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Litigation Update

Class Action Fairness Act of 2005 Dramatically Changes Federal-State Class Actions

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President Bush signed into law the Class Action Fairness Act of 2005 (the Act) on February 18, 2005, which applies to class actions filed on or after that date. The Act is the most significant federal litigation reform in decades. The Act responds to perceived abuses of class actions in two ways. First, it allows most class actions that plaintiffs' attorneys file in state court to be removed to federal court, where it is generally harder to have classes certified. This aspect of the Act is a positive development for the business community. Second, the Act discourages "coupon" settlements and requires greater scrutiny of proposed class action settlements by judges and other government officials. These provisions will make it more difficult and expensive for defendants to settle cases. Businesses that are sued in state court class actions should carefully consider the Act's provisions before removing the suits to federal court.

A. Federal Courts Will Now Have Jurisdiction Over Most Class Actions

The Act's key benefit is that it will allow most class actions that plaintiffs' attorneys file in state court to be removed to federal court, even if the claims are based only on state, rather than federal law. In the last several years, federal courts have been perceived to be less likely than state courts to certify classes, especially in product liability and false advertising cases. Before certifying a case to proceed as a class action, a federal district court must conduct a thorough analysis of how the case can be manageably tried on a class basis. By allowing removal of most putative class actions from state to federal court, the Act should result in fewer class actions being certified.

Before the Act, defendants could almost never remove these cases to federal court because to have federal diversity jurisdiction: (1) all class members had to be citizens of different states than all the defendants; and (2) the value of each class member's claim had to exceed $75,000, which rarely occurred.

The Act creates special rules for determining diversity jurisdiction for class actions. Under the Act, federal courts have original and removal jurisdiction over any class action if: (1) the class has at least 100 members (2) the aggregate amount in controversy is at least $5 million; and (3) any class member is a citizen of a state different from any defendant.

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There are two significant exceptions to these jurisdictional and removal provisions:

1. Federal courts nearly always *must* remand a case to state court if at least one primary defendant is incorporated in or has its principal place of business in the forum state and at least *two-thirds* of the class members are citizens of the forum state.

2. Federal courts *may* remand a case to state court if at least one primary defendant is incorporated in or has its principal place of business in the forum state and at least *one-third* of the class members are citizens of the forum state. In deciding whether to remand under this exception, the court will consider six factors:
   - Whether the claims "involve matters of national or interstate interest";
   - Whether the forum state's law will govern;
   - Whether the claims were pleaded "in a manner that seeks to avoid federal jurisdiction";
   - Whether the forum state has a "distinct nexus with the class members, the alleged harm or the defendants";
   - Whether the number of forum state citizens in the putative class is "substantially larger" than the number of citizens in the putative class from any other state and the other class members are citizens of a "substantial number" of states; and
   - Whether during the preceding three years one or more class actions asserting the "same or similar claims" on behalf of the "same or similar persons" have been filed.

The Act eliminates the one-year time limitation for removing a case to federal court based upon diversity jurisdiction. A defendant may arguably seek removal of a class action at any time prior to trial if an amended pleading, motion or other paper reveals a proper basis for removing the case to federal court.

The Act also allows any defendant to remove a class action without the consent of the other defendants. This provision is different from the general rule that requires the consent of all defendants to remove a case to federal court.

Finally, the Act gives federal courts the discretion to accept an appeal from an order remanding an action to state court. Previously, remand decisions were not appealable. The Act requires a court of appeals to decide the case within 60 days. The imposition of this time constraint makes it unlikely that appellate courts will accept many appeals from remand orders.

