

Report for Congress

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Class Actions and Proposed Reform in the 107th Congress: Class Action Fairness Act of 2002

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Summary

On March 13, 2002, the Class Action Fairness Act of 2002 (H.R. 2341) passed the House by a vote of 233-190. Similar legislation is pending in the Senate (S. 1712). Both bills allow defendants to move certain class action cases from state to federal court on diversity grounds (plaintiffs from different states than defendants) even in the absence of the complete diversity. Proponents contend that existing law permits unfair forum shopping for friendly state courts. Opponents argue that the change works to the disadvantage of consumers. Both bills afford consumers and other class action plaintiffs greater protection which includes: (1) notices to class members in "Plain English," (2) judicial scrutiny of settlements in which class members receive minimal benefits or actually incur losses, (3) elimination of inequitable discrimination in favor of class agents at the expense of other class members, (4) prompt consideration of interstate class actions, and (5) application of the principles of federal diversity jurisdiction to interstate class actions.

H.R. 2341 requires (1) plaintiffs' attorneys to disclose their fees in any class action settlement or final judgment favoring plaintiffs; (2) prevents judges from sealing records in class action settlements except for orders consistent with the public interest and narrowly drawn; (3) directs the Judicial Conference to study ways to improve class action attorney's fee arrangements; and (4) authorizes pre-trial appeals of district court decisions to grant or deny certification to a class. S. 1712 insists on none of these things, but unlike H.R. 2341, it does postpone the effective date of any class action settlement until 90 days after federal and state authorities have been notified of its provisions.

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Background

In 2001, the House and Senate reintroduced the Class Action Fairness Act after the previous legislation had withered in the Senate.¹ Each bill—H.R. 2341, the House companion bill to S. 1712—has three main sections: (1) an amendment to the federal diversity statute, 28 U.S.C. § 1332;² (2) a provision regarding removal;³ and (3) a consumer class action “bill of rights.”⁴

¹See CRS Report RS20667, *Class Actions and Proposed Reform in 106th Congress: Class Action Fairness Act of 2000* and CRS Report RS20347, *Class Actions: H.R. 1875, 106th Congress, the “Interstate Class Action Jurisdiction Act of 1999.”*

Prior to passage, the House Judiciary Committee conducted hearings on the proposal, *Class Action Fairness Act of 2001: Hearing Before the House Committee on the Judiciary*, 107th Cong., 2d Sess. (2002), and reported it out with amendments, H.Rept. 107-370 (2002), both hearings and report are available at www.house.gov/judiciary. The bill was further amended during debate on the House floor, 148 Cong. Rec. H859-H882 (daily ed. Mar. 13, 2002). Hereafter, references to H.R. 2341 mean the bill as passed by the House.

²The federal jurisdiction section amends Section 1332 to provide for federal jurisdiction in class actions where the aggregate amount in controversy of all individual claims exceeds \$2 million and *any* member of the putative plaintiff class is a citizen of a state different from *any* defendant. This section excepts actions where (1) a substantial majority of the proposed plaintiffs and the primary defendants are citizens of the state where the case was filed; (2) the primary defendants are states or state officials; or (3) the proposed plaintiff class has fewer than 100 members. H.R. 2341 and S. 1712 also deems so-called private attorney general actions, and cases involving claims of more than 100 people with common questions of law or fact, to be class actions for purposes of federal jurisdiction and removal.

³H.R. 2341 and S. 1712 removal provision allows any defendant or absent class member to remove a class action to federal court if Section 1332 is satisfied, regardless of whether a defendant is a citizen of the state where the action was filed, and without the consent of other defendants or class members.

⁴The “bill of rights” portion of the proposed legislation requires a hearing and written findings before a court may approve any class settlement providing noncash benefits or requiring expenditure of funds in order to obtain the proposed benefits. Similarly, a court must make written findings in order to approve a settlement that obligates a class member to pay class in an amount that would result in a net loss to the class member. Further, the two bills prohibit approval of a settlement that pays class members higher amounts based solely on their economic proximity to the court or that pays a bounty to the class representatives (other than payment for reasonable time and cost). The two bills also

(continued...)

The Legislation

Section 1. Short Title. The Act may be cited as the “Class Action Fairness Act of 2002.” This section also states that it amends title 28 of the United States Code.

Section 2. Findings And Purposes Of The Act. Sets out Congress’ findings describing the: (1) circumstances in which class actions are valuable to our legal system; (2) abuses of the class action process that injure both plaintiffs and defendants, i.e., plaintiffs’ lawyers receiving large fees, while class members are left with coupons or other awards of little or no value, unjustified rewards being made to certain plaintiffs at the expense of other class members, and the publication of confusing notices that prevent class members from being able to fully understand and effectively exercise their rights; (3) the impact of interstate class actions on principles of federalism through the use of artful pleading thereby permitting the plaintiffs to avoid litigating class actions in federal court and forcing businesses and other organizations to defend interstate class action lawsuits in county and state courts where (i) the lawyer, rather than the claimants, is likely to receive the maximum benefit, (ii) less scrutiny may be given to the merits of the case, and (iii) defendants are effectively forced into settlements, in order to avoid the possibility of huge judgments that could destabilize their companies; and (4) the cost that these suits impose on the national economy.

