



Independent Insurance Agents



Brokers of America, Inc.



EXECUTIVE SUMMARY OF THE CLASS ACTION FAIRNESS ACT OF 2005

February 23, 2005

This Executive Summary regarding the Class Action Fairness Act of 2005 is not intended to provide specific advice about individual legal, business or other questions. It was prepared solely for use as a guide, and is not a recommendation that a particular course of action be followed. If specific legal or other expert advice is required or desired, the services of an appropriate, competent professional, such as an attorney, should be sought.

Background and Purpose of this Executive Summary

On February 18, 2005, President Bush signed into law the Class Action Fairness Act of 2005 ("Act"), introducing significant changes to class action lawsuits. This sweeping federal legislation will affect the prosecution and defense of complex litigation across the country and attempts to equal the playing field for lawyers, businesses and consumers alike. The enactment of this legislation was the culmination of over six years of effort, and followed revisions in late 2003 that were designed to attract the votes necessary to pass the legislation.

As noted in the Act, "[c]lass action lawsuits are an important and valuable part of our legal system when they permit the fair and efficient resolution of legitimate claims of numerous parties by allowing the claims to be aggregated into a single action." Congress passed the Act to curb perceived abuse of this system, and the Act sets forth a consumer class action bill of rights promoting fair settlements and the resolution of national disputes at the federal level.

Put simply, the Act seeks to: (1) assure fair and prompt recoveries for class members with legitimate claims; (2) protect responsible companies and other institutions against interstate class actions in state courts; (3) restore the intent of the framers of the United States Constitution by providing for federal court consideration of interstate cases of national importance; and (4) benefit society by encouraging innovation and lowering consumer prices. Some of the key provisions of the Act are summarized below.

New Jurisdictional Requirements

The Act seeks to curb state court forum shopping, noting that “[a]busive interstate class actions have harmed society as a whole by forcing innocent parties to settle cases rather than risk a huge judgment by a local jury, thereby costing consumers billions of dollars in increased costs to pay for forced settlements and excessive judgments.” The Act therefore expands access to federal courts, while simultaneously enabling states to retain control over any case with which they maintain a distinct connection. Thus, class actions that are truly local in nature will remain in state court, while cases that involve multiple states are now more easily heard in federal court.

The Act sets forth jurisdictional requirements (rules establishing qualifying criteria to litigate in a federal court) under three scenarios: (1) instances where the federal court shall have jurisdiction; (2) instances where the federal court can have or decline jurisdiction; and (3) instances where the federal court does not have jurisdiction, as follows:

(1) Federal Courts Shall Have Jurisdiction over Certain Class Actions:

Federal courts shall have jurisdiction over any action involving 100 or more possible class members where the amount in controversy exceeds \$5 million and any plaintiff and defendant are from different states. The \$5 million requirement is determined by aggregating the claims of all individual class members.

(2) Federal Courts Can Have or Decline Jurisdiction over Certain Class Actions:

Even if the case falls under the criteria in (1) above, federal courts can decide whether or not to accept a case when more than 1/3 but less than 2/3 of the class members are from the state in which the action is brought. Federal courts will consider a variety of factors when exercising this discretionary jurisdiction, including any issues of national interest, what law governs, whether the lawsuit was drafted in a way to avoid federal jurisdiction, whether any similar actions have been filed in the state within the past three years, and the state’s connection, if any, to the parties and alleged injury.

(3) Federal Courts Do Not Have Jurisdiction over Certain Class Actions:

Federal courts cannot exercise jurisdiction when more than 2/3 of the class are from the state where the action was filed, where at least one major defendant is also a citizen of that state, where the principal harm occurred in that state, and when no other class actions asserting the same harm were filed in the state within three years.

None of these jurisdictional rules apply to cases involving fewer than 100 plaintiffs or where the federal court is not otherwise permitted to hear the case.

The Act also applies to “mass actions,” involving claims of 100 or more plaintiffs seeking to try their common claims together in the same proceeding. Mass actions were not previously subject to class action requirements. Now, mass actions may be moved to federal court if they meet the minimum dollar amounts required for federal court. These

cases may remain in state court if they, for instance, arise from a sudden accident or are brought based on state law on behalf of the public.

The Act also sets forth provisions regarding moving class actions from state court to federal court, and authorizes appellate review of a federal court's order granting or denying a motion to send a case back to state court. The Act provides for expedited rulings on these appeals, and contains a number of specific requirements for appeals.

New Settlement Provisions

In seeking passage of the Act, business advocates, including insurers, paid particular attention to perceived abuses of the class action system involving settlement and recovery. Business groups alleged that in many cases plaintiffs' lawyers received exorbitant fees while class members recovered little or nothing. Important provisions of the Act address settlement, and specifically "coupon settlements" in which defendants issue coupons to class members and cash fee awards to plaintiffs' counsel. Generally speaking, coupon settlements require class members to purchase company products in order to redeem the coupons and are often used in cases in which the class is not readily identified. In those cases, attorneys' fees are often calculated based upon the total benefits achieved for the class, which may include calculating the total number of coupons issued, their value, and *expected* redemption rates.

One of the greatest potential impacts of the Act to class action litigants is the change in attorneys' fee awards. Under the Act, attorney's fees are restricted to the hours billed or the number of coupons actually redeemed by class members, depending on the fee arrangement reached with the plaintiffs. The Act provides that unclaimed coupons may be distributed to charity, and that any coupons so distributed shall not be used to calculate attorney's fees. Moreover, class members are not obligated to pay their attorney any amount resulting in a loss to class members, unless the court finds non-monetary benefits that outweigh that loss.

Courts still possess the discretion to approve coupon and non-cash settlements under the Act, but only after holding a hearing and determining that the settlement is fair, reasonable and adequate to class members. The Act also prevents the court from approving any settlement that pays more to class members residing in closer geographic proximity to the court.

The Act implements various notification provisions, which require each defendant to serve state or federal officials (designated in the Act) with detailed notice of the action, any proposed settlement, and all rights class members may have to exclude themselves from the settlement. The rationale behind this provision is that the notification will provide an additional measure of oversight to proposed settlements. If notice is not provided, class members may choose not to be bound by the settlement agreement.

The Act provides for the Judicial Conference of the United States to prepare a report on class actions settlements to the Committees on the Judiciary of the Senate and the House

of Representatives within 12 months after enactment. Among other things, the report must include recommendations on best practices for courts to ensure that: (1) settlements are fair to class members; and (2) fees and expenses awarded to plaintiffs' counsel reflect the lawyers' success in getting appropriate remedies/recoveries for the class and the risk undertaken by counsel in pursuing the lawsuit.

Implications for Insurers and Business Community as a Whole

The Act has been criticized by opponents as an attack on the plaintiff's class action bar and an outright denial of justice to consumers. Some opponents of the new law argue that plaintiffs are less likely to recover in the federal courts, which are already overburdened and less inclined to approve class actions going forward. Although the true effects of the Act have yet to be seen, Congress reached a consensus that the benefits of the Act outweigh any such criticism. With the Act's passage comes the potential for fewer frivolous actions, greater consistency in results, and a decreased likelihood that truly "national" class actions will be filed and remain in state courts.

Many feel that the insurance industry should particularly benefit in at least two ways. First, commercial property and casualty insurers, which often pick up the defense costs (and sometimes the settlement costs) when corporations are sued by plaintiffs' attorneys, may benefit from better underwriting margins due to lower costs or at least slowing loss cost inflation. Second, personal lines insurers may also benefit from class action reform because these companies are often targeted by the plaintiffs' bar and may be less susceptible to such efforts.

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