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Diversity Jurisdiction

Central Aspects of the Class Action Fairness Act of 2005

By Robin R. Mocabee

Enacted in February 2005, the Class Action Fairness Act (CAFA)¹ substantially altered the practice of class action litigation across the nation. The purpose of this article is limited to highlighting the three fundamental aspects of CAFA by detailing how it (1) expands diversity jurisdiction of federal courts, (2) permits the removal of certain class actions from state courts to federal courts, and (3) impacts the settlement of class actions.²

Findings and Purposes of CAFA

In enacting CAFA, Congress recognized the inherent value and importance of class actions, but it also found that abuses had occurred over the past decade in the practice of class actions that needed to be remedied.³ The abuses involved harm to class members and defendants who had acted responsibly, interstate commerce, and the public's respect of the judicial system.⁴ The stated purposes of CAFA are to "assure fair and prompt recoveries for class members with legitimate claims," to permit federal courts to "consider interstate cases of national importance under

diversity jurisdiction," and to "benefit society by encouraging innovation and lowering consumer prices."⁵

Expanding the Jurisdiction of Federal Courts

The heart and soul of CAFA involves its significant expansion of federal diversity jurisdiction. Class actions involving claims that arise under federal law are not affected by CAFA. Federal courts, under CAFA, however, are now authorized to hear certain class actions involving claims that arise under state law.⁶ Federal courts have "original jurisdiction" of any civil action when (1) the size of the class involves 100 or more members, (2) the sum or value in controversy exceeds \$5,000,000 (exclusive of interests and costs), and (3) any class member is diverse from any of the defendants.⁷ To determine whether the required amount in controversy is met, the claims of individual class members are to be aggregated.⁸ Even once this basic threshold is met, however, CAFA contains additional jurisdictional provisions that either require or permit federal courts to decline jurisdiction.

Exceptions to Diversity Jurisdiction of the Federal Courts

Three exceptions expressly stated in CAFA specify the jurisdictional boundaries vested in federal district courts. The purpose of the exceptions is to ensure that certain class actions remain in state courts. Under the first exception—known as the home state controversy exception—a district court does not have jurisdiction if more than two-thirds of the proposed class members and the “primary defendants” are citizens of the forum state.⁹ The phrase “primary defendants” is used throughout CAFA, but it is not defined.

Under the second exception—known as the local controversy exception—a federal court lacks diversity jurisdiction when more than two-thirds of the members of all of the proposed class and at least one defendant are citizens of the forum state, the defendant’s conduct forms a “significant basis” for the asserted claims, “principal injuries” occurred in the forum state, and the class seeks “significant relief” from a defendant.¹⁰ The exception applies only when a class action involving similar factual allegations against any of the defendants has not been filed during the previous three years.

Under the third exception, a district court may decline jurisdiction “in the interests of justice” when more than one-third but fewer than two-thirds of the aggregate class members and the “primary defendants” are citizens of the forum state.¹¹ To do so, courts are required to engage in a balancing test based on the totality of the circumstances to determine (1) whether the claims involve matters of national or interstate interest; (2) whether the claims are governed by laws of the forum state or laws of other states; (3) whether the allegations pled by the class were crafted to avoid federal jurisdiction; (4) whether a “distinct nexus” exists between the forum state and the class members, the alleged harm, or the defendants; (5) whether the class members of the forum state outnumber the rest of the class members, which are dispersed among several states; and (6) whether any other class actions involving similar claims were filed during the previous three years.¹²

Particular Class Actions Excluded under CAFA

Certain class actions do not fall within the jurisdictional provisions of CAFA:

- Primary defendants who are “State, State officials, or other governmental entities”
- When the aggregate number of members of a class action is less than 100
- Claims exclusively involving a “covered security” under either the Securities Act of 1933 or the Securities Exchange of 1934; state laws governing corporations; and rights, duties, obligations (inclusive of fiduciary duties) relative to any security that falls within the Securities Act of 1933¹³

