

CLASS ACTIONS UPDATE

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CLASS ACTIONS UPDATE

I. INTRODUCTION

Over the past several years, Texas class action law has been dramatically altered by two forces: seminal cases issued by the Texas Supreme Court and rules changes largely dictated by House Bill 4. During the same time period, changes have been made to the federal rules and, most recently, the Class Action Fairness Act has been signed into law. It is not yet clear exactly how these latest changes will affect class actions in federal court and, through the effect of the expanded removal provisions on the design of cases, class actions brought in state court.

This paper will provide an overview of Texas class action law, discuss the recent Texas and federal rules changes, and then discuss the recently-enacted Class Action Fairness Act of 2005.

II. BACKGROUND IN STATE COURT

In 2000, the Texas Supreme Court decided three significant class action cases: *Southwest Refining Inc. v. Bernal*, 22 S.W.3d 425 (Tex. 2000); *Ford Motor Co. v. Sheldon*, 22 S.W.3d 444 (Tex. 2000); and *Intratex Gas Co. v. Beeson*, 22 S.W.3d 398 (Tex. 2000). The court made clear that it would apply a "rigorous analysis" and would no longer "certify now and worry later." *Bernal*, 22 S.W.3d at 435. Trial courts will be required to go beyond the pleadings to understand the claims and substantive law. *Id.* Trial courts will also be required to state how the claims would be tried, *i.e.*, provide a trial plan. *Id.* at 436.

This was a strong statement for class action reform. It was also an unequivocal retreat from prior Texas class action jurisprudence. The supreme court has reinforced this position by its more recent decisions such as *Henry Schein, Inc. v. Stromboe*, 102 S.W.3d 675 (Tex. 2002), and *Compaq Computer Corp. v. LaPray*, 135 S.W.3d 657 (Tex. 2004).

III. CERTIFICATION OF CLASS ACTIONS UNDER TEXAS LAW

In Texas, there is no right to bring a lawsuit as a class action. *Ford Motor Co. v. Sheldon*, 22 S.W.3d 444, 452-53 (Tex. 2000). Courts may not certify a case as a class action unless all the requirements of TEX. R. CIV. P. 42 have been met. *Southwestern Refining Co., Inc. v. Bernal*, 22 S.W.3d 425, 433 (Tex. 2000). This rule was further reinforced by the Texas Supreme Court's recent decisions in *Henry Schein, Inc. v. Stromboe*, 102 S.W.3d 675 (Tex. 2002), *Union Pacific Resources Group, Inc. v. Hankins*, 111 S.W.3d 69 (Tex. 2003), and *State Farm Mutual Automobile Insurance Co. v. Lopez*, 156 S.W.3d 550 (Tex. 2004). Any suggestion that "trial courts should favor certifying a class" is based on pre-*Bernal*

precedent and cannot be accepted in light of *Bernal*, *Schein*, and the many cases following those decisions.

It is not enough merely to allege that the requirements of Rule 42 are satisfied; the burden is on the class proponent to plead and prove the right to maintain a class action. *Sheldon*, 22 S.W.3d at 453. Any court evaluating the propriety of class certification is required "to perform a rigorous analysis *before* ruling on class certification to determine whether all prerequisites to certification have been met." *McAllen Med. Ctr., Inc. v. Cortez*, 66 S.W.3d 227, 232 (Tex. 2001) (internal quotations omitted) (emphasis in original). Accordingly, a court cannot presume conformance with Rule 42's requirements; instead, there must be actual conformance. *Bernal*, 22 S.W.3d at 435. "[A] cautious approach to class certification is essential." *Id.*

The Texas Supreme Court has also explicitly rejected a "certify now and worry later approach." *Bernal*, 22 S.W.3d at 433. Instead, courts must "meaningfully determine the class certification issues by inquiring beyond the pleadings to understand the claims, defenses, relevant facts and applicable substantive law." *Id.* at 435; *see Union Pacific*, 111 S.W.3d at 72. The Texas Supreme Court reiterated this stance again in *Henry Schein, Inc.*, rejecting a court of appeals statement that it should "entertain every presumption" in favor of a trial court's certification of a class, stating that "compliance with Rule 42 must be demonstrated; it cannot merely be presumed." 102 S.W.3d at 691. Therefore, all aspects of the class certification, including how the claims will be tried, evaluation of damages, and all meaningful defenses, must be fully understood by the court prior to certifying the class action.

A. Class definition.

The threshold inquiry in determining class certification is the parameters of the class. *Intratex Gas Co. v. Beeson*, 22 S.W.3d 398, 402 (Tex. 2000). Accordingly, the representative plaintiffs must not only demonstrate that an identifiable class exists, but that it is susceptible to precise definition. *See id.* Failure to precisely define a class creates a substantial risk that class members cannot adequately exercise their right (if any) to opt out of or remain in the suit before they are bound by a class judgment. *See id.*; *see also General Tel. Co. of the Southwest v. Falcon*, 457 U.S. 147, 160-61 (1982). It is an abuse of the court's discretion and implicates due process rights to certify a class in which the definition is fundamentally flawed. *Sheldon*, 22 S.W.3d at 453.

