



The Class Action Fairness Act Two Years Later

By Ted Frank

On February 18, 2005, President George W. Bush signed into law the Class Action Fairness Act (CAFA) of 2005,¹ the most significant civil justice reform of his administration. Has it succeeded in curbing abusive class actions? Because litigation tactics are dynamic, the long-term answer will depend in part on the plaintiffs bar's response.

CAFA addressed two sizable problems in the area of class action litigation by expanding federal jurisdiction over class actions and scrutiny over class action settlements. First, the plaintiffs bar would use “magnet jurisdictions,” sometimes called “judicial hellholes,” to bring cases of nationwide significance in local courts that tended to rubber-stamp illegitimate certifications.² Such certifications, by creating aggregate litigation in which individualized issues predominated, prevented defendants from being able to adequately defend themselves, and created settlement pressure on defendants where none would otherwise exist.³ Second, there were negotiated settlements (often approved by these same courts) that rewarded attorneys at the expense of the unrepresented class members. In one notorious example involving an Alabama state court class action settlement against Bank of Boston approved by an elected judge, class members found that their escrow accounts faced deductions because the attorneys' fees exceeded the minimal recovery for the class.⁴ Even more common and less extreme “coupon” settlements involved situations in which class members received rarely redeemed coupons of questionable value while attorneys

received fees reflecting the exaggerated face value of the entire coupon issue.

Two years later, how well is CAFA working? What remains to be done?

One needs to be careful before jumping to conclusions about the success or failure of CAFA because the class action environment is still in flux. The American litigation system is a shining beacon to the principle that incentives work: the possibility of billions of dollars of attorneys' fees provides gigantic incentives for creative entrepreneurial lawyering to effectuate such wealth transfers. The degree to which CAFA succeeds in cabining abusive class actions depends on the success of the response by the plaintiffs bar and the degree to which all three branches of government counterrespond.

This *Liability Outlook* raises four points. First, the effectiveness of CAFA will be difficult to measure because changing strategies mean that old metrics no longer provide accurate comparisons for what is going on in the courtrooms. Second, if CAFA is to fully succeed, federal courts (and, if necessary, Congress) will need to react effectively to the efforts of the plaintiffs bar to transport the tactics that succeeded in state courts pre-CAFA to the post-CAFA federal court environment. Third, those interested in civil justice need to be wary of academic efforts that seek to eliminate limits on class actions and aggregate litigation and the effect that will have on the rights of unnamed class members and defendants. Fourth, even if CAFA fully

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succeeds, there remains work to be done. In a post-*Erie*⁵ world, there are still problems from substantive state laws that are conducive to class action abuse, and CAFA merely shifts the forum for such problems to federal courts that lack the power to correct them.

The Difficulty of Measurement

There is an inherent difficulty in attempting to measure CAFA's overall effect. CAFA was not passed in a vacuum, and lawyers who acted one way before CAFA find new ways to maximize their results after it. For example, one might be surprised to learn that the most controversial word in CAFA is "commence." Why? CAFA applies only to class actions that were "commenced" after the date of its passage.⁶ Trial lawyers have often successfully attempted to evade CAFA's jurisdiction by amending old class actions to add new claims and sometimes even new plaintiffs and defendants instead of filing new class actions. On rare occasions, federal courts have held these amended complaints to have a transformative effect that "commences" a new action. More often, courts applying CAFA have defined "commence" narrowly to apply only to amended claims that cannot be related back to the original filing of the complaint.⁷ This is not an unreasonable interpretation of the statute—except that it contradicts a tremendous amount of precedent of how federal courts interpret the word "commence" in federal jurisdictional statutes. In the vast majority of such cases before CAFA, federal courts interpreted "commence" in jurisdictional statutes broadly—and simply—to mean cases "commenced in federal court" after the passage of the statute. These cases thus commenced on the day they were removed to federal court,⁸ but those earlier statutes limited federal jurisdiction rather than expanded it.

This change in tactics has had two important effects. First, one can no longer reliably look at the number of new filings to measure class action activity. Once upon a time, plaintiffs would start a new class action by making a new filing. Now plaintiffs amend old class actions, so counting filings is no longer a good proxy for the level of litigation. Any statistical study that fails to account for this is going to have a garbage-in/garbage-out problem. Second, it remains unclear two years out—and will remain unclear for even more time—what CAFA's

long-term effect on class action litigation is going to be. There were hundreds of nationwide class actions pending in Madison County, Illinois, where some of the worst abuses occurred,⁹ and thousands more nationwide when CAFA was passed. There is no telling how many of them and for how long those pending suits will continue to serve as "sourdough starters" for new actions. Until that pig works its way through the python, the impact of CAFA will be dampened. That is not to say CAFA has had no effect: after all, plaintiffs always had the option of amending complaints before CAFA, so the fact that they did not resort to doing so until after CAFA suggests that trial lawyers find this tactic an inferior option at the margin. But one cannot simply look at the fact that plaintiffs rarely file new class actions in Madison County and assume there is no longer a problem.

