New Route for Class Actions

Proposals Raise Questions About Whether Giving Federal Courts More Power Over Cases Will Cure the System's Ills

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THE ADAGE THAT SAYS "IF IT ain't broke, don't fix it" does not apply these days to the class-action litigation process. Instead, the widespread view is that the class action system is badly broken and in sore need of fixing.

It is not surprising to hear that opinion expressed by the nation's business community and lawyers who defend companies in class action lawsuits brought on behalf of consumers and other groups.

Not only do class actions compel companies to expend significant sums on legal defense costs, the business community maintains, but damages or settlement amounts can reach well into the millions of dollars and threaten the very existence of a company or even an entire industry. Moreover, defendants complain, plaintiffs lawyers often reap the greatest financial rewards when they win or settle a case, while individual plaintiffs receive little more than a token recovery.

Consumer advocates and even some members of the plaintiffs bar voice many of the same complaints about the class action system, a unique invention of American law. While these lawsuits are intended to give individuals

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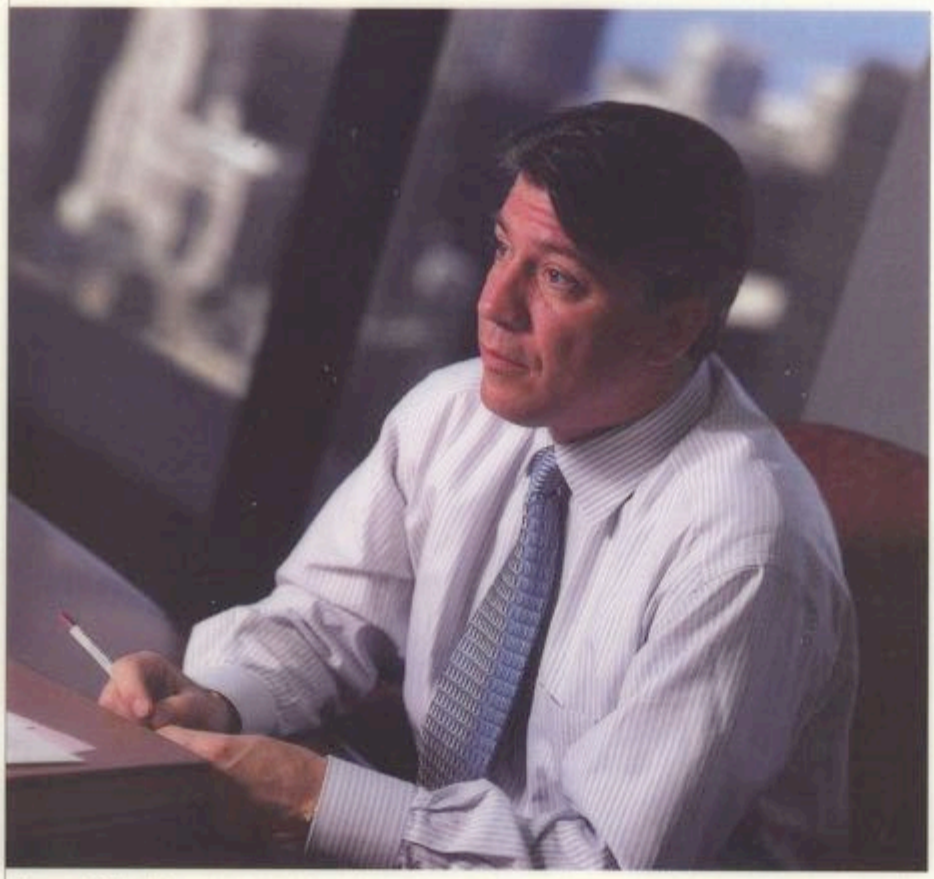

Kenneth Moll: "It's more manageable to have one case in one courthouse than 50 cases in 50 courthouses."

the collective power to seek damages from alleged wrongdoers without having to file separate lawsuits, they often result in minuscule rewards for plaintiffs, according to consumer advocates. And sometimes, they say, those recoveries even come in the form of things like discount coupons for a defendant's products rather than any monetary payout.

"It's just another milking of the system by professionals, in this case lawyers," says Lawrence W. Schonbrun, a solo practitioner in Berkeley, Calif., who represents unnamed class members in challenges to class-action lawsuit outcomes. Class actions, he says, "are not deterring anything. It's a horrible swindle of the American public in the name of trying to help them. And that the courts and the legal system are at the center of this is shocking and depressing, to say the least."

CORPORATE ADVANTAGE

IN ONE CASE, SCHONBRUN IS CHALLENGING A SETTLEMENT that is a better deal for corporate plaintiffs than for individuals who sued. The defendant, accused of inflating its prices for vitamins, has agreed to an $80 million settlement. Companies that bought the vitamins in bulk will share $42 million of the proceeds. But the $38 million allotted to individual plaintiffs is going to charity because each individual's share would be so small. The individual plaintiffs "didn't even get coupons," says Schonbrun.