B. Requirements of rule 42(A).

To qualify for class certification, the proponents of a class must show that they meet each of the four requirements of rule 42(a): numerosity, commonality,

typicality, and adequacy. To meet the requirement of numerosity, the proponent must plead and prove that it is impracticable to join all the members of the class. TEX. R. CIV. P. 42(a)(1); *Bernal*, 22 S.W.3d at 433.

To show commonality, the proponent must plead and prove that there are questions of law and fact common to the class. TEX. R. CIV. P. 42(a)(2). Questions common to the class are those which, when answered as to one class member, are answered as to all class members. *Phillips Petroleum Co. v. Bowden*, 108 S.W.3d 385, 394 (Tex. App.—Houston [14th Dist.] 2003, pet. granted).

To meet the requirement of typicality, the proponent must plead and prove that the claims or defenses of the representative parties are typical of the claims or defenses of the class. TEX. R. CIV. P. 42(a)(3). A nexus must exist between the injury suffered by the representatives and the injuries suffered by other members of the class. *Bailey v. Kemper Cas. Ins. Co.*, 83 S.W.3d 840, 853-54 (Tex. App.—Texarkana 2002, pet. dismissed w.o.j.).

Finally, to show adequacy, the proponent must plead and prove that the representative parties will fairly and adequately protect the interests of the class. TEX. R. CIV. P. 42(a)(4). The factors that need to be shown and which the court considers in determining adequacy include: (1) the adequacy of counsel; (2) the potential for conflicts of interest; (3) the personal integrity of the class representatives; (4) whether the class is manageable because of geographic limitations; (5) whether the class representative can afford to finance the class litigation; and (6) the representative's familiarity with the litigation. *Bailey*, 83 S.W.3d at 854-55.

1. Numerosity.

As a prerequisite to class certification, Rule 42(a)(1) requires that "the class is so numerous that joinder of all members is impracticable." To satisfy the impracticability requirement, plaintiffs must show that it is difficult or inconvenient to join all the members of the class "in view of the size of the class and such factors as judicial economy, the nature of the action, geographical location of class members, and the likelihood that class members would be unable to prosecute individual lawsuits." *Lebron v. Citicorp Vendor Finance, Inc.*, 99 S.W.3d 676, 680 (Tex. App.—Eastland 2003, no pet.); see *Daigle v. Shell Oil Co.*, 133 F.R.D. 600, 603 (D. Colo. 1990)¹ (court denied class certification in case with over 4,000 putative members and noted that "for relatively large

¹ Rule 42 is based on its federal counterpart, Federal Rule of Civil Procedure 23. As such, cases interpreting the federal rule are persuasive authority. *Beeson*, 22 S.W.3d at 403.

classes, certification may be denied if all plaintiffs can be joined").

2. Commonality.

As a prerequisite to class certification, Rule 42(a)(2) requires that "there are questions of law or fact common to the class." Texas has adopted a strict standard for establishing "commonality" under rule 42(a). In Texas, "common questions" under rule 42(a) are questions "which when answered as to one class member are answered as to all class members." *Bailey*, 83 S.W.3d at 853. Common issues must "be applicable to the class as a whole and be subject to generalized proof." *Union Pac. Resources Group, Inc. v. Hankins*, 111 S.W.3d 69, 74 (Tex. 2003) (internal quotations omitted).

The existence of a number of affirmative defenses may preclude commonality. *Bernal* made clear that part of the rigorous analysis that must be performed includes that the trial court "meaningfully determine the class certification issues by inquiring beyond the pleadings to understand the claims, defenses, relevant facts, and applicable substantive law." 22 S.W.3d at 435. Further, certification must not unduly restrict a party's ability to "adequately and vigorously present material claims and defenses." *Id.* A trial court must therefore review all defenses that the party opposing certification raises, and analyze the defenses' effect on the case proceeding as a class action. See *West Teleservices, Inc. v. Carney*, 75 S.W.3d 455, 459 (Tex. App.—San Antonio 2001, no pet.). This substantive analysis is a necessary prerequisite to certification. *Union Pacific*, 111 S.W.3d at 72-73 (The substantive merits of a case "must be taken into consideration in determining whether the purported class can meet the certification prerequisites under Rule 42.").