Removal and Remand

Section 1453(b) of CAFA incorporates most, but not all, of the requirements and procedures contained in 28 USC 1441, 1446, and 1447. Subject to certain exceptions, class actions may be removed to a federal court located in the state in which the action is filed. Due to the elimination of four critical impediments to removal, it is highly probable that efforts to remove a class action from state court to federal court will increase. First, in a diversity case, section 1446(b) precludes the filing of a notice of removal more than one year after the action was commenced. Section 1453(b) expressly provides that “the 1-year limitation under § 1446(b) shall not apply[.]” As a result, a defendant may file a notice of removal within 30 days after receiving an amended pleading, motion, or order and determining that the action is subject to removal in accordance with 28 USC 1332(d). Second, pursuant to section 1441(b), a defendant who is a citizen of the forum state is generally precluded from removing an action. But

FAST FACTS:

The Class Action Fairness Act of 2005:

- expands diversity jurisdiction of federal courts;
- authorizes the removal of certain class actions from state courts to federal courts; and
- creates a “Consumer Bill of Rights,” which impacts the settlement of class actions.



section 1453(b) excepts class actions from this requirement by permitting removal “without regard to whether any defendant is a citizen of the State in which the action is brought[.]”¹⁴ Third, under section 1446(b), all defendants are required to consent to removal. However, section 1453(b) eliminates the requirement by permitting any defendant to file a notice of removal “without the consent of all defendants.” Finally, pursuant to section 1447(b), in relation to other civil actions, appellate review of a district court’s order denying removal and remanding the action to state court is unavailable. But, in the context of class actions, section 1453(c) deviates from the requirement by expressly permitting a party to appeal a remand order.

The appellate procedures set forth in section 1453(c) require litigants and the court of appeals to act according to set time frames. Litigants must file an “application...to the court of appeals not less than 7 days after entry of the order.”¹⁵ If an appellate court accepts the appeal, it is then required to “complete all action on such appeal, including rendering judgment” no later than 60 days from the filing date of the appeal.¹⁶ An appellate court may grant an extension of this time period for two reasons. First, if all parties agree, an extension for any length of time may be granted.¹⁷ Second, if good cause is shown and in the interests of justice, the 60-day period may be extended another 10 days.¹⁸ In the event a final judgment is not issued within 60 days or at the end of any extension period, a court of appeals “shall” deny the appeal.¹⁹

Creation of “Consumer Bill of Rights and Improved Procedures”

Designed to protect class members, CAFA creates a “Consumer Bill of Rights,” which consists of three sections that govern particular types of settlements and one section that requires federal and state officials to receive notice of a proposed settlement.²⁰

Coupon Settlements

Section 1712 governs “coupon settlements,” which Congress viewed as particularly abusive and inequitable, primarily because the attorney fees received by plaintiffs’ class counsel were often vastly disproportionate to the value of a coupon or voucher received by a class member. The use of coupon settlements continues under CAFA subject to certain exceptions, which focus on the amount of attorney fees awarded to class counsel. The calculation of attorney fees varies depending on the particular use of coupons in a proposed settlement. First, the portion of class

counsel’s attorney fees that correlate to the award of coupons must “be based on the value to class members of the coupons that are redeemed.”²¹ Second, when class counsel’s fees are not proportionate to the coupons redeemed, “any attorney fees shall be based on the amount of time class counsel reasonably expended working on the action.”²² Courts are required to approve attorney fees awarded under section 1712(b)(1) and must include, if applicable, proper attorney fees for any equitable relief obtained for the class.²³ In addition, section 1712(b)(2) permits the “lodestar with multiplier method” to be used to determine attorney fees. Finally, the requirements of sections 1712(a) and (b) are to be followed to calculate attorney fees when a proposed settlement provides for both the recovery of coupons to class members and for any equitable relief obtained for a class.²⁴

