

Commentary on the Class Action Fairness Act

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I suppose at some point I will have to stop calling the new class action legislation the “so-called” Class Action Fairness Act (CAFA). While its proponents in Congress claimed to be acting to protect unnamed class members from abusive class actions, the inaptly-named legislation offers little, if anything, in the way of “fairness” to class members. What it does create is a host of new procedural advantages for corporate defendants, who can force most class actions – including those based entirely on state law – into federal court.

The “Good” News

Ever the Pollyanna, I am compelled to begin with the silver lining in this legislation – it could have been worse, far worse. Earlier House versions of the bill included an automatic right of appeal for all class certification orders, a prohibition on incentive bonuses for named plaintiffs, and the right of *any* absent class member to remove the case to federal court at any stage of the litigation, all applicable retroactively. These provisions would have driven up litigation costs, created years of delay and invited extortionate demands from wily class members. Fortunately, these very bad ideas did not make it into the final bill.

CAFA Settlement Provisions (“Consumer Class Action Bill of Rights”)

Proponents of the legislation frequently invoked the notorious “coupon settlement” as the poster child of abusive class actions. In such settlements, class members receive coupons for products sold by the defendant, while plaintiffs’ attorneys get paid their fees in cash. Ironically, CAFA does not prohibit these highly questionable settlements, perhaps because they are popular with corporate defendants. Instead CAFA simply reaffirms the existing authority and duty of district courts to scrutinize the fairness of coupon settlements. CAFA does, however, limit percentage-based attorneys’ fees for class counsel in coupon settlements: the percentage fee is calculated based upon the number of coupons *actually redeemed* rather than the number *distributed*. This is a win-win for corporate defendants, who pay class members nothing out-of-pocket for their wrongdoing, and enlist plaintiffs’ counsel in their marketing scheme to sell another round of products to the captive audience of absent class members.

The remaining CAFA “protections” for class members are equally illusory. The Act prohibits settlements whose benefits discriminate among class members based on their residence (a solution to what most agree is a non-existent problem). Similarly, the CAFA calls for additional scrutiny of (but not a prohibition on) settlements that result in a net out-of-pocket loss to class members. Such settlements are all but unheard-of and would already have been subject to substantial scrutiny (if not disapproval) by the district court under Rule 23(e). Finally, CAFA adds a cumbersome requirement that notice of any class action settlement be provided to “appropriate” federal and state officials no

more than 10 days after the proposed settlement is filed in federal court. The Act does not require the federal or state officials to actually read the notices or do anything with them. While the likely result is that these notices will be largely ignored, they do provide the opportunity for eleventh-hour political grandstanding by government officials.

Expanded Diversity and Removal Jurisdiction

The CAFA settlement provisions are simply window-dressing for the heart of the bill: the broad expansion of original diversity jurisdiction and removal jurisdiction. The key changes are summarized in the attached charts.

For class actions, CAFA provides that diversity and removal jurisdiction exist if **any** class member and **any** defendant are citizens of different states. The amount of controversy is satisfied if the aggregate of all class claims would exceed \$5 million. There are exceptions for cases with fewer than 100 class members, those against state officials, and certain securities and corporate governance cases. There is also a complicated pair of exceptions where most class members and the “primary” defendants are all citizens of the forum state. Consent of all defendants for removal is no longer required. Remand orders are now subject to expedited, discretionary appeal.

What CAFA Means for Employment Class Actions in California

The most immediate consequence of the legislation will be to shift a large portion of the class action docket in California state courts to federal judges. While there are 1498 state trial judges in California, there are only 62 federal trial judges in the four California federal districts. Class actions are typically far more complex and labor intensive than the typical lawsuit so one can expect that the already overburdened federal bench will be simply more so.

For employment-related class actions specifically, the impact of CAFA will depend on the underlying cause of action. Many class actions challenging workplace discrimination are based on federal statutes (e.g. Title VII, Equal Pay Act, ADA) and are brought in federal court in the first instance. The CAFA will not have a direct effect on the litigation of those cases, except to the extent that the legislation increases the workload of federal judges.

For class actions based on California state law, such as state wage and hour cases, CAFA will have repercussions – how significant remains to be seen. Even if the class membership is defined entirely as California residents, the case will still be subject to removal if the defendant is a citizen of another state. For purposes of diversity, corporate “citizenship” is determined by both its place of incorporation *and* its principal place of business, i.e. may have dual citizenship.

Assuming that the case satisfies the new requirements for removal, the question is what effect will a federal forum, in lieu of a California court, have on the adjudication of the case. When critics of the legislation argued that CAFA undermined the role of state

courts in interpreting state law and adjudicating state law actions, its proponents repeatedly deflected the criticism by arguing that the legislation did not affect substantive rights. Federal courts would still apply *substantive* state law, although federal courts apply their own *procedural* rules. *Hanna v. Plumer*, 380 U.S. 460, 469-474 (1965); *Erie R.R. Co. v. Tompkins*, 304 U.S. 64 (1938). This raises at least two significant concerns.