3. Typicality.

As a prerequisite to class certification, Rule 42(a)(3) requires that "the claims or defenses of the representative parties are typical of the claims or defenses of the class." Typicality under Rule 42(a)(3) requires proof that the class representatives' claims have the same essential characteristics as those of the class as a whole. *Bailey*, 83 S.W.3d at 853-54. The presence of even an arguable defense peculiar to a named plaintiff or a small subset of the plaintiff class destroys the typicality of the class if such a defense is likely to become a major focus of the litigation. *Id.*

4. Adequacy.

As a prerequisite to class certification, Rule 42(a)(4) requires that plaintiffs demonstrate that "the representative parties will fairly and adequately protect the interests of the class." The factors that plaintiffs must plead and prove and which the court will review

in determining adequacy include: adequacy of counsel; potential for conflicts of interest; personal integrity of the class member; whether the class is unmanageable because of geographic limitations; whether the class representative can afford to finance the class action; and the representative's familiarity with the litigation. *Bailey*, 83 S.W.3d at 854-55. Several courts have also found that representative plaintiffs who unduly limit the class claims, therefore precluding other possible claims by class members, are not adequate representatives. *Phillips*, 108 S.W.3d at 404.

A plaintiff cannot adequately represent a class if his or her interests conflict with those of others in the putative class. *Phillips*, 108 S.W.3d at 399 ("The primary consideration" concerning adequacy is "whether any antagonism exists between the interests of the plaintiffs and those of the remainder of the class."); *see also State Farm Mut. Auto. Ins. Co. v. Lopez*, 45 S.W.3d 182, 191-92 (Tex. App.—Corpus Christi 2001) (any antagonism between the interests of the named plaintiffs and those of the remainder of the class destroys adequacy requirement), *rev'd on other grounds*, 156 S.W.3d 550 (Tex. 2004). Class certification is inappropriate if the class "includes members who benefit from the same acts alleged to be harmful to other class members." *Phillips*, 108 S.W.3d at 400. A conflict of interest among class members at the time of filing the suit or anticipated to develop at a later time should preclude the court's certification of the class when the conflict is evident from the parties involved. *See Citizens Ins. Co. of Am. v. Daccach*, 105 S.W.3d 712, 727-28 (Tex. App.—Austin 2003, pet. granted).

C. Requirements of rule 42(b).

In addition to meeting all of the requirements of Rule 42(a), a proposed class must fall within one of the categories described in Rule 42(b) to qualify for certification.

1. Rule 42(b)(1).

The standard of Rule 42(b)(1)(A) is a stringent standard, requiring a showing by the plaintiffs that the party opposing the class will be unable to comply with one judgment without violating the terms of another judgment. *See Peter Enters., Inc. v. Hilton*, 51 S.W.3d 616, 625 (Tex. App.—Tyler 2000, pet. denied). The mere possibility of varying results in individual litigation does not mean that such litigation would "establish incompatible standards of conduct." *Schein*, 102 S.W.3d at 691. A mere risk that a defendant may be liable for damages to one plaintiff, but not to another, fails to satisfy the requirements. *See id.*

Rule 42(b)(1)(B) permits certification where adjudications as to individual plaintiffs would "as a practical matter" impede the ability of other class

members to protect their interests. This provision applies when the class is claiming against a limited fund for recovery. For a court to certify under this subsection, there must be some evidence that only a limited fund is available; a "broad assertion" in the pleadings will not suffice. *St. Louis Southwestern Ry. v. Voluntary Purchasing Groups, Inc.*, 929 S.W.2d 25, 32-33 (Tex. App.—Texarkana 1996, no writ).

2. Rule 42(b)(2).

Rule 42(b)(2) will permit a class action if the party opposing the class has acted or refused to act on grounds applicable to the class. However, this subdivision only applies to cases if the predominant relief is declaratory and does not apply to cases seeking "to shoehorn damages into the (b)(2) class framework." *Dairyland Cty. Mut. Ins. Co. of Tex. v. Casburg*, 63 S.W.3d 590, 592 (Tex. App.—Beaumont 2001, pet. dismissed w.o.j.).

The Beaumont Court of Appeals addressed this issue in *Casburg*, and ruled that "the mere recitation of a request for declaratory relief cannot transform damage claims into a (b)(2) class action." 63 S.W.3d at 592. If the declaratory aspects are "incidental baggage" added on to a case when the main objective is money damages, class certification is inappropriate. *Allison v. Citgo Petroleum Corp.*, 151 F.3d 402, 403 (5th Cir. 1998); *see also TCI Cablevision v. Owens*, 8 S.W.3d 837, 847 (Tex. App.—Beaumont 2000, pet. dismissed by agmt.). Additionally, the declaratory judgment claim should not merely be the basis for a later award of damages. *Casburg*, 63 S.W.3d at 592.

If the merits of each putative class member's claims "depend on that individual's circumstances," this requirement that "the party opposing the class has acted . . . on grounds generally applicable to the class" is not met. *American Nat'l Ins. Co. v. Cannon*, 86 S.W.3d, 801, 809 (Tex. App.—Beaumont 2003, no writ). Certification under rule 42(b)(2) is only appropriate when the requested remedy is a "group remedy," which is not the case when the merits of the case depend on individual circumstances. *See id.* at 809-10; *Casburg*, 63 S.W.3d at 592-93.

