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The future of class actions in New Jersey

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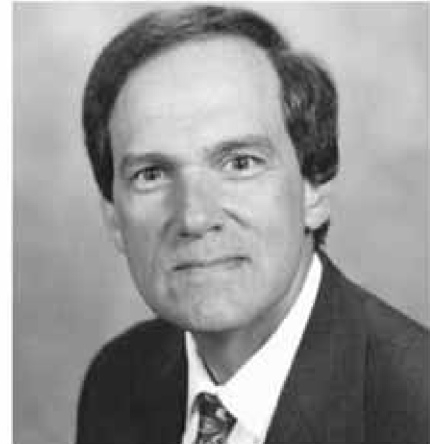

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Recent years have seen a shift of many class actions traditionally brought in the federal courts to state forums. New Jersey state courts have been well-represented in the increase in state class-action filings. While the class action landscape is forever changing, recent developments new ones on the horizon have great potential for significantly affecting New Jersey class action practice. Those developments include changes to the federal class-action rule, the possible passage of the Class Action Fairness Act, which would remove most state court class-actions to federal court, and case law developments involving federal preemption, arbitration and suits against professionals.

— Federal class-action rule —

Effective Dec. 1, 2003, extensive changes to Rule 23 of the Federal Rules of Civil Procedure went into effect. With the exception of the addition of Rule 23(f) providing for permissive interlocutory appeals from class certification decisions, and that went into effect in 1998, these changes were the first to Rule 23 since it went into effect in its modern form in 1966. While the prime focus of the rule changes are procedural, the changes put much more detail into the text and establish guidelines for federal best practices.

State practitioners must be aware of these rule changes because they have the potential for impacting state practice in two respects. First, since New Jersey's class action rule, Rule 4:32, is modeled after federal Rule 23, state courts look to the federal courts' interpretation of the federal rule for guidance. Second, since New Jersey models its class-action rule on the federal rule, the federal provisions may be adopted by our New Jersey Supreme Court. Indeed, the New Jersey State Bar Association Class Action Committee is currently reviewing these rule changes with an eye toward presenting its views to the Supreme Court's Civil Practice Committee.

The subjects addressed by the rule changes include the timing of a class certification decision, class notice, the process by which class settlements are approved, the appointment of class counsel and the award of attorneys' fees.

— Timing of certification —

The old rule requires the class certification decision be made "as soon as practicable." It is now to be made "at an early practicable time." While not dramatic, the language change was designed to recognize that the class certification decision must be informed by the nature of the issues that will be presented at trial. Although not designed to permit undue delay, the language change recognizes the need to defer the initial certification decision to permit limited discovery, motions to dismiss and summary judgment motions.

— Notice —

The rule adds a new provision permitting the court to require notice in (b) (1) and (b) (2) class-actions, those without a right to opt-out. While the proposal originally required mandatory notice in such cases, the proposal was cut back out of a sensitivity that the cost of notice could chill the bringing of civil rights cases. Since there is no right to opt out, the purpose of notice in such cases is to inform class members of the litigation so they can monitor it, as well as the appointed counsel. The rule changes also require all class action notices to be in plain, easily understood language. The rule sets forth what must be in the notice and the Federal Judicial

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Center has created model notice forms for different substantive types of actions.

— Settlement —

The new rule provides much more detail as to how the court should go about approving a class-action settlement. It now contains a settlement approval standard, requiring approval of settlements that are "fair, reasonable and adequate." The court is required to hold a hearing and make detailed findings that the standard is met. The court also is given the authority to require the disclosure of all side agreements that may affect a settlement. Also, court approval is required before an objection to a class settlement may be withdrawn, a provision designed to shed some light on dealings with objectors.

The rule changes also clarify the confusion in the pre-existing rule as to what is required when a settlement is reached with an individual class representative. When is court approval needed and when must the class be notified? The rule now provides that court approval need not be obtained if the dismissal does not bind the class. If a voluntary dismissal or settlement does seek to bind the class, court approval, as well as notice to the class, is required.