Another cause for complaint is that class actions impose daunting logistical burdens on the courts that must administer them. Typically, class actions involve anywhere from hundreds to millions of plaintiffs, usually in different states, and sometimes there are multiple defendants, as well. The largest class actions may involve cases being litigated simultaneously in courthouses around the country.

Even less-massive cases present a serious problem when similar class actions against the same defendants are pursued in different state courts, or state and federal courts simultaneously. Although judges in these differing jurisdictions may try to work together cooperatively on such cases to prevent inconsistent or conflicting results, there generally are no set rules for doing so.

Many critics of the current class action system maintain that its ills would be alleviated if more cases went to the federal courts rather than the states. Federal judges are widely viewed as being less lenient toward class actions than their colleagues in the state courts, particularly on the key issue of whether to certify a class so the case may proceed.

"If you ask most attorneys why they file in state court and why they want to avoid federal court like the plague, it's because of the recent [federal court] rulings decertifying and not certifying class actions," says Kenneth B. Moll, a Chicago lawyer who represents plaintiffs in class actions.

A sizable number of class actions are filed in the federal courts. In 2001, for instance, 3,092 class actions were filed in the federal courts, according to *Class Action Reports*, a publication in Washington, D.C., although in some other recent years the number has been considerably lower. Most federal class actions are based on claims arising from federal statutory law in areas such as securities, antitrust, employment discrimination and civil rights.

Class actions filed in the state courts are far more numerous, seeking recoveries for individual plaintiffs numbering into the millions on claims for consumer fraud, product liability, contractual breaches, environmental hazards and insurance issues. The federal courts are largely constrained by jurisdictional rules from taking many of those types of cases.

But the power of the federal courts over class actions will increase dramatically if two measures now before Congress go into law.

First, the Class Action Fairness Act of 2003 would significantly increase the jurisdiction of the federal courts over many class actions that now are handled by state courts. And second, proposed amendments to Rule 23 of the Federal Rules of Civil Procedure, which governs class actions handled in the federal courts, would give judges more power to control those cases.

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Congress is likely to act before the end of this year on both measures. If they go into effect, they could create a whole new world for class actions, say experts. But whether it would be a better world is a question on which there is much debate.

TIGHTENING THE FEDERAL REINS

THE BUSINESS COMMUNITY AND ITS ALLIES VIEW THE FEDeral courts as a key to accomplishing their goal of reining in class action litigation. If only the federal courts could have broader jurisdiction over class actions, the thinking goes, fewer cases would be certified, and those that do go forward would be more tightly controlled, especially if the proposed amendments to Rule 23 go into effect.

And increasing federal court jurisdiction over class actions is at the heart of the Class Action Fairness Act.

"Basically, the class action legislation is the priority legislation for the business community in this Congress," says Leo J. Jordan of West Orange, N.J., a past chair of the ABA Tort Trial and Insurance Practice Section who serves on the association's Task Force on Class Action Legislation. "Regardless of what else they talk about—medical malpractice, asbestos—this is really their key issue."

As introduced in the Senate by Charles Grassley, R-Iowa, in February, the Class Action Fairness Act would give the federal courts original jurisdiction over class actions if two key requirements are met. First, the amount in controversy must exceed $2 million and, second, any member of a class of plaintiffs must be a citizen of a state different from any defendant.

In effect, the bill would remove class actions from the "complete diversity" standard that now applies under the Federal Rules of Civil Procedure. Complete diversity requires that all plaintiffs and all defendants in an action be citizens of different states for federal jurisdiction to exist. Without federal diversity jurisdiction, a case must be pursued in state court (unless it qualifies for federal question jurisdiction).

An amendment introduced by Sen. Dianne Feinstein, D-Calif., with Grassley as one of the co-sponsors, tightens the requirements for federal jurisdiction in the original bill. One provision increases the required minimum amount in controversy to $5 million. Another bars district court jurisdiction in any class action in which at least two-thirds of the proposed plaintiff class and the primary defendants are citizens of the same state. A third provision allows a district court to decline to exercise jurisdiction over class actions in which more than a third but fewer than two-thirds of the members of the proposed plaintiff class and the primary defendants are citizens of the same state.

The measure provides that any class action meeting the requirements for federal court jurisdiction could be removed from state court at the initiative of any single plaintiff or defendant without the consent of other members of the class.

Other provisions of the bill would:

- Permit settlements in federal class actions calling for plaintiff class members to receive "noncash benefits" or to spend their own money to receive some of the settlement benefits only after a court hearing to determine whether the settlement "is fair, reasonable and adequate for class members."
- Require that notices use plain language.