In *Compaq*, the Texas Supreme Court stated that the trial court "must consider, and due process may require, individual notice and opt-out rights to class members who seek monetary damages under any theory." 135 S.W.3d at 667. The court also re-emphasized the requirement that the trial court undertake a "rigorous analysis of 'cohesiveness'" which, "[i]n many cases . . . will be identical to the 'predominance and superiority' directive undertaken by trial courts certifying (b)(3) classes." *Id.* at 670-71.

3. Rule 42(b)(3).

The requirement of rule 42(b)(3) (formerly rule 42(b)(4)) that common questions of law and fact

predominate is "one of the most stringent requirements to class certification." *Bernal*, 22 S.W.3d at 433. The test for predominance is not whether common issues outnumber uncommon issues, but rather whether "common or individualized issues will be the object of most of the efforts of the litigants and the court." *Id.* at 434. The requirement for common questions of law and fact predominating is "far more demanding than the commonality requirement" under Rule 42(a)(2). *Id.* at 435 (citations omitted).

Additionally, before certifying a class under Rule 42(b)(4), the court must determine that the class is superior to other available methods for the fair and efficient adjudication of the controversy. To be "superior," the class must provide a fair trial to all the litigants. *Id.* at 437. If proceeding as a class action alters the substantive prerequisites to recovery without consent by the parties, it is not a superior method and the class is not maintainable under rule 42(b)(4). As the Texas Supreme Court observed in *Schein*, "it is not clear that a class action is superior . . . if it necessitates that plaintiffs give up substantial rights." 102 S.W.3d at 695.

D. Class action standing

To establish standing, the burden is on the plaintiff to show "a distinct injury to the plaintiff and a real live controversy which will actually be determined by the judicial declaration sought." *Brown v. Todd*, 53 S.W.3d 297, 305 (Tex. 2001). A plaintiff lacks standing if his or her alleged injury is not "likely to be redressed by the requested relief." *MET-Rx v. Shipman*, 62 S.W.3d 807, 810 (Tex. App.—Waco 2001, pet. denied). Stated another way, the plaintiff must have a "personal stake in the outcome." *TCI Cablevision*, 8 S.W.3d at 848. These same standing requirements apply to a class action. *M.D. Anderson Cancer Ctr. v. Novak*, 52 S.W.3d 704, 710 (Tex. 2001); see *American Nat'l Ins.*, 86 S.W.3d at 806.

E. Choice of law analysis

The Texas Supreme Court's decision in *Schein* "requires us to abandon our practice of postponing choice-of-law questions until after certification, as we can hardly evaluate the claims, defenses, or applicable law (as *Schein* requires) without knowing what the law is." *Tracker Marine, L.P. v. Ogle*, 108 S.W.3d 349, 351-52 (Tex. App.—Houston [14th Dist.] 2003, no pet.). Significantly, the *Schein* court observed that "[s]tate and federal courts have overwhelmingly rejected class certification when multiple states' laws must be applied." *Schein*, 102 S.W.3d at 698-99. The Texas Supreme Court reaffirmed the necessity of a pre-certification choice-of-law analysis in *State Farm Mutual Automobile Insurance Co. v. Lopez*. See 156 S.W.3d 550, 556 (Tex. 2004).

It is the duty of the party urging certification to show that all of the requirements for certification have been met. *Sheldon*, 22 S.W.3d at 453. It is clear, after *Schein*, that the requirements include a determination of the applicable law, so that the court may decide whether the requirement of commonality is met.

F. Trial plan

A trial plan that will satisfy the requirements of *Bernal* and *Schein*, must contain "a specific explanation of how class claims are to proceed to trial." *Schein*, 102 S.W.3d at 689; see also TEX. R. CIV. P. 42(c)(1)(D) (listing requirements for class certification order). The trial plan must establish "from the outset that the individual issues can be considered in a manageable, time-efficient, yet fair manner." *Bernal*, 22 S.W.3d at 436. A trial plan is required in any case in which a class is certified. *Lopez*, 146 S.W.3d at 554-55. Texas courts have made clear that affidavits or proof-of-claim forms cannot substitute for testimony of individual plaintiffs when credibility is at issue. See, e.g., *Tracker Marine*, 108 S.W.3d at 363.

IV. HOUSE BILL 4

In the 2003 legislative session, House Bill 4 added chapter 26 dealing with class actions to the Texas Civil Practice & Remedies Code. The Legislature ordered the Texas Supreme Court to adopt rules for a "fair and efficient resolution" of class actions. TEX. CIV. PRAC. & REM. CODE ANN. § 26.001(a) (Vernon Supp. 2004-05). The court was given mandatory guidelines. For example, attorneys' fees were to be determined on a Lodestar method. *Id.* § 26.003(a). Attorneys' fees must also be awarded in the same proportion of cash and noncash benefits as for the class. *Id.* § 26.003(b). There was also a requirement that pleas to the jurisdiction must be heard before class certification. *Id.* § 26.051(a).