Forum-Shopping in Federal Court

In terms of the future, it is important to realize that CAFA is not, by any means, the last word on the subject. Litigation tactics are dynamic rather than static. Just as we can now expect defense counsel to always engage in § 1453 appeals of remand orders now that CAFA makes that tactic available to them, we have to expect plaintiffs' attorneys to use tactics in federal court that worked well for them in state court. Federal courts do not create quite the same opportunities for forum-shopping that the magnet jurisdictions of old did, but some opportunities are there.

As Judge Jose Cabranes once said in a Second Circuit argument, "I can't help but wonder how and why these cases involving so-called aggregation of claims invariably are assigned to Judge [Jack B.] Weinstein."¹⁰ None of the named plaintiffs and none of the defendants in the *Schwab v. Philip Morris USA* light cigarettes class action reside in the Eastern District of New York, yet the complaint was filed there and then related to Judge Weinstein's courtroom, where he certified an unprecedented nationwide class.¹¹ Judge Weinstein's courtroom shows that there are still some magnet jurisdictions out there, and that those magnets will grow even stronger if the Second Circuit does not take a stand on defending federal class-certification standards.

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We are also seeing the beginning of a magnet jurisdiction in the Ninth Circuit, where the courts have signed off on improper class certifications of employment litigation. A close look at *Dukes v. Wal-Mart*¹² will show how outrageous and lawless that decision is. The Committee Notes to Federal Rule of Civil Procedure 23 say that “a court that is not satisfied that the requirements of Rule 23 have been met should refuse certification until they have been met.” Judge Harry Pregerson turned that command on its head and held that a class could be certified until the defendant could demonstrate decertification was appropriate. The *Dukes* plaintiffs are seeking a half trillion dollars in compensatory and punitive damages, yet the Ninth Circuit held that declaratory and injunctive relief “predominate,” thus permitting certification under the mandatory class provision of Rule 23(b)(2). (There is the substantive inappropriateness of certification as well: aside from the individualized issues that would be erased by a class trial, as Judge Andrew J. Kleinfeld noted in his dissent, “the Civil Rights Act expressly prohibits orders requiring the reinstatement, promotion, or payment of back pay to anyone injured ‘for any reason other than discrimination.’”¹³ A million-person class-wide remedy would necessarily violate the law.) The certification of the *Dukes* class—and its possibility of a settlement in the billions—has already led to another gigantic class certification against Costco, and there is little doubt that any retailer would be safe from this new magnet jurisdiction if a Ninth Circuit en banc or the Supreme Court does not intervene in *Dukes*. The recent *Philip Morris v. Williams*¹⁴ decision in the Supreme Court may provide unexpected support. The Supreme Court’s command that “the Constitution’s Due Process Clause forbids a State to use a punitive damages award to punish a defendant for injury that it inflicts upon nonparties or those whom they directly represent, *i.e.*, injury that it inflicts upon those who are, essentially, strangers to the litigation,”¹⁵ implies that aggregate punitive damages awards in class litigation are too inherently arbitrary to withstand constitutional scrutiny.

Long-Term Threats to Due Process in Class Actions

The American Law Institute (ALI) was established in 1923 to promote the clarification and simplification of

American common law. It used to be satisfied with “Restatements” of the law, which compiled existing precedent. In September, an ALI committee propounded its “Preliminary Draft No. 4” of the “Principles of Law of Aggregate Litigation,” which openly acknowledges itself as a “conscious break” from class action precedent¹⁶ with the objective of “maximizing the net value” of class claims¹⁷ through such mechanisms as single-issue class-certification¹⁸ or holding defendants liable for ethical breaches by plaintiffs’ class counsel.¹⁹ This is not the place for a full critique of the problems in the ALI Principles,²⁰ but all those interested in civil justice need to pay attention to what eventually comes out of ALI on this subject because there is little doubt that it will move precedent when this influential organization speaks.