The most controversial change in the new rule is one dubbed the "second opt-out." Under the change, the court may provide that class members in already-certified classes have a second opportunity to opt-out of the class after learning the settlement terms. The purpose of this provision is to allow class members to see the terms of a settlement before they are bound, even if they did not previously opt-out. These class members are put on an equal footing with settlements of previously uncertified class actions. While the original proposal contained a mandatory second opt out, the provision ultimately adopted simply gave the court discretion to require the second opt-out.

— Appointing counsel —

The rule contains two new provisions, one requiring the court to appoint class counsel in all class actions and a second establishing formal procedures for the award of attorneys' fees. With respect to appointment of class counsel, under the new rule, this is to be done by the court at the class certification stage. This is in contrast to the procedures set in place by statute in federal court in securities cases under the Private Securities Litigation Reform Act. That act requires the appointment of counsel be done at the first stage of the litigation.

The rule establishes the procedure and factors to be considered by the court in appointing class counsel. Similarly, the new attorneys' fee provision formalizes the procedure for the award of attorneys' fees and requires the class be notified of the fees sought, but does not select a substantive basis for the fee award. Thus, the Rule does not prefer a percentage of recovery method, a lodestar method, or a method that employs both. It simply sets forth procedures for the court to follow.

While these rule changes are procedural in nature, they will substantially influence class-action practice by providing more guidance to courts unfamiliar with class action procedures and ensure greater consistency in class action practice. They very well may serve as a basis for an amended state court class-action rule.

— Shifting class actions —

The new congress is poised to consider the Class Action Fairness Act, introduced in the Senate Feb. 10. If passed, it would move most nationwide class actions to federal court. This legislation has been considered in one form or another by successive congresses since 1998. It has passed the House of Representatives on three occasions.

It is subject to intense lobbying by the business community and it is a priority of the current administration. It failed by one vote in the Senate in October 2003 and shortly thereafter a compromise was reached. It also is a priority of the Senate Majority Leader, although it is criticized by consumer groups.

The legislation is aimed at what is described in legislative findings as abuses over the past decade. As described in the bill, one of purpose is to provide a federal court forum for interstate cases of national importance using the court's diversity jurisdiction.

The bill expands diversity jurisdiction through the concept of minimal diversity. Today, many nationwide class actions cannot be removed, although they involve claims for millions of dollars, because current law does not permit aggregation of individual class-member claims to meet the $75,000 individual jurisdictional threshold.

Moreover, complete diversity on each side is needed and certain plaintiffs have avoided diversity by joining non-diverse parties to make the case removal-proof. Minimal diversity permits aggregation of all claims to meet the jurisdictional threshold and eliminates the need for complete diversity. Diversity between any two parties on alternate sides of the "v." creates diversity. In addition, the citizenship of absent class members count. Thus, parties would look to the citizenship of not only the class representatives, but all putative class members in a search for minimal diversity.

In view of the broad reach of diversity jurisdiction under the minimal-diversity approach, areas of compromise were designed to ensure those cases properly belonging in state courts are permitted to stay there. Toward that end, the jurisdictional threshold is increased from $75,000 to $5 million, and at least 100 class members are required.

In addition, if the class members and defendants are from the forum state, there would be no federal jurisdiction if more than two-thirds of the members of the proposed plaintiff class and at least one defendant from whom significant relief is sought or whose conduct forms a significant basis for the claims asserted is a citizen of the forum state. If the number of state residents of the proposed plaintiff class is between one-third and two-thirds, the federal court would have discretion to retain the case.

The bill sets forth the factors the court would consider in deciding how to exercise that discretion. Other carve-outs are made for securities actions already governed by the Securities Litigation Uniform Standards Act of 1998, for corporate governance and fiduciary duty claims, known as the Delaware Carve-Out, and for cases against state officials or other government entities over whom

federal courts would not have jurisdiction under the 11th Amendment. Mass actions also are included in the legislation if there are 100 or more claimants and each has the $75,000 amount in controversy.

The bill also eases removal jurisdiction. For class actions, consent of all defendants would not be needed to effect removal. Any defendant, even from a forum state, would be able to remove — a privilege not now granted to forum residents under existing removal law.

Moreover, removal can occur after one year of the commencement of the action as long as it is within 30 days of notice of the class action. Also, while existing law does not permit any appeals from orders granting or denying motions to remand, such appeals would be permitted in the discretion of the court of appeals.