The amended version of the Senate bill, S. 274, was approved in April by the Judiciary Committee and sent to the full Senate for consideration.

This isn't the first time that Congress has considered broader federal court jurisdiction for class actions. In recent years, nearly identical versions of the Class Action Fairness Act—drafted initially by the U.S. Chamber of Commerce—have passed the House only to stall in the Senate. But this time, supporters have changed their tactics by introducing the bill first in the Senate, where the current Republican majority gives it a better chance at passage. Many observers still expect House approval to come even more easily.

"I think it's quite likely that this bill will pass the Senate sometime this summer, and that it will probably pass the House somewhere around the fall," says Jordan.

A bill similar to S. 274 was expected to be considered by the House of Representatives as early as June. President Bush has expressed support for legislation giving federal courts broader jurisdiction over class actions.

RULE CHANGES PROPOSED

WHILE CONGRESS CONTINUES TO DELIBERATE THE ACT, IT has received another measure that also could have a significant impact on how class actions are handled by the federal courts.

This spring, the U.S. Supreme Court conveyed to Congress a series of amendments to Rule 23 of the Federal Rules of Civil Procedure. The amendments will become effective on Dec. 1 unless Congress acts affirmatively to reject them.

The amendments, which were drafted by the Committee on Rules of Practice and Procedure of the U.S. Judicial Conference, would give federal judges tighter control over several key aspects of administering class actions. Among the proposed amendments are provisions that would:

- Require notices to class members regarding the nature of the actions and their rights to use plain language.
- Specifically require the court to approve any settlement, voluntary dismissal, or compromise of claims, issues or defenses of a certified class. Before granting that approval, the court must hold a hearing and find that the action is "fair, reasonable and adequate." Current rules give

Dinita James: Expanded federal jurisdiction will likely make plaintiffs think twice about filing class actions.

the courts specific power to approve only dismissals or compromises.

• Allow the court to reject any settlement unless it gives individual class members a chance to request exclusion once they are notified of the settlement terms. This power does not currently exist under Rule 23.

• Require the court to appoint class counsel and allow the court to award "reasonable" attorney fees and costs. Current Rule 23 does not specifically call for the court to appoint counsel or to review fees.

While S. 274 emphasizes increasing federal court jurisdiction over class actions, the primary focus of the proposed amendments to Rule 23 is on giving federal judges more power to oversee the class action cases that come before them, notes Edward F. Sherman. He is a professor and former dean at Tulane University School of Law in New Orleans who chairs the ABA Task Force on Class Action Legislation. "Both broad responsibility and discretion are given to the judge" under the proposed Rule 23 amendments, says Sherman.

UNCERTAIN IMPACT

AS THE CLASS ACTION FAIRNESS ACT PROGRESSES TOWARD adoption, debate continues over its potential impact.

Proponents of S. 274 maintain that increasing federal court jurisdiction over class actions would streamline the litigation process. They say eliminating duplicative cases in state courts and consolidating them under the control of a single federal court judge would assure that parties in different parts of the country are treated uniformly and would encourage settlements.

And even some plaintiffs lawyers agree that approach has merit. In class actions of national scope, "I think it's more manageable to have one case in one courthouse than 50 cases in 50 courthouses," says Moll of Chicago.

Federal judges "just have more control of the defendants, the evidence, the witnesses of the case," Moll points out, since their jurisdiction can extend far beyond the boundaries of any one state.

Many in the field, however, express concern that the antidote for class action ills prescribed in the bill—shifting much of the nation's class action litigation from state to federal court—may create more problems than it solves. At the same time, they say, the proposed legislation does not adequately address several known problems with class actions.

Opponents of the bill contend that giving federal courts more jurisdiction over class actions will in effect derail many cases because federal judges will be less likely than state court judges to certify them. They point out that not only does a refusal to certify a case essentially kill it, but certification usually brings about at least some recovery for plaintiffs. As many as 95 percent of certified class actions are estimated to settle prior to trial.

The reason, says Jordan, is that so many class actions tend to be "bet the company" cases for defendants. "They are unwilling to shake the dice and do that. And if you can settle and keep the company intact, it's often the smart business thing to do. That's why certification is a key issue."

The likelihood of facing the stricter certification process in the federal courts may discourage plaintiffs from filing class actions even in state court, from which they could be more easily removed to federal court under the bill.

"There's definitely a problem with state court judges and how they approve these settlements," says plaintiffs lawyer Schonbrun. "But I don't know that class members are going to benefit from this particular legislation" if class actions aren't even filed in the first place. "They may even get less."