Section 3. Consumer Class Action Bill Of Rights And Improved Procedures For Interstate Class Actions. This section would add seven new sections to 28 U.S.C. which are intended to provide greater protections for class members. In particular, section 3 would add the following:

! **Section 1711–Judicial scrutiny of coupon and other noncash settlements**

This provision is aimed at certain proposed settlements of class actions, in which the plaintiffs’ lawyer and the defendant work out a settlement that provides class members with essentially valueless coupons while rewarding the lawyers with substantial attorneys’ fees. To address this problem, this section provides that a judge “may approve a proposed settlement under which the class members would receive noncash benefits or would otherwise be required to expend funds in order to obtain part or all of the proposed benefits only after a hearing to determine whether, and making a written finding that, the settlement is fair, reasonable, and adequate for class members.”

! **Section 1712–Protection against loss by class members**

This provision provides that a judge may not approve a class action settlement in which the class members will be required to pay attorney’s fees that would result

⁴(...continued)

contain “plain English” requirements regarding written notice to class members.

H.R. 2341 and S. 1712 provide that the Act’s provisions apply to any civil action begun on or after the date of enactment of the Act.

in a net loss to the class members until after a hearing to determine whether the nonmonetary benefits to the class outweigh the monetary loss, and if so making a written finding to that effect.

! **Section 1713–Protection against discrimination based on geographic location**

This provision provides that a settlement may not award some class members a larger recovery than others solely because the favored members of the class are located closer to the courthouse in which the settlement is filed.

! **Section 1714–Prohibition on the payment of bounties**

This provision provides that a class action may not be settled on terms that award special and disproportionate bounties to the named class representatives. A class representative will, however, be able to be compensated for his reasonable time or costs that were required to be expended in fulfilling his obligations as a class representative. The payment of bounties gives the class representatives a share of the damages award that is disproportionately larger than that provided to absent class members.

! **Section 1715–Clearer and simpler settlement information**

This provision provides that class notices should present information in “plain English.” The notices must be designed to attract the attention of class members by stating at the outset, in 18-point type, that the recipient is a plaintiff in a class action lawsuit and has legal rights that are affected by the settlement described in the notice. In addition, the notice must offer:

- (A) the subject matter of the class action;
- (B) the members of the class;
- (C) the legal consequences of being a member of the class;
- (D) detailed information about any proposed settlement, (i) including a description of the benefits for class members, (ii) the rights that class members will lose or waive through settlement, (iii) the obligations imposed on the defendant, and (iv) the amount of attorney’s fee counsel will be seeking or, if not possible, a good faith estimate of such fee;
- (E) any other material matter.

! **Section 1716–Disclosure of attorney’s fees (H.R. 2341 only)**

This provision requires plaintiffs’ attorneys to inform each member of the class of the full amount of the attorney’s fees. Notice must be given when the class members receive their awards or (if there is no award) when notified of final settlement or judgment.

! Section 1716-Notifications to appropriate Federal and State officials (S. 1712 only)

This provision requires defendants to notify the appropriate state and federal officials of the particulars of any class action settlement and delays the effective date of the settlement until 90 days after they have done so. The appropriate federal officials include the Attorney General and in the case of financial institutions the federal regulatory authorities. State officials entitled to notice include the authorities with regulatory jurisdiction over a defendant in any state in which any member of the class resides.

! Section 1717–Sunshine in court records (H.R. 2341 only)

This provision precludes courts from sealing the records of class actions or making them subject to a protective order unless the order is narrowly tailored, in the public interest, consistent with the protection of public health and safety, and in the circumstances where the interests of confidentiality clearly outweigh those favoring disclosure.

! Section 1717–Class action definitions (Section 1718 in H.R. 2341)

(1) Class Action–The term is defined to include any civil action filed in federal district court under Rule 23 of the Federal Rules of Civil Procedure, as well as actions filed under similar rules in state court that have been removed to federal court. The definition also appears to suggest that some suits that are not necessarily representative actions in the traditional sense, but seek various forms of monetary relief on behalf of persons who are not parties to the litigation may be treated as class actions.

(2) Class Counsel–The term is defined as “the persons who serve as the attorneys for the class members in a proposed or certified class action.”

(3) Class Members–The term is defined as “the persons who fall within the definition of the proposed or certified class action.”

(4) Plaintiff Class Action–The term is defined as “a class action in which class members are plaintiffs.”

(5) Proposed Settlement–The term is defined as “an agreement that resolves claims in a class action, that is subject to court approval and that, if approved, would be binding on the class members.”

