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A legal update from Dechert's Antitrust, Financial Services and Securities Litigation, and Mass Torts and Product Liability Groups

“Class Action Fairness Act of 2005” Makes Changes to Interstate Class Actions, Removal Rights, Coupon Settlements

President Bush signed into law last week “The Class Action Fairness Act of 2005” (“The Act”). The new law applies to class actions that were commenced on or after February 18, 2005. The most significant aspects of the new law are:

- Original federal court jurisdiction for “interstate class actions”
- Enhanced rights to remove class actions to federal court
- Stricter judicial review of “coupon” settlements
- Notice of proposed class action settlements to federal and state regulators

Original Jurisdiction Over “Interstate Class Actions”

Under the new law, federal courts have original jurisdiction over class actions in which the aggregate amount of the plaintiff class claims exceeds \$5 million, and any member of the proposed plaintiff class is a citizen of a state different from any defendant. This change greatly expands federal court jurisdiction over class actions.

Prior to the new law, the “amount in controversy” jurisdictional threshold of \$75,000 had to be satisfied by each individual member of the proposed class. In addition, complete diversity of

citizenship between each member of the proposed plaintiff class and each defendant was required.

Nothing Congress does is ever quite so straightforward, and this new law is no exception. Thus, federal district courts may decline to exercise jurisdiction in class actions if more than 1/3 but less than 2/3 of the proposed plaintiff class members and the primary defendants are citizens of the state where the class action was originally filed. The statute specifies a number of factors courts should consider in exercising their discretion.

Federal court jurisdiction must be declined if:

- at least 2/3 of the proposed plaintiff class members and the primary defendants are citizens of the state of filing.
- at least 2/3 of the proposed plaintiff class members and at least one defendant from whom significant relief is sought and whose conduct forms an important basis for the claims are citizens of the state in which the class action was initially filed and principal injuries occurred in the original forum state, *provided* no other class action has been filed asserting similar allegations against any of the defendants in the three years before filing of the subject action.

- where there are fewer than 100 proposed class members, and where the primary defendants are governmental entities against which the federal court may be foreclosed from ordering relief.

Of course, “primary defendant,” “significant relief,” “important basis,” and “principal injuries” are not defined in the statute.

Enhanced Removal Rights

A defendant in a class action may now remove the class action to federal court if the federal court jurisdiction requirement of the Act is met, i.e., minimal diversity between one defendant and any class member and \$5 million at stake.

The Act makes two important changes to the removal rules for class actions:

- First, in a typical removal situation, all defendants must consent to removal to federal court. Under the Act, in a class action, any defendant may remove without the consent of all, or any other, defendant.
- Second, removal ordinarily is not allowed if any defendant is a citizen of the state in which the action is brought. The Act eliminates this limitation. In addition, the Act exempts class actions from a statutory one-year time limitation on removal, and it provides for an immediate appeal from any order remanding the case to state court.

Notably, the new legislation does not affect two major class action types: securities class actions and class actions raising corporate governance issues. Many securities class actions commenced in state court are already subject to the removal jurisdiction established by the Securities Litigation Uniform Standards Act (“SLUSA”). In passing the Class Action Fairness Act, Congress also determined not to provide removal jurisdiction over actions that purport to raise only state law claims relating to the governance or internal affairs of corporations.

Scrutiny of Coupon Settlements

In its findings, Congress expressed hostility to coupon settlements, which provide for the issuance of coupons (non-cash payments that typically provide a discount on a new purchase of a defendant’s goods or services) to a class member.

The Act contains a number of provisions that may make coupon settlements an “endangered species.” For example, the Act:

- specifically requires a hearing and written findings addressing the fairness and adequacy of any coupon settlement, although the class action rules already require judicial scrutiny and approval of any class action settlement.
- vests discretion in the court to require any unclaimed coupons to be distributed to charitable or governmental entities.
- provides that any attorney fee award based on the coupon settlement may only take into account the value of the coupons redeemed, and creates a mechanism for the court to receive expert testimony on the value of the coupons.
- establishes specific requirements before a court can approve a settlement that would result in a net loss to class members.

Notice of Proposed Settlements to Regulators

The Act requires defendants to provide notice to “appropriate” federal and state officials within 10 days of filing a proposed class action settlement in court. The appropriate official will typically be the U.S. Attorney General and the various state attorneys general or other state official who authorizes any defendant to conduct business. The Act does not specify what, if any, rights these government officials may have to intervene, but it prohibits final approval by the court until 90 days after notice to the government officials.

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This reform measure has been the subject of intense lobbying and legislative effort for five years, and is regarded as a victory for the Bush administration. The Act leaves open a number of questions, most critically:

- How will the plaintiffs' class action bar react?
- Will federal courts (as expected) deny class certification in a higher proportion of cases filed?
- Will the number of filings decline?
- Will the number of state-focused plaintiff classes grow to avoid federal court jurisdiction, leading to more class actions scattered around the country?

Practice group contacts

If you have questions regarding the information in this legal update, please contact one of the attorneys listed or any Dechert LLP attorney with whom you regularly work, or any of the attorneys listed. Visit us at

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