B. Settling Class Actions Will be More Difficult and Expensive Under the Act

The Act changes the way that class actions may be settled in federal courts in two main ways. *First*, the Act requires greater judicial scrutiny of "coupon" settlements. In a coupon settlement, a defendant issues coupons to class members as their settlement payment. In the past, contingent-fee plaintiffs' attorneys liked coupon settlements because their fee was typically calculated based on the aggregate value of the coupons to the entire class. Defendants also favored coupon settlements because they avoided cash outlays and the redemption rate for the coupons was usually very low. Coupon settlements remain permissible under the Act, but in awarding the fee plaintiffs' counsel may receive, a federal court must now consider the coupons' expected redemption rate (as opposed to the

coupons' theoretical maximum value). Moreover, the Act encourages courts to require defendants to make guaranteed minimum payments and pay a portion of the value of unclaimed coupons to one or more charitable or governmental organizations. These provisions are expected to make coupon settlements less attractive to plaintiffs' attorneys and more expensive for defendants.

Second, the Act requires defendants to send detailed notices of prospective class action settlements to the Justice Department and the Attorneys General or relevant regulatory agency in each state where class members reside. This requirement raises the specter of politically ambitious officials objecting to proposed settlements to gain publicity or to require defendants to pay more money.

The Act's provisions concerning settlements make it imperative for defendants in putative class actions filed in state court to evaluate the likelihood that the class might be certified if they remove the lawsuit to federal district court. For those cases where there is a significant risk of class certification, defendants may prefer to remain in state court in order to avoid these provisions of the Act and more easily settle the case.

C. Considerations for Litigating in Federal Court Versus Arizona State Court

This section highlights some of the differences between Arizona state court litigation and federal court litigation. These differences illustrate the advantages a defendant may be able to achieve by removing a class action to federal court under the Act.

1. Admissibility of Scientific and Expert Evidence

   The standards for the admissibility of scientific and expert evidence are stricter in federal court than in Arizona state court. Federal courts apply the standard set forth by the United States Supreme Court in *Daubert v. Merrell Dow Pharmaceuticals, Inc.*,[1] which often enables defendants to exclude the plaintiffs' key expert testimony and obtain summary judgment.[2] Arizona courts apply the more lenient *Frye* test[3], under which defendants have difficulty excluding the plaintiffs' proffered expert evidence.

   Because the federal standard is stricter, litigating a class action in federal court will likely be an advantage for a defendant, particularly where scientific evidence is at issue.

2. Disclosure Rules

   Federal court disclosure rules are, in general, more beneficial to defendants than Arizona state court disclosure rules. In federal court, a defendant may identify the documents that it has to support its defenses without necessarily disclosing documents that relate to the plaintiff's claims and which may be harmful. In contrast, Arizona's state court rules require parties to disclose the documents they believe to be relevant to the subject matter of the case, regardless of whether the disclosing party intends to use the documents to support its claims or defenses. Under Arizona's state court rules, a defendant may be required to voluntarily disclose documents that are harmful to its case if they are relevant to the plaintiff's claims.

   These differences in disclosure requirements may cause defendants to prefer to be in federal court rather than Arizona state court.

3. Jury Issues

Several jury issues make federal court more favorable to defendants than Arizona state court. For example, in federal court, a plaintiff must make a demand for a jury trial within a relatively limited time period. By comparison, a plaintiff in state court has a much broader time period in which to demand a jury trial.

Additionally, in federal court, there may be as many as twelve jurors and all of them must agree on the verdict. In state court, there are eight jurors and only six of them must agree on the verdict. Juror unanimity in federal court favors defendants and may be a significant consideration in deciding whether to remove a case from Arizona state court.

4. Appeal of Class Certification Decisions

In Arizona state court, parties cannot immediately appeal an order by the trial court granting or denying a motion for class certification. In federal court, however, such decisions can be immediately appealed.

[1] 509 U.S. 579 (1993).
[2] *See, e.g., Cloud v. Pfizer, Inc.,* 198 F.Supp.2d 1118 (D. Ariz. 2001).
[3] *Frye v. United States*, 293 F. 1013 (D.C. Cir. 1923); *see Logerquist v. McVey*, 196 Ariz. 470, 1P.3d 113 (2000).

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