On a party’s motion, a court may hear expert witness testimony on the “actual value to the class members” on coupons redeemed.²⁵ Federal district courts are precluded from approving a proposed coupon settlement unless a hearing is held and a written finding is made that “the settlement is fair, reasonable, and adequate for class members.”²⁶ In addition, federal courts are permitted to require that a proposed settlement address “the distribution of a portion of the value of unclaimed coupons to 1 or more charitable or governmental organizations, as agreed to by the parties.”²⁷

Settlements That Require Class Members to Incur Costs

CAFA also seeks to protect class members from settlements that require a class member to pay class counsel out of pocket, which results in a net loss to the class member. To approve such a proposed settlement, a federal district court is required to make “a written finding that nonmonetary benefits to the class member substantially outweigh the monetary loss.”²⁸

Settlements That Discriminate Geographically

Additionally, CAFA protects class members from settlements that pay some class members larger sums exclusively because they are geographically close to the court. A federal district court is prohibited from approving these settlements that discriminate based on geographic location.²⁹

Federal and State Officials Required to be Notified of Proposed Settlements

CAFA requires that certain federal and state officials receive notice of a proposed settlement before the issuance of an order

The stated purposes of CAFA are to “assure fair and prompt recoveries for class members with legitimate claims,” to permit federal courts to “consider interstate cases of national importance under diversity jurisdiction,” and to “benefit society by encouraging innovation and lowering consumer prices.”

granting final approval of such settlement. Each participating defendant of a settlement must serve “upon the appropriate State official of each state in which a class member resides and the appropriate Federal official” notice of a proposed settlement no more than 10 days after the proposed settlement is filed in court.³⁰ The notice must provide information and documents as required by the eight categories specified in section 1715(b).

Once 90 days have passed from the last date a notice is served on a proper federal or state official, a court may issue an order granting final approval of a proposed settlement.³¹ In the event a class member “demonstrates” that the notice requirements contained in section 1715(b) were not met, a class member may “refuse to comply with and may choose not to be bound by a settlement agreement or consent decree.”³² But there is a limitation to a class member’s right of refusal. Participating defendants in a proposed settlement may bind class members to a settlement or consent decree if notice is “directed to the appropriate Federal official, and to either the State attorney general, or the person that has primary regulatory, supervising, or licensing authority over the defendant.”³³

Effective Date of CAFA

CAFA “applies to any civil action commenced on or after the date of enactment of this Act.”³⁴ This statement, in conjunction with removal statute 28 USC 1453(b), has been subject to a fair amount of litigation due, in large part, to attempts by defendants to remove class actions filed in state court to federal court based on a broad interpretation of the term “commenced.”³⁵

Conclusion

The long-term effects of CAFA are unknown. In the short term, however, CAFA has had a dramatic impact on the number of cases filed or removed to federal courts. The Federal Judicial Center, as part of its long-term study on the impact of CAFA on the federal courts, recently released a second interim report.³⁶ The preliminary results of the study, which involves the filing and removal of class actions in 85 federal district courts from July 1, 2001 through June 30, 2005, indicate that there has been a substantial increase in the number of class actions filed and removed to the federal courts since the enactment of CAFA. Since one of the purposes of CAFA was to expand the subject matter jurisdiction of federal courts over state-law class actions, the finding is not a complete surprise. But what is surprising is that the expansion objective of CAFA was realized in less than five months. It remains to be seen if the other goals of CAFA will be accomplished so effectively. ■

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FOOTNOTES

1. Class Action Fairness Act, PL 109-2, 119 Stat 4, 9 (February 18, 2005); codified at 28 USC 1 note, 1332(d), 1332 note, 1453, 1711-1715, 2071 note, and 2074 note.
2. For more expansive analysis of CAFA, see Nelson, Scott, *The Class Action Fairness Act of 2005: An analysis*, available at <<http://www.abanet.org/litigation/committees/classactions/cafa.html>> (accessed January 12, 2007); Vairo, Georgene M., *Class Action Fairness Act of 2005: A review and preliminary analysis* (September 2005), available at <[www.http://ssrn.com/abstract=806405](http://ssrn.com/abstract=806405)> (accessed January 12, 2007); and Joseph, Gregory P., *Federal class action jurisdiction after CAFA, Exxon Mobil and Grable*, 8 Del L R 157 (2006).
3. 28 USC 1711 note.
4. *Id.*
5. 28 USC 1711(b).
6. A class action is defined as “any civil action filed under rule 23 of the Federal Rules of Civil Procedure or similar State statute or rule of judicial procedure authorizing an action to be brought by 1 or more representative persons as a class action[.]” 28 USC 1332(d)(1)(B); see also 28 USC 1711(2).
7. 28 USC 1332(d)(2) and (5)(B).
8. 28 USC 1332(d)(6).