— Other provisions —

The proposed legislation contains other provisions known as the Consumer Class Action Bill of Rights and Improved Procedures for Interstate Class Actions. There are sections addressing coupon settlements and regulating attorney fees for such settlements, protecting against class members experiencing net losses or geographic discrimination. The Senate bill includes a provision requiring notification be sent to state and federal officials of any proposed class-action settlement before final approval hearing.

The bill also requires the U.S. Judicial Conference to prepare a report on class action settlements, best practices as of the awarding of attorneys' fees, and procedures to insure that class members are the prime beneficiaries of class action settlements.

If this bill is enacted, there is no doubt that the courts would see a shifting of most nationwide class actions that are now in state court to the federal courts. This would not, however, portend the death of state court class actions. We certainly could see an increase in class actions brought in the state courts on behalf of all class members who are residents of New Jersey.

As one of the most densely populated states, and one with a receptive attitude toward class actions, New Jersey could become a desirable state for plaintiff attorneys seeking to litigate national issues through the vehicle of several single state class actions. Thus, if the legislation passes, we may very well see an evolution, not elimination, of class actions in New Jersey.

Other developments arising from case law also will have a role in shaping the class action landscape in New Jersey. These include the impact of arbitration clauses in consumer agreements, the ability to sue federally regulated entities under state consumer fraud and common law claims, and the susceptibility of professionals to being sued under consumer fraud class actions.

— Arbitration clauses —

Class actions may very well be taken out of the court system through the existence of arbitration clauses. In *Gras v. Associates First Capital Corp.*, 346 N.J. Super. 42, the New Jersey Appellate Division held that an arbitration clause in a consumer loan agreement was enforceable even though the agreement was a contract of adhesion, and enforcement would preclude the plaintiffs from bringing their claims as a class action.

The court specifically rejected the plaintiffs' claim that the arbitration agreement should be found void because it contravened public policy by precluding class actions. Even if the arbitration clause does not clearly preclude a class arbitration, it is for the arbitrator to determine whether the arbitration clause permits or precludes a class arbitration. This was the holding by a plurality of the U.S. Supreme Court in the recent opinion in *Green Tree Financial Corp. v. Bazzle, 539 U.S. 444.* Thus, parties may find class actions barred through an arbitration clause or they may find that class actions are proceeding in arbitration in accordance with decisions of the arbitrators.

— Federal pre-emption —

Second, class actions against federally regulated entities may very well be barred by issues of federal preemption. In *Smith v. SBC Communications, Inc.*, 178 N.J. 265, the New Jersey Supreme Court found that a consumer class action against SBC Communications for claims arising out of a telephone calling card was barred by the filed-rate doctrine. Since interstate telecommunications carriers are subject to regulation by the Federal Communications Commission (FCC) pursuant to the Federal Communications Act of 1934, the state law claims could not be brought because the rates actually charged were disclosed in the tariff filed with the federal agency. Similarly, in *Rosenberg v. Washington Mutual Bank*, A-55996-02T3, the Appellate Division affirmed the dismissal of a consumer fraud and state law contract action against a federally chartered savings association on the grounds of federal preemption.

The statewide class action complained of the manner in which the bank described the monthly amounts due in connection with a negative amortization adjustable rate mortgage, one allowing a consumer to pay a fixed payment for a year, even in the face of rising interest rates which would add to the principal amount due. The court determined these claims were preempted by the federal Home Owners Loan Act and regulations promulgated by the Office of Thrift Supervision which governed disclosures on billing statements.

— Professional defendants —

As to consumer fraud class actions against physicians and possibly, attorneys and other professionals, the Supreme Court most recently determined that a physician's advertisements regarding its professional services were insulated from claims under the Consumer Fraud Act (CFA). *Macedo v. Dello Russo*, 178 N.J. 340. The extent to which this decision will have lasting impact is in doubt, however, as the Senate Commerce Committee on March 8 passed a bill to amend the CFA to include within its scope advertising by professionals. If that legislation were to pass, a great increase in the number of consumer fraud claims brought against professionals may be on the horizon.

— Conclusions —

New Jersey's class-action landscape is ever-changing. It may dramatically change during the course of the next year. While the nature of the class actions may be dramatically different, they will still attract great attention from the courts and those who practice on all sides of the class-action field.■