added claim rather than the entire lawsuit. *Id.* If that suggestion holds true, then a defendant may be forced to fight its legal battle on two fronts, the existing action in state court and the new claim in federal court. The resulting costs and coordination effort involved are likely to exceed any benefit to be gained by the removal of a new claim under those circumstances.

Where either a new party or a new liability theory is added to a preexisting class action, counsel should evaluate whether the action can thereafter or should be removed under the Act in light of Knudsen's and Schorsch's discussion of the issues noted above.

Conclusion

Only time will tell whether the Act accomplishes its intended purpose of directing large class-actions to federal court. While the Act may lessen the number of actions in which a nationwide class is sought, it could result in a proliferation of state-wide class actions invoking the Act's jurisdictional exemptions where the majority of the putative class members reside in the forum state.

Following the enactment of the Private Securities Litigation Reform Act of 1995, class counsel engaged in a strategy of shifting securities-fraud class actions to state court which prompted Congress three years later to enact Securities Litigation Uniform Standards Act of 1998. We may see history repeat itself with class counsel adopting specific strategies in an attempt to dodge federal court jurisdiction. Thus, the Act's immediate affect could result in the proliferation of coordinated state-court of class action filings in an attempt to take advantage of the Act's one-third and two-third's jurisdictional rules.

About the Author

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