Section 4. Federal District Court Jurisdiction Of Interstate Class Actions. Article III of the Constitution protects out-of-state litigants against the prejudice of local courts by allowing for federal diversity jurisdiction when the plaintiffs and defendants are citizens of different states. However, under current law, federal diversity jurisdiction for a class action does not exist unless every member of the class is a citizen of a different state from every defendant, and every member of

the class is seeking damages in excess of \$75,000.⁵ This section changes the law by providing additional protection for out-of-state litigants by creating a minimal diversity rule for class actions and by determining satisfaction of the amount-in-controversy requirement by looking at the total amount of damages at stake.

Federal district courts receive original jurisdiction over any class action in which the amount in controversy, exclusive of interest costs, exceeds \$2,000,000 and in which (A) “any member of a class of plaintiffs is a citizen of a state different from any defendant;” (B) “any member of a class of plaintiffs is a foreign state or a citizen or subject of a foreign state and any defendant is a citizen of a state;” or (C) “any member of a class of plaintiffs is a citizen of a state and any defendant is a foreign state or a citizen or subject of a foreign state.”

This section contains a similar class action definition as section 3, defining a class action as (A) any civil action filed pursuant to rule 23 of the Federal Rules of Civil Procedure or a similar state statute or rule; (B) an action seeking monetary relief on behalf of persons who are not parties to the action (unless the named plaintiff is the state attorney general); or (C) an action that asserts claims seeking monetary relief on behalf of 100 or more persons, in which the claims involve common questions of law or fact and are to be jointly tried.

In order that actions lacking national implications remain in state court, the minimal diversity rule does not apply in any action where (A) “the substantial majority of the members of the proposed plaintiff class and the primary defendants are citizens of the state in which the action was originally filed; and the claims asserted [in the suit] will be governed primarily by the laws of the state in which the action was originally filed;” (B) “the primary defendants are states, state officials, or other governmental entities against whom the district court may be foreclosed from ordering relief;” or (C) “the number of proposed plaintiff class members is less than 100.”

Section 5. Removal Of Interstate Class Actions To Federal District Court. This section provides that the legislation applies to any civil action commenced on or after the date of enactment. H.R. 2341 precludes a class member who is not a named party or class representative to move for removal prior to certification of the class.

Section 6. Appeals Of Class Action Certification Orders (H.R. 2341 only). This section provides that orders granting or denying class certification may be appealed if notice of appeal is filed within 10 days after entry of the order. It also provides that discovery be stayed during the pendency of the appeal unless the judge finds that specific discovery is necessary to preserve evidence or to prevent undue prejudice to a party.

⁵28 U.S.C. § 1332. See also *Zahn v. International Paper Co.* 414 U.S. 291, 301 (1973) (The Supreme Court decided that in class actions based on diversity of citizenship, every single class member must satisfy the “matter [amount] in controversy” requirement of section 1332).

Section 7 (H.R. 2341) [Section 6 in S. 1712]. Report on class action settlements. This provision directs the Judicial Conference of the United States to report to the Judiciary Committee within 12 months of the enactment with recommendations and action taken to ensure that class action settlements are to the benefit of and fair to class members and that attorneys' fees appropriately reflect the extent and success of the attorneys' efforts.

Section 8 (H.R. 2341) [Section 7 in S. 1712]. Effective date. This section provides that the legislation applies to any civil action commenced on or after the date of enactment.

On March 13, 2002, H.R. 2341 passed the House by a vote of 233-190. During the floor debate, the House passed three of nine amendments offered to the bill: (1) an amendment by Rep. Jerrold Nadler which would prevent judges from sealing records in class action settlements dealing with public health and safety;⁶ (2) an amendment by Rep. Ric Keller which would require plaintiffs' attorneys to disclose their fees in any class action settlement or final judgment favoring plaintiffs;⁷ and (3) an amendment by Rep. Melissa Hart which would require a study by the U.S. Judicial Conference on ways to improve class action attorneys' fee arrangements.⁸ All three amendments passed by voice vote. A companion bill (1712) awaits Senate action.

Possible Objections

Although balanced by the enhanced class member protection features, the jurisdictional and removal components of H.R. 2341 are much like their antecedents in the 106th Congress. Opponents object that they:

- ! would overburden the federal courts;⁹
- ! are inconsistent with the principles of federalism;¹⁰
- ! would make consumer and public interest litigation more difficult to bring, more expensive, and more burdensome.¹¹

⁶148 Cong. Rec. H859-H860, H866 (daily ed. March 13, 2002).

⁷*Id.* at H863-H866.

⁸*Id.* at H879-H882.

⁹H.Rept. 107-370, at 125-26 (Dissenting views of Reps. Conyers, Berman, Nadler, Scott, Watt, Lofgren, Jackson-Lee, Waters, Meehan, Delahunt, and Baldwin) (Dissenting views)

¹⁰*Id.* at 126-29.

¹¹*Id.* at 129-34.

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