THE CLASS ACTION FAIRNESS ACT OF 2005

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On February 11, 2005, the U.S. Senate passed the Class Action Fairness Act of 2005, a bill designed to address abuses in class action litigation. The Senate passed the bill by a large margin, and the House of Representatives is now considering the proposed reform statute. The bill is expected to pass easily in the House – particularly because the House has passed a similar bill three times since 1998. This Alert summarizes the key provisions of the bill, as passed by the Senate.

FEDERAL JURISDICTION OVER CLASS ACTIONS

The bill amends the diversity of citizenship statute to create federal jurisdiction over many (but not all) class actions. Under the bill, federal courts have subject matter jurisdiction over a putative class action if:

• The claims of putative class members in the aggregate exceed $5 million, exclusive of costs and interest; and

• Diversity of citizenship exists between any putative class member and any defendant; and

• The case does not fall within an exception (discussed below) to the jurisdictional provision.

The bill’s grant of federal jurisdiction is not without exception. Federal jurisdiction will not lie if the putative class consists of less than 100 class members. Likewise, the bill’s grant of jurisdiction does not extend to certain specified types of securities lawsuits.


2 More specifically, the grant of federal jurisdiction does not apply to class actions that solely involve a claim concerning a covered security as defined under Section 16(f)(3) of the Securities Act and Section 28(f)(5)(E) of the Securities Exchange Act that: (1) relates to the internal affairs or governance of a business enterprise and that arises under or by virtue of the laws of the state in which such business enterprise is incorporated or organized; or (2) that relates to the rights, duties, and obligations relating to or created by or pursuant to any security as defined under Section 2(a)(1) of the Securities Act.
In addition, the bill requires federal courts to decline jurisdiction if two-thirds or more of the putative class members as well as the primary defendants are citizens of the state where the case was filed. Federal courts also must decline jurisdiction if:

- Two-thirds or more of the putative class members are citizens of the state where the case was filed and at least one defendant:
  - Is a defendant from whom significant relief is sought;
  - Is accused of conduct that forms a significant basis for the claims asserted by the putative class; and
  - Is a citizen of the state in which the action was filed; and
- Principal injuries resulting from the alleged conduct of each defendant were incurred in the state in which the action was originally filed; and
- During the three-year period preceding the filing of the class action, no other class action has been filed asserting the same or similar factual allegations.

Although the wording of this provision is complex, among other things, it continues to allow the removal of nationwide class actions and “copy cat” class actions.

Finally, the bill provides that a district court may decline jurisdiction when more than one-third and less than two-thirds of the class members and the primary defendants are citizens of the state in which the action was filed. The bill identifies a number of factors that a court should consider in determining whether to decline jurisdiction in such a case.³

In sum, the bill’s jurisdictional provision will greatly impact corporate defendants if it becomes law. In today’s world, class actions in which the plaintiffs assert state law claims are frequently not removable because of judicial precedent (existing in many judicial circuits) that precludes the aggregation of putative class members’ claims in determining the amount in controversy. The jurisdictional provision set forth in the Senate’s bill would greatly improve a class action defendant’s chances of successfully removing a putative class action to federal court – particularly nationwide or copy cat class actions. In addition, the creation of federal jurisdiction should deprive plaintiffs’

³ These factors include: (1) whether the claims involve national and interstate interests; (2) whether the forum state’s laws apply to the action; (3) whether the action was pled in a way that seeks to avoid federal jurisdiction; (4) the forum state’s nexus with putative class members, the alleged harm, and defendants; (5) whether the number of class members from the forum state is substantially larger than the number of class members from any other state; (6) whether similar class actions have been filed in the previous three years.
lawyers of one of their favorite tactics – filing putative class actions in state courts notorious for certifying class actions.  

**COUPON SETTLEMENTS**

The bill reflects Congress’ skepticism regarding the benefit that coupon settlements provide to class members. Class Action Fairness Act of 2005, S.5 at § 2(a)(3) (“Class members often receive little or no benefit from class actions, and are sometimes harmed, such as where . . . counsel are awarded large fees, while leaving class members with coupons or other awards of little or no value”). Accordingly, the bill requires judicial scrutiny of any proposed settlement in which class members would be awarded coupons. A court may approve such a settlement only after a hearing to determine whether the settlement is fair, reasonable, and adequate for class members. The court must make a written finding that this requirement is met.

The bill also legislates the treatment of attorneys’ fees in coupon settlements. In contingency fee cases, the value to class members of coupons actually redeemed must be used in calculating the attorneys’ fees of class counsel. In coupon settlements where class counsel’s fees are not based on a portion of the coupon value, an attorneys’ fees award must be based on the amount of time class counsel reasonably expended working on the action.

**NOTIFICATION OF CLASS ACTION SETTLEMENTS**

The bill requires defendants settling class actions to provide notice of the proposed settlement to certain federal and state officials (including the Attorney General of the United States). This notice must be provided within 10 days of filing a proposed settlement with the court. If a defendant fails to comply with notice requirements, class members “may refuse to comply with and may choose not to be bound by a settlement agreement.”

**CONCLUSION**

The Class Action Fairness Act will significantly alter the landscape of class action litigation. Once the bill becomes law, we will publish a Class Action Advisory that summarizes the final version of the Act and analyzes the Act’s impact on companies defending putative class actions.

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4 The bill also proposes amendment of the removal statutes so that a single defendant can remove a class action without the consent of all defendants. The bill further provides that the courts of appeal may review – on an interlocutory and expedited basis – a district court order granting or denying a motion to remand a class action. This provision is significant inasmuch as remand orders are ordinarily subject to interlocutory review only under narrowly proscribed circumstances.
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