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Remaining Substantive Problems

One might not know it to read the press releases of the lobbyists who opposed CAFA, but (outside of settlement approval) CAFA did not change substantive law, just procedure. But this means that the substantive law that led to abusive class actions remains a problem. CAFA does nothing to change federal securities laws, for which recent judge-made expansions of law have resulted in billions of dollars of extortionate settlements in the Enron and WorldCom cases from innocent-bystander deep-pocket investment banks that also lost money in the collapse of those businesses. Many calculated that it was better to pay a billion dollars in settlement to avoid the expense of hundreds of millions of dollars in litigation costs and the outside risk of being held entirely liable for the tens of billions of dollars in securities losses plaintiffs were claiming.²¹

The new Democratic Congress, beholden to trial lawyer special interests, is likely to attempt substantive changes in federal law that create opportunities for class action abuse, a process that the American Tort Reform Association’s Victor Schwartz has called “trial-lawyer earmarks.” A recent *New York Times* story quotes Representative Barney Frank (D-Mass.) as promoting legislation that would hold deep-pocket innocent bystanders who purchase or package mortgage-backed securities liable for “predatory lending” by the lenders of the underlying mortgages, an unprecedented expansion of liability.²²

The problem can be even more intractable in the state law context because federal courts, unlike state courts, cannot modify inefficient state law in response to abuses. CAFA thus ossifies the development of state law relating to substantive claims that are litigated mostly or entirely in the class action context. For example, in many states consumer protection lawsuits have strayed from their original purpose of protecting consumers, and many “consumer fraud” laws have become vehicles for trial lawyers and special-interest groups to bring lawsuits alleging purely hypothetical injury for their own benefit at the expense of consumers and the democratic process.²³ Such lawsuits have already cost consumers billions of dollars.

The attention CAFA gives to settlements deters some of the worst abuses. Even in cases in which CAFA does not apply, the attention it drew to unjust settlements has caused judges to provide more scrutiny to settlement approval.²⁴ Such scrutiny deters the lawsuits brought purely for nuisance value. While meritless but mildly colorable lawsuits may still be cheaper to settle than to defend, if trial lawyers can extract only 30 percent instead of 90 percent of the cost of the settlement to the defendant, it reduces the ability of the plaintiffs bar to profitably bring such nuisance lawsuits. And cases such as *Avery v. State Farm*²⁵ have rolled back some of the worst abuses of the class action system in Illinois.

But future reforms will have to come at the legislative level or on rare occasions when federal courts certify questions to state courts. Much work remains to be done at the state level to fix these problems and restore consumer fraud laws to the focus of protecting any consumer who “reasonably relies upon an act or practice declared unlawful” and suffers a monetary or property loss.²⁶ The success of Proposition 64 in California, which limited the scope of that state’s notoriously abuse-friendly “Section 17200” unfair competition law, shows that reform in this area is not just good policy, but good politics.

AEI research assistant Philip Wallach and editorial associate Nicole Passan worked with Mr. Frank to edit and produce this Liability Outlook.

Notes

1. Class Action Fairness Act of 2005, Public Law 109-2, 109th Congress, amending 28 USC § 1332 *ff.*, approved February 18, 2005.

2. E.g., L. Mullenix, *Abandoning the Federal Class Action Ship: Is There Smoother Sailing for Class Actions in Gulf Waters?*, 74 TUL. L. REV. 1709, 1715 (2000) (prevailing sense among some

practitioners is that in Gulf states “judges are more than willing to certify almost anything that walks through the courtroom doors”); John H. Beisner & Jessica Davidson Miller, *Class Action Magnet Courts: The Allure Intensifies*, MANHATTAN INST. CIV. JUST. REP. NO. 5 (July 2002), available at www.manhattan-institute.org/pdf/cjr_05.pdf.

3. See *In re Bridgestone/Firestone, Inc.*, 288 F.3d 1012, 1015–16 (7th Cir. 2003) (Easterbrook, J.); *West v. Prudential Securities, Inc.*, 282 F.3d 935, 937 (7th Cir. 2002) (Easterbrook, J.); *Szabo v. Bridgeport Machines, Inc.*, 249 F.3d 672, 675 (7th Cir. 2001) (Easterbrook, J.); *In re Rhone-Poulenc Rorer Inc.*, 51 F.3d 1293, 1299–1300 (7th Cir. 1995) (Posner, J.); Henry J. Friendly, *Federal Jurisdiction: A General View* 120 (1973); see also Milton Handler, *The Shift from Substantive to Procedural Innovations in Antitrust Suits—the Twenty-Third Annual Antitrust Review*, 71 COLUM. L. REV. 1, 9 (1971); Richard A. Epstein, *Class Actions: Aggregation, Amplification and Distortion* 2003 U. CHI. LEGAL F. 475; George L. Priest, “Class Warfare,” *Wall Street Journal*, May 5, 2003.