First, in class actions, the procedural rules may be the whole story. If a case does not meet threshold Rule 23 certification requirements, the federal court never gets around to applying any substantive law – state or federal. The California Supreme Court’s recent decision in *Sav-On Drug Stores v. Superior Court*, 17 Cal. Rptr. 3d 906 (2004), illustrates the point. *Sav-On Drugs* addressed whether the superior court properly certified a state-wide class of assistant managers alleging overtime misclassification. Interpreting California’s class action law, the state’s highest court affirmed class certification and provided a strong endorsement for the certification of wage and hour class actions, including an affirmation of California’s *public policy favoring class actions*. In contrast, federal law interpreting Rule 23 is not nearly as definitive nor is there any clearly articulated national public policy favoring class actions. The difference between state and federal procedural rules could well have prompted a different result and no class action.

CAFA presents a second problem where federal courts are called upon to apply state substantive law. If the federal courts must address the application of a particular state law provision, which has not previously been interpreted by the courts of that state, case law in some circuits suggests that the federal court should adopt the interpretation that limits, rather than expands, liability. *Werwinski v. Ford Motor Co.*, 286 F.3d 661, 680 (3rd Cir. 2002); *Trimble v. Asaco*, 232 F.3d 946, 963 (8th Cir. 2000). In effect, the law includes a pro-defendant presumption where an open issue of state law exists.

In such cases, counsel may want to consider filing a motion in federal court to certify a novel question of state law to the state’s supreme court, if permitted. All states within the Ninth Circuit permit such certification. Whether the federal court agrees to certify the question to the state supreme court and whether the state court agrees to accept the certification are discretionary. Such certification will, moreover, invariably delay the litigation by a year or more, depending on the state court’s backlog.

For employment class actions filed in the first instance in state court, counsel should anticipate that removal petitions will be filed as a matter of course with protracted battles over whether the cases meet the new requirements for removal jurisdiction. This will include early skirmishes about the scope of the class and the identity and residence of class members, including appeals of any remand orders. In the past, defendants have done everything possible to avoid providing information about the identify and location of class members early on in litigation, knowing that this allows plaintiffs’ counsel the ability to collect anecdotal evidence. In order to take advantage of removal jurisdiction, defendants will bear the burden of demonstrating the residency of class members, which will require disclosure of the names and addresses of class members.

Retroactivity

By its terms, CAFA applies to “any civil action commenced on or after the date of enactment of this Act,” which was February 18, 2005. While this provision would appear to preclude any claim of CAFA retroactivity, defendants have argued that “commenced on or after” refers to the date upon which the case was *timely removed* to federal court, even if the case was filed in state court prior to CAFA’s enactment. In the only published decision to date to address it, a district court in Colorado rejected the argument. *Prichett v. Office Depot*, 2005 WL 563979 (D.Colo. Mar. 9, 2005). In an unpublished order, a district court in California reached a similar conclusion and remanded a state law unfair competition action on its own motion. *Hankins v. Pfizer, Inc.*, CV 05-1797 ABC (C.D. Cal, March 25, 2005).

CHANGES IN DIVERSITY JURISDICTION FOR CLASS ACTIONS		
	BEFORE CAFA	AFTER CAFA
Whose Citizenship Must be Diverse?	Complete Diversity – All Named Plaintiffs and All Defendants Citizens of Different States	Diversity if Any Class Member and Any Defendant Citizens of Different States
How to Calculate Amount in Controversy?	Each and Every Class Member must have Claim Over \$75,000 – No Aggregation	Aggregate Amount in Controversy over \$5 Million

CHANGES IN REMOVAL JURISDICTION FOR CLASS ACTIONS		
	BEFORE CAFA	AFTER CAFA
Presence of Defendant from Forum State	No Removal	Removal Permitted
Consent Requirement	All Defendants Must Consent to Removal	Any Defendant May Remove - No Consent Required from Others
Time Limit on Removal	Within One Year of Commencing of Action	Within 30 days of first pleading showing federal jurisdiction, even if over one year.
Appeal from Order Remanding to State Court	No Appeal	Discretionary Appeal <ul style="list-style-type: none"> • File within 7 days • Must be decided in 60 days (plus 10 day extension) or denied

EXCEPTIONS TO CAFA NEW DIVERSITY AND REMOVAL REQUIREMENTS

Two-Thirds Rule	<p>No diversity jurisdiction if:</p> <ul style="list-style-type: none"> • two-thirds of the class members are from forum state; • primary defendants OR one defendant from whom significant relief is sought <u>and</u> whose conduct is a significant basis for the relief sought are citizens of forum state; • principal injuries from each defendant suffered in the forum state; • no similar case filed within the past three years
One-Third Rule	<p>Federal court may decline jurisdiction if:</p> <ul style="list-style-type: none"> • between one-third and two-thirds of class members are from forum state; • primary defendants are citizens of forum state; • court must consider interests of justice and the totality of the circumstances (factors enumerated)
Securities and Corp. Governance Cases Exception	<p>Does not apply to:</p> <ul style="list-style-type: none"> • State Law Corporate Governance Cases • Securities Cases (already federal question cases)
State Entities and Officials Exception	<p>Does not apply to:</p> <ul style="list-style-type: none"> • State law actions in which primary defendants are state entities or officials (i.e. protected by 11th Amendment sovereign immunity)
Small Class Exception	<p>Does not apply to:</p> <ul style="list-style-type: none"> • Classes with fewer than 100 members • But may satisfy pre-CAFA diversity reqs. – complete diversity and \$75,000 amount in controversy