The Legislature also amended section 22.225(d) of the Texas Government Code to give the supreme court jurisdiction over interlocutory appeals from orders certifying or refusing to certify a class. TEX. GOV'T CODE ANN. § 22.225(d) (Vernon 2004). Section 51.014(b) of the Civil Practice and Remedies Code was also amended to provide that an appeal of an order certifying or refusing to certify a class stays all other proceedings in the trial court. TEX. CIV. PRAC. & REM. CODE ANN. § 51.014(b) (Vernon Supp. 2004-05).

V. RULES CHANGES

On October 9, 2003, the Texas Supreme Court revised Texas Rule of Civil Procedure 42 in accordance with the directives in House Bill 4. The amended rules implemented the requirement of House Bill 4 regarding the recovery of attorneys' fees and

followed many of the changes Congress had recently made to Federal Rule of Civil Procedure 23.

This section will discuss the changes to Texas Rule of Civil Procedure 42. It will also identify changes to Federal Rule of Civil Procedure 23

A. Rule 42(a)

The provision in rule 42(a) regarding derivative suits was deleted because it was redundant of the Texas Business Corporation Act.

B. Rule 42(b)

The provisions in rule 42(b)(3), allowing for a class to be certified where the object of the action is the adjudication of claims affecting specific property in the action, were deleted as unnecessary. Rule 42(b)(4) was renumbered to 42(b)(3).

C. Rule 42(c)

There were several changes to rule 42(c), which deals with the order certifying a class. The requirement in rule 42(c)(1)(A) that class certification be decided "as soon as practicable" was changed to "at an early practicable time." This change was made to allow the trial court flexibility in obtaining needed information before deciding whether to certify a class. TEX. R. CIV. P. 42 cmt. A requirement was added in rule 42(c)(1)(B) that the certification order must define the class and issues and must appoint class counsel. The provision in rule 42(c)(1) that the order could be conditional was deleted.

Amended rule 42(c)(1)(D) added eight specific requirements that must be contained in the order granting or denying certification:

- the elements of each claim or defense;
- any common issues of law or fact;
- any individual issues of law or fact;
- the issues that will be the object of most of the efforts of the litigants and the court;
- other available means of adjudication;
- why common issues do or do not predominate;
- why a class action is or is not superior to other methods; and
- if certified, how individual issues will be tried.

These requirements basically codified *Southwest Refining, Inc. v. Bernal*, 22 S.W.3d 425 (Tex. 2000), and *Henry Schein, Inc. v. Stromboe*, 102 S.W.3d 675 (Tex. 2002).

Amended rule 42(c)(2)(A) made notice discretionary for classes certified under rule 42(b)(1) (separate actions could create inconsistent adjudications) and rule 42(b)(2) (party has acted on

grounds generally applicable to the class making injunctive relief appropriate). Amended rule 42(c)(2)(B) maintained the "best practicable notice" requirement, which includes individual notice, for classes certified under rule 42(b)(3) (common questions of law or fact predominate over individual issues). The amended rule also added six specific requirements that must be clearly stated in the notice in plain, easily understood language.

Federal changes: The changes to Federal Rule of Civil Procedure 23(c) track the changes to the Texas rule except that rule 23(c) did not add the eight requirements that must be stated in the class certification order.

D. Rule 42(e)

Rule 42(e) deals with settlements and dismissals. Amended rule 42(e)(1) provides that the court must approve the settlement or dismissal of a certified class. Notice of the settlement or dismissal and an explanation of when and how to elect to be excluded from the class shall be given as directed by the court. The approval of a settlement or dismissal requires a hearing and a finding that the settlement or dismissal is "fair, reasonable, and adequate." Amended rule 42(e)(2) requires the parties to file any agreement made in connection with the settlement or dismissal. Amended rule 42(e)(3) requires that in an action previously certified as a rule 42(b)(3) class, the settlement must allow a new opportunity to request exclusion to individual class members. Amended rule 42(e)(4) allows any class member to object to the settlement or dismissal and requires court approval to withdraw an objection.

Federal changes: The changes to Federal Rule of Civil Procedure 23(e) generally track the changes to the Texas rule with two exceptions. Rule 23(e)(1) requires reasonable notice of settlement or dismissal only to the class members who will be bound, *i.e.*, no notice is required if only the class representatives will be bound. Rule 23(e)(3) gives the court discretion whether to refuse to approve a settlement if it does not allow a new opportunity to request exclusion rather than requiring the new opportunity to request exclusion.

E. Rule 42(g)

Rule 42(g) is a new section on class counsel. Under amended rule 42(g)(1), the court must appoint class counsel. Counsel must fairly and adequately represent the interests of the class. Amended rule 42(g)(1)(C) is a non-exclusive list of the factors the court must consider:

- the work counsel has done in investigating the claims;

- counsel's experience in handling class actions, complex litigation, and claims of the type asserted;
- counsel's knowledge of the applicable law; and
- the resources that counsel will commit to representing the class.