4. “Class counsel asked for attorney’s fees equaling 33 1/3% of all the money the bank was wrongfully holding in escrow; that is, one-third of all the excessive cushion money. The trick was in characterizing all that money as money recovered by this lawsuit. Had there been no lawsuit, 100% of the excess cushion would have been returned to class members at the time their mortgages were repaid. Therefore, what the lawsuit recovered for each class member was (in addition to the back interest) only the difference between the value of the excess cushion money in the class members’ hands today and the value of the money had the bank held it until the mortgage was paid off. The lawsuit and class counsel did not ‘recover’ the excessive cushion money being held in escrow because that money was never lost. All that the class members had lost by the bank’s allegedly wrongful acts was the use of that money today and the use of that money in years past.” S. Koniak & G. Cohen, *Under Cloak of Settlement*, 82 VA. L. REV. 1051, 1068 (1996). Pursuant to the Alabama settlement, Maine resident Dexter Kamilewicz received a \$2.19 credit and a \$91.33 debit for attorney’s fees in his Florida bank account. *Kamilewicz v. Bank of Boston Corp.*, 100 F.3d 1348 (7th Cir. 1996) (Easterbrook, J., dissenting).

5. *Erie R. Co. v. Tompkins*, 304 U.S. 64 (1938), created a rule that federal courts must apply state law to diversity actions. Previously, such actions were decided under federal common law.

6. Class Action Fairness Act of 2005, § 9.

7. E.g., *Knudsen v. Liberty Mutual Insurance Co.*, 411 F.3d 805 (7th Cir. 2005).

8. E.g., *Lorraine Motors, Inc. v. Aetna Cas. & Sur. Co.*, 166 F. Supp. 319 (E.D.N.Y. 1958) (interpreting (Pub. L. No. 85-554, § 3, 72 Stat. 415 (1958) (raising “amount in controversy” in 28

U.S.C. § 1332 from \$5000 to \$10,000)); *Nolan v. Boeing Co.*, 715 F. Supp. 152 (E.D. La. 1989) (interpreting Judicial Improvements and Access to Justice Act, Pub. L. No. 100-702, § 202(b), 102 Stat. 4642 (1988)). See generally Lonny Sheinkopf Hoffman, *The 'Commencement Problem': Lessons from a Statute's First Year*, 40 U.C. DAVIS L. REV. 469, 475-79 (2006).

9. See Beisner & Miller, *supra* n. 2.

10. Oral argument for *Empire Healthchoice, Inc. v. Philip Morris USA Inc.* Nos. 02-7276, 02-7394, 02-7424 (2d Cir. Feb. 13, 2003).

11. *Schwab v. Philip Morris USA, Inc.*, 449 F.Supp.2d 992 (E.D.N.Y. 2006).

12. *Dukes v. Wal-Mart, Inc.*, 474 F.3d 1214 (9th Cir. 2007).

13. *Id.*, at 1248-49 (Kleinfeld, J., dissenting).

14. 127 S.Ct. 1057 (2007).

15. *Id.* at 1063.

16. § 1.01, Comment a.

17. § 1.05.

18. § 2.03, Comment b.

19. § 3.18(f).

20. Attorneys James M. Beck and Mark Herrmann provide an excellent critique at their blog, Drug and Device Law, <http://druganddevicelaw.blogspot.com/>. "31 (or More) Reasons

to Watch ALI's Principles of the Law of Aggregate Litigation," February 8, 2007, available at <http://druganddevicelaw.blogspot.com/2007/02/31-or-more-reasons-to-watch-alis.html>.

21. Three banks that refused to pay protection money in the Enron litigation and instead defended themselves despite the risk of a \$40 billion downside were vindicated on March 19, 2007, when the Fifth Circuit corrected the trial court's error and decertified the class. *Regents of the University of California v. Credit Suisse First Boston (USA), Inc.*, No. 06-20856 (5th Cir. Mar. 19, 2007). Plaintiffs' attorney William Lerach vowed to appeal; the \$7.3 billion he has already received from other defendants in settlement is not affected by the decision.

22. Stephen Labaton, "Lawmakers Aim to Curb Loan Abuses," *New York Times*, March 17, 2007.

23. See Michael Greve, *Harm-Less Lawsuits?* (Washington, DC: AEI Press, 2005), available at www.aei.org/book814/.

24. E.g., *Synfuel Technologies, Inc. v. DHL Express (USA), Inc.*, 463 F.3d 646 (7th Cir. 2006).

25. *Avery v. State Farm Mut. Auto. Ins. Co.*, 835 N.E.2d 801 (Ill. 2005).

26. Victor E. Schwartz & Cary Silverman, *Common-Sense Construction of Consumer Protection Acts*, 54 KANSAS L. REV. 1 (2006), at 70.