

# Classing Up Class Action Litigation: How The Reforms Pending In Congress May Affect The Defense Of Class Actions

It seems that every week a new story makes the papers highlighting the settlement of a class action lawsuit that requires a corporation to pay a whopping amount of fees to class counsel: \$9.2 million in

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attorneys' fees for class counsel who brought suit against a video rental corporation alleging misleading information about

late fees; \$30 million to class counsel in a suit alleging defective automobile tires; \$49 million in fees to class counsel in a suit alleging deceptive practices by a tax preparation service. In many cases such as these, while class counsel profited handsomely, the settlement did not result in much benefit to the class members themselves other than the provision of coupons for free or discounted merchandise or services.

Watchdog groups and legislators have long questioned the fairness of the class action process to both consumers and corporate defendants. Many potentially meritorious suits have left consumers with settlements of little or no value. In many more instances, corporate defendants have been required to expend millions in legal fees to mount a successful defense to essentially frivolous claims, only to be sued again in another forum on the same theory.

After years of stalled efforts, Congress appears poised to significantly alter the rules affecting class action litigation. The Class Action Fairness Act passed the House last June and a similar, yet more aggressive, version of the bill was recently introduced in the Senate. President Bush already has promised to sign the legislation. A close study of the proposed Act raises the question of whether the contemplated reforms will provide the intended relief to corporate defendants or whether the legislation will constrain the ways in which corporations can dispose of class action lawsuits.

## The Class Action Fairness Act

Almost all class actions are filed in state courts

because class action plaintiffs' attorneys perceive state court judges and juries to be more sympathetic to plaintiffs, more inclined to grant class certification, and more likely to force corporate defendants to trial than their federal counterparts. Current law makes it difficult for defendants to remove class action lawsuits from the state courts. As a result, multiple class actions purporting to assert the same claims often proceed simultaneously in different state courts. This system promotes inefficiencies and often results in state court rulings that have national consequences, although the rulings may conflict with the laws and policies of other jurisdictions.

The Class Action Fairness Act recently introduced in the Senate seeks to address this situation in three principal ways. The proposed Act would (1) greatly expand federal court jurisdiction to encompass virtually all class action cases that are now litigated in state courts; (2) prohibit federal courts from approving coupon-only settlements without a written finding that the settlement actually benefits class members; and (3) require, in coupon-only settlements, that class counsel's fees be based on the monetary value of the coupons actually redeemed by settling class members. While the first of these reforms undoubtedly will benefit corporate defendants, the latter two may not.

## Expanding Jurisdiction For Class Actions

There are two methods by which federal courts obtain jurisdiction over lawsuits. Courts can either have federal question jurisdiction (i.e. over matters arising under the constitution or federal law) or diversity jurisdiction (matters arising between citizens of different states where the amount in controversy exceeds \$75,000). Under the present system, almost all class actions raising state law claims are litigated in state courts because the requirements of diversity jurisdiction cannot be met. Plaintiffs and defendants must have "complete diversity" for the federal courts to have jurisdiction, i.e. every plaintiff must be from

a different state than every defendant, and no defendant can be from the state where the suit was filed. Class action attorneys have easily skirted the complete diversity requirement by naming one plaintiff or defendant from the same state, thus keeping the case in state court. Moreover, class counsel can also easily defeat the complete diversity requirement by filing suit in a state where one of the defendants is incorporated or has its principal place of business. The amount in controversy requirement also keeps almost all class action cases in state courts because each named plaintiff must claim damages in excess of \$75,000. While the aggregate sum in a class action may be in the tens of millions of dollars, rarely does a class action lawsuit involve claims by individual class members worth more than \$75,000.

The proposed Class Action Fairness Act addresses both of these issues by substantially expanding federal court jurisdiction over class actions that implicate interstate commerce. The Act would grant federal courts jurisdiction to hear class action cases where (1) any member of the proposed class is a citizen of a different state from any defendant; (2) the suit seeks aggregate damages in excess of \$5 million; and (3) the class involves 100 members or more. Enactment of the proposed legislation would mean that corporate defendants could remove almost all significant class actions to federal court. For example, under the proposed reforms, a defendant could remove a class action to federal court even if the suit was filed in a state where the defendant resides, and even if the named plaintiff and the defendant or one of its co-defendants reside in the same state. As long as the \$5 million/100 class member threshold was met, the case would end up in federal court rather than the plaintiffs' selected state court forum.

### Judicial Scrutiny Of Proposed Settlements

Coupon and non-cash settlements are valuable to corporate defendants because settling class members' claims can be resolved at little or no cost beyond the payment of class counsel's fees, and the settlements require class members to do business with settling defendants again. These types of settlements allow corporate defendants to settle potentially ruinous lawsuits for relatively modest sums. Moreover, depending on the definition of the class used in the settlement agreement and approval order, such settlements will have preclusive effect on other potential class actions alleging the same conduct, thereby

buying peace and certainty for the settling defendants.

The proposed reforms might significantly alter the ability of corporate defendants to settle class actions through non-monetary settlements. The proposed Act includes a provision requiring court approval of any proposed settlement in which class members receive non-cash benefits after a hearing and subsequent written finding that the proposed settlement is "fair, reasonable, and adequate for class members." Moreover, the version of the Act pending in the Senate would require courts to tie class counsel fee awards to the value of class members' redeemed coupons. Because the number of redeemed coupons will likely pale in comparison to the number issued under the settlement, courts are likely to invalidate large fee payments to class counsel that cannot be justified by the true value of the settlement to the class. The drafters of these provisions undoubtedly hope that they will discourage plaintiffs' attorneys from filing frivolous class actions, and the reforms may have the desired effect. They may also, however, force defendants to litigate certain cases through class certification, summary judgment or trial that would have previously settled via coupon settlements and large payments of fees to class counsel. Depending on how courts implement the heightened scrutiny requirements, settling certain class actions may be much more expensive, complicated, and time-consuming for defendants.

It is too early to tell whether the Class Action Reform Act, if enacted, will be a net positive for corporations that are or become the target of class action lawsuits. Most defense attorneys would agree that expanded federal jurisdiction will generally provide defendants with a fairer forum in which to litigate than state court. It is unknown, however, whether this benefit will be outweighed by the heightened scrutiny of non-cash settlements that may make it more difficult and expensive for defendants to settle these cases.

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