Amended rule 42(g)(2) provides that if there is only one applicant, the court may appoint that applicant only if the applicant is adequate under rule 42(g)(1). If there is more than one applicant, the court must appoint the applicant or applicants best able to represent the interests of the class. The court may appoint interim counsel before determining whether to certify the class.

F. Rule 42(h)

Rule 42(h) sets forth the procedure for determining attorneys' fees awards. Under amended rule 42(h)(1), a claim for attorneys' fees and costs must be made by motion. Notice of the motion must be served on all parties and directed to class members in a reasonable manner. Amended rule 42(h)(2) provides that a class member or a party from whom payment is sought may object to the motion. Amended rule 42(h)(3) requires the court to hold a hearing and make findings of fact and conclusions of law.

Federal changes: The changes to Federal Rule of Civil Procedure 23(h) track the changes to the Texas rule except that rule 23(h) provides that the court *may* hold a hearing rather than requiring a hearing.

G. Rule 42(i)

Rule 42(i) deals with attorneys' fees awards. This provision is mandated by section 26.003(a) of the Texas Civil Practice & Remedies Code. Under amended rule 42(i)(1), the court must determine a Lodestar figure by multiplying the number of hours reasonably worked times a reasonable hourly rate. The attorneys' fee award must be in the range of 25% to 400% of the Lodestar figure. In making these determinations, the court must consider the factors in TEX. DISC. R. PROF. COND. 1.04(b). Amended rule 42(i)(2) requires the attorneys' fees award to be in the same proportion of cash and non-cash benefits as the recovery for the class.

Federal changes: There is no comparable provision to rule 42(i) in the changes to Federal Rule of Civil Procedure 23. The federal courts generally use either the Lodestar or percentage method of determining attorneys' fees.

H. Rule 42(j)

These changes to rule 42 were generally effective January 1, 2004, presumably for procedural steps not

already taken. Amended rule 42(j), however, provides that rule 42(i) governing attorneys' fees awards applies only to cases filed after September 1, 2003.

Federal changes: The amendments to Federal Rule of Civil Procedure 23 were effective on December 1, 2003.

VI. THE CLASS ACTION FAIRNESS ACT

The Class Action Fairness Act of 2005, P.L. 109-2, was signed and went into effect on February 18, 2005. The Act, which adds several provisions to Title 28 of the United States Code as well as amending several existing sections of Title 28, greatly expands federal jurisdiction over class action suits. In addition, the Act provides new rules for the review of certain types of class action settlements. The Act appears certain to shift much of class action litigation from the state courts—which in 2000 handled 60% of all class actions—to the federal courts.

A. Background of the Act

The Class Action Fairness Act was the culmination of some six years of effort on the part of would-be reformers. A bipartisan compromise was first reached in November 2003. Prior to 2005, however, all of the proposed bills had died after being bogged down by amendments. Following the Republican congressional gains in 2004, however, the process moved quickly: the bill was introduced in the Senate on January 25, 2005, and signed by the president less than one month later.

The main effect of the Act is to expand federal courts' jurisdiction over class actions, even if those actions involve state law claims. A recent study of state class actions between 1997 and 2003 found that the Act would permit the removal of 40% of state class actions to federal court. Linda S. Mullenix & Paul D. Rheingold, *Class Actions; Impact of Class Action Fairness Law*, N.Y. LAW J., March 3, 2005, at 5. A study cited by Senator Hatch on the floor of the Senate indicated that, of 113 class actions filed in Madison County, Illinois between 1998 and 2002, 98 could have been removed to federal court under the Act. 151 Cong. Rec. S1086, *S1096.

A Rand Corporation study supports this goal of the Act's proponents, stating that federal courts are better venues for class actions than are state courts:

First, federal judges scrutinize class action allegations more strictly than state judges, and deny certification in situations where a state judge might grant it improperly.

Second, state judges may not have adequate resources to oversee and manage class actions with a national scope.

Finally, if a single judge is to be charged with deciding what law will apply in a multi-

state class action, it is more appropriate that this take place in federal court than in state court.

See 151 Cong. Rec. S450-01, S451 (statement of Senator Grassley introducing bill).

Congress made a number of findings, set out in the Act, regarding the status and purposes of class actions. First, it acknowledged that class actions are an important part of the legal system when they permit the fair resolution of legitimate claims. However, over the past decade, there have been abuses of the class action device. These abuses harm plaintiffs with legitimate claims and defendants that act responsibly, adversely affect interstate commerce, and undermine respect for our judicial system.

Under the current class action law, Congress found, class members often get little or no benefit and are sometimes harmed by class litigation. Counsel are awarded large fees, while leaving class members with coupons or other awards of little or no value. In addition, unjustified awards are made to some plaintiffs at the expense of others and confusing notices prevent class members from being able to fully understand and exercise their rights.