Another plaintiffs lawyer concurs. "You're taking away the practical means of obtaining a remedy," says Richard T. Seymour of Washington, D.C. "It's just as if you were taking the victims of fraud, taking away their remedies and restoring the money to the pockets of wrongdoers," says Seymour, a council member of the ABA Section of Labor and Employment Law who serves on the association's class action task force.

Experts say S. 274 could give rise to problems from the other direction—that already busy federal courts will be

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deluged with class actions under their broader jurisdiction.

That could lead to a potentially disastrous slowdown of business-related litigation throughout the federal courts, says Seymour.

"I think this is going to be nothing but pain all the way for everybody," he says. Even though the business community has been spearheading the class action bill, "My own prediction is that the effect on the federal courts is going to be so drastic that it might be only just a year before business is screaming to Congress to repeal it. Once they understand that the federal courts are going to be bogged down, I think the cries for relief from Congress are going to be very substantial."

Seymour also predicts that the jurisdictional scheme of the class action bill would trigger constitutional challenges. "When you take a huge chunk of state court business and transfer it into federal court, I think that's going to cause very extensive 10th Amendment concerns," he says.

Another member of the ABA class action task force says the ultimate test of expanded federal jurisdiction over class actions would come from plaintiffs.

"Are plaintiff lawyers going to continue to bring as many class actions?" says Dinita L. James, a lawyer in Tampa, Fla., who defends employee class actions. James is a co-chair of the Class Actions and Derivative Suits Committee in the ABA Section of Litigation. "If they do, I think the federal courts will be overburdened," she says. "But I think it's more likely that some class actions that are brought now in state court won't be brought at all. It won't be worth it."

In opposing S. 274, the Consumer Federation of America and the U.S. Public Interest Research Group cite concerns about clogging the federal courts with more litigation and eliminating remedies for consumers.

"It is true that there is a need to curtail some abuses of the class action process," say the two groups in a joint letter sent on April 2 to members of the Senate Judiciary Committee. "However, rather than simply eliminating these abuses, S. 274 would create barriers to a consumer's effort to obtain redress." In addition to facing barriers to obtaining class certification in federal courts, the consumer groups warn that the bill "will also deny consumers access to protections afforded by their state consumer protection statutes."

The U.S. Judicial Conference also opposes the class action bill, at least in its original version. Its opposition is "based on concerns that the provisions would add substantially to the workload of the federal courts and are inconsistent with the principles of federalism," states a letter sent by conference secretary Leonidas R. Mecham on March 26 to Senate Judiciary Committee chair Orrin G. Hatch, R-Utah.

SEARCH FOR SOLUTIONS

EVEN SOME WHO FAVOR GIVING FEDERAL COURTS MORE power over class actions are cautious about just how extensive that power should become.

In February, for instance, the ABA's policy-making House of Delegates approved a recommendation by the Task Force on Class Action Legislation that "some concerns over class action practice could be addressed with

Continued on page 64

New Route
for Class Actions

Continued from page 53

federal legislation providing for expanded federal court jurisdiction." But the ABA measure further states that any such expansion "should preserve a balance" between the benefits of greater federal court jurisdiction and legitimate state court interests. Moreover, the recommendation states that Congress should take into account the impact on federal court resources and caseloads in considering class action legislation.

(The task force's recommendation was co-sponsored by the sections of Antitrust Law, Labor and Employment Law, Litigation, and Tort Trial and Insurance Practice.)

The ABA measure also opposes enactment of legislation that would conflict with provisions of Rule 23 in its current form or the amendments proposed by the U.S. Judicial Conference.

While the proposed Rule 23 amendments don't directly address federal court jurisdiction over class action suits, they do address a number of other issues relating to control over class actions by federal judges that also are covered by the proposed class action bill, according to task force chair Sherman. He is among those who favor giving the rule-making process a chance to address concerns about class actions before adopting more sweeping legislation.

"The rulemaking process is the proper way to deal with these judicial matters," Sherman says. "Let's see how that works." And if it doesn't, he adds, "Congress always has an opportunity to come back" and try a legislative approach.

Moll, however, suggests that S. 274 could have a positive effect on Rule 23. "The new legislation may breathe new life into Rule 23, as far as nationwide class action certification," he says, because federal judges would no longer be in a position to reject class certifications knowing that their state court colleagues would step into the breach. "They can never, from that day forward, use as an excuse, 'Go file your case in state court.' "

Meanwhile, Schonbrun says both the amendments to Rule 23 and the Class Action Fairness Act miss an issue that gripes both potential plaintiff class members and businesses that have to defend against class actions. His solution: Make class action plaintiff classes "opt in" instead of "opt out." Under an opt-in system, he says, "One person wouldn't be able to sue on behalf of thousands or millions of people who don't know anything about the lawsuit and wouldn't want these people representing them if they did. That's one of the biggest problems." ■