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9. 28 USC 1332(d)(4)(B).
10. 28 USC 1332(d)(4)(A). CAFA does not provide definitions for the phrases set off by quotation marks.
11. 28 USC 1332(d)(3)(A).
12. 28 USC 1332(d)(3).
13. 28 USC 1332(d)(5) and (9). The removal of particular "mass actions" is also governed by CAFA. 28 USC 1332(d)(11); see also *Abrego v Dow Chemical Co*, 443 F3d 676 (CA 9, 2006) (discussing but not resolving the complex and confusing statutory "mass action" provisions of CAFA).
14. 28 USC 1453(b).
15. The court of appeals for the ninth and tenth circuits construed this statutory language to mean the exact opposite of authorizing an appeal "not less than 7 days after entry of the order." 28 USC 1453(c)(1). Those courts rely on legislative history to hold that the filing of an appeal must occur not more than seven days after entry of the order. *Amalgamated Transit Union Local 1309, AFL-CIO v Transit Services, Inc*, 435 F3d 1140, 1145-46 (CA 9, 2006) (quoting S Rep 109-14 at 49 (2005), as reprinted in 2005 USCCAN 3, 46) and *Pritchett v Office Depot, Inc*, 420 F3d 1090, 1093 (CA 10, 2006) (citing to the same Senate report). But see *Lao v Wickes Furniture Co Inc*, ___ FSupp2d ___, 2006 WL 2879763, *4-6 (CD Cal 2006) (thoroughly discussing the limited value of the Senate report due to its post-enactment publication and pointing out a subsequent determination by the Ninth Circuit Court of Appeals that "the committee's report 'is entitled to exceptionally little weight'").
16. 28 USC 1453(c)(2).
17. 28 USC 1453(c)(3)(A).
18. 28 USC 1453(c)(3)(B).
19. 28 USC 1453(c)(4).
20. 28 USC 1711-1715.
21. 28 USC 1712(a).
22. 28 USC 1712(b)(1).
23. 28 USC 1712(b)(2).
24. 28 USC 1712(c)(1) and (2).
25. 28 USC 1712(d).
26. 28 USC 1712(e).
27. *Id.*
28. 28 USC 1713.
29. 28 USC 1714.
30. 28 USC 1715(b).
31. 28 USC 1715(d).
32. 28 USC 1715(e)(1).
33. 28 USC 1715(e)(2).
34. 28 USC 1332 note.
35. A detailed discussion of such case law is beyond the scope of this article; however, a compilation of the early decisions relating to this issue as well as others exists. See Schmelz, Ronnie M., *The Class Action Fairness Act of 2005: An overview of CAFA and the early decisions*, from the web program, *Class Action Litigation: Prosecution and Defense Strategies 2006*, recorded July 2006, New York City, available at <http://www.pli.edu/product/book_detail.asp?ptid=503&stid=28&id=EN00000000026680> (accessed January 15, 2007); see also Joseph, *supra*.
36. Willging, Thomas E. and Lee III, Emery G., *The Impact of the Class Action Fairness Act of 2005, Second Interim Report to the Judicial Conference Advisory Committee on Civil Rules*, Federal Judicial Center, September 7, 2006, available online at <http://www.fjc.gov/library/fjc_catalog.nsf/autoframepage!openform?url=/library/fjc_catalog.nsf/DPublication!openform&parentunid=DC82A3BD40951310852571E2006C5A7E> (accessed January 12, 2007).