The findings in the Act state that abuses in class actions undermine the national judicial system, the flow of interstate commerce, and the concept of diversity jurisdiction. Class actions in state courts keep cases of national importance out of the federal courts. State courts in nationwide class actions impose their view of the law on other states and bind the residents of those states. In addition, state courts sometimes demonstrate bias against out-of-state defendants.

The purposes of the Act as set out by Congress were threefold: first, to assure fair and prompt recoveries for plaintiffs with legitimate claims; second, to restore the intent of the framers of the Constitution by providing for federal court consideration of interstate cases of national importance under diversity jurisdiction; and third, to benefit society by encouraging innovation and lowering consumer prices.

Opponents of the Act have questioned whether it will serve its stated purposes. The Act seems clearly intended to reduce the number of classes certified, but a Federal Judicial Center study reports that federal courts certify 22% of class actions, while state courts certify only 20% of class actions. In addition, questions have been raised regarding whether federal courts, in many cases already overcrowded, will have the time to oversee and manage many more large class actions.

B. Expansion of Federal Jurisdiction

1. General Expansion of Jurisdiction

In an amendment to 28 U.S.C. § 1332 (adding a new subsection (d)), the Act expands diversity

jurisdiction to include class actions in which the matter in controversy exceeds \$5 million (aggregated class claims) and (1) any class member is a citizen of a state different from any defendant; or (2) any class member is a foreign state or citizen of a foreign state and any defendant is a citizen of any state; or (3) any class member is a citizen of any state and any defendant is a foreign state or citizen. 28 U.S.C. § 1332(d)(2), (5). This overrules the "complete diversity" requirement that no named plaintiff could have the same domicile as any defendant. See *Strawbridge v. Curtiss*, 7 U.S. (Cranch) 267 (1806); *Supreme Tribe of Ben-Hur v. Cauble*, 255 U.S. 356 (1921). It also would have overruled the rule against aggregating class members' claims for the diversity amount set out in *Zahn v. International Paper Co.*, 414 U.S. 291 (1973); however, the Supreme Court has recently held that 28 U.S.C. § 1367 already permitted the aggregation of class members' claims in *Exxon Mobil Corp. v. Allapattah Servs., Inc.*, 125 S.Ct. 2611 (2005).

The Act excludes certain types of cases from federal jurisdiction even if they meet the other requirements in the Act. Certain actions involving securities and corporate governance are not subject to the new federal jurisdiction provisions. 28 U.S.C. § 1332(d)(9). In addition, there will be no federal jurisdiction if the defendants are a state, state official, or "other governmental entities against whom the district court may be foreclosed from ordering relief." 28 U.S.C. § 1332(d)(5)(A). Other types of cases are governed by the rules described below.

2. No Federal Jurisdiction Even if There Is Minimal Diversity

Even if the minimal jurisdictional requirements are met, the federal court must decline jurisdiction if more than 2/3 of the class members are citizens of the state in which the action was originally filed, at least one significant defendant is a citizen of that state, the principal injuries were incurred in that state, and no other class action based on the same allegations has been filed during the previous 3 years (this was called in the Congressional debates the "local controversy" exception). 28 U.S.C. § 1332(d)(4). In addition, the court also must decline jurisdiction if more than 2/3 of the class members are citizens of the state in which the action was originally filed and the primary defendants are citizens of that state (this was called the "home state" exception). *Id.* The Act does not define "primary defendant."

3. Discretionary Jurisdiction Where There Is Minimal Diversity

The federal court has discretionary jurisdiction if between 1/3 and 2/3 of class members are citizens of the state in which the action was originally filed. 28 U.S.C. § 1332(d)(3). The court is directed to

consider six factors in determining whether declining jurisdiction would, under the totality of the circumstances, serve the interests of justice: (1) whether the claims are of national or interstate interest; (2) whether claims will be governed by local or out-of-state law; (3) whether the case was pleaded to avoid federal jurisdiction; (4) whether the forum has a nexus to the parties or the harm; (5) whether the number of in-state plaintiffs is substantially larger than the number of plaintiffs from any other state; and (6) whether during the prior three years the same class action has been filed. *Id.*

4. Mandatory Federal Jurisdiction

The Act does not explicitly address the treatment of class actions in which fewer than 1/3 of the class members are domiciled in the state. Therefore, if there is minimal jurisdiction (as described above) in such a class action, the federal court must take jurisdiction over the case.

5. Mass Actions

For purposes of the expansion of federal jurisdiction, the Act also treats certain "mass actions" as class actions. These include actions that are not technically class actions, but more than 100 plaintiffs are joined in the same action and each plaintiff seeks more than \$75,000 in relief (the federal court will not have jurisdiction over any plaintiff that does not meet the jurisdictional amount). 28 U.S.C. § 1332(d)(11). There are a number of exceptions to this jurisdiction, however. There will be no federal jurisdiction over a mass action if all of the injuries occurred in the state where the action was filed or in contiguous states. *Id.* There also will be no jurisdiction if the suit is a private attorney general suit, or if the plaintiffs were joined on a defendant's motion. *Id.* Finally, there will be no jurisdiction if the plaintiffs are joined only for pretrial proceedings, as may be the case in some multi-jurisdiction proceedings. *Id.* Unlike other federal cases, mass actions removed to federal court will not be subject to transfer to a federal Multi-District Litigation proceeding unless a majority of the plaintiffs request such a transfer. *Id.*

C. **New Removal Rules**

The Act adds a new 28 U.S.C. § 1453, providing for removal of class actions to federal court. The one-year limitation on removal will not apply to these actions. 28 U.S.C. § 1453(b). Defendants may remove without regard to whether a defendant is a citizen of the state in which the action was filed, and without the consent of any other defendant. *Id.* Also, contrary to the general rule, new section 1453 allows—at the discretion of the court of appeals—a party to appeal a district court's decision to remand a class action suit to state court. 28 U.S.C. § 1453(c).

A party may file an application to appeal within seven days of an order granting or denying a motion to remand. *Id.* The court of appeals must complete all action on the appeal, including rendering judgment, within 60 days of the filing of the appeal. *Id.* The court can grant one 10-day extension in the interests of justice, or longer extensions if all parties agree. *Id.* In the absence of such an extension, if there is no ruling by the sixtieth day, the appeal will be considered to be denied. *Id.*

D. **Review of Class Action Settlements**

The Act, in new 28 U.S.C. § 1712, sets out provisions for the review of settlements in which class members are awarded coupons. First, just as is required under the current rules, the court must determine that the settlement is fair, reasonable, and adequate. 28 U.S.C. § 1712(e). The Act then requires more specific scrutiny of attorneys' fees. If attorneys' fees are to be based on a contingent fee, the fees must be based on the value of coupons actually redeemed, not the coupons distributed. 28 U.S.C. § 1712(a). To determine this amount, the court may admit expert testimony on the actual value of the coupons to class members. 28 U.S.C. § 1712(d).

If the value of coupons is not used to determine attorneys' fees, the fee shall be based on the amount of time expended; a lodestar calculation may be used. 28 U.S.C. § 1712(b). If there is a mixed settlement (including coupons and equitable relief), the attorneys' fees attributable to the coupons are to be determined based on the value of the coupons redeemed, and the fees attributable to the equitable relief are to be based on the amount of time expended by the attorneys. 28 U.S.C. § 1712(c). In all cases, the court is permitted to require that the value of any unclaimed coupons go to a charity or a governmental entity. 28 U.S.C. § 1712(e).

In another settlement-related provision, new 28 U.S.C. § 1713, the Act requires courts to give particular scrutiny to "net loss" settlements. If the class members end up owing their attorneys more than they recover, the court should approve the settlement only if the nonmonetary benefits of the settlement substantially outweigh the monetary loss. 28 U.S.C. § 1713. The Act also, in new 28 U.S.C. § 1714, prohibits the award of a larger recovery to class members because they live closer to the court.

In new 28 U.S.C. § 1715, the Act requires class action defendants to notify appropriate state and federal officials of any proposed class action settlement. The "appropriate official" is the official with regulatory or supervisory responsibility over matters at issue in the case, or the attorney general (of the United States or of the state in question). 28 U.S.C. § 1715(a). Each defendant must provide notice to a federal official and to a state official in each state

where a putative class member resides. 28 U.S.C. § 1715(b). This notice includes information about the complaint, the proposed settlement, the notice given to the class, any other agreement between class counsel and counsel for the defendant, and the names of class members and the proportionate share of the total settlement that will go to class members in the state to which notice is sent. *Id.* If providing names of class members is not feasible, the defendant can provide an estimate of the number of class members in the state. *Id.* A court may not give final approval of any settlement until 90 days after this notification is filed. 28 U.S.C. §1715(d). If a defendant fails to file the notice, class members are not bound by the settlement. 28 U.S.C. § 1715(e).

E. Effective Date

All of the provisions of the Act apply to any civil action commenced on or after February 18, 2005. A court in the District of Colorado has already had occasion to point out that the Act will not apply to cases filed prior to that date. *Pritchett v. Office Depot, Inc.*, No. 05-MK-392 (D. Colo. Apr. 11, 2005).

F. Judicial Conference Report

Finally, the Act requires a report from the Judicial Conference of the United States within twelve months. The report shall recommend best practices to ensure that settlements are fair and best practices on awarding attorneys' fees.

G. Conclusion

It is not entirely clear what the ultimate effect of the Class Action Fairness Act will be. The new rules will result in more class action cases being removed to federal courts. The extent of this increase may be limited, however, by plaintiffs' attorneys' attempts to structure classes that can remain in state courts. In addition, because a number of states have already adopted their own class action reform legislation, the effects of this Act may vary across states, depending on the governing state rules.