

**TESTIMONY OF JOHN H. BEISNER, ESQ.
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BEFORE THE COMMITTEE ON THE JUDICIARY, U.S. HOUSE
OF REPRESENTATIVES**

**HEARING ON H.R. 1115:
"THE CLASS ACTION FAIRNESS ACT OF 2003"**

May 15, 2003

Since 1997, the House and Senate Judiciary Committees have held eight hearings to address concerns about a troubling scandal that is hurting consumers and businesses and undermining confidence in our legal system.¹ With each hearing, it has become clearer that the problem is getting worse. Yet, millions of Americans continue to be ripped off, our courts continue to be misused for personal gain, and the public is still waiting for their elected representatives to pass corrective legislation.

The scandal that I am referencing, of course, is class action abuse. Every

¹ *Class Action Lawsuits – Examining Victim Compensation and Attorneys' Fees: Hearing before the Subcomm. on Administrative Oversight and the Courts, Senate Comm. on the Judiciary*, SERIAL NO. J-105-62 (S. HRG. 105-504), 105th Cong., 1st Sess. (Oct. 30, 1997); *Mass Torts and Class Action Lawsuits: Hearing before the Subcomm. on Courts and Intellectual Property of the House Comm. on the Judiciary*, SERIAL NO. 141, 105th Cong., 2d Sess. (Mar. 5, 1998); *Class Action Jurisdiction Act of 1998: Hearing before the Subcomm. on Courts and Intellectual Property of the House Comm. on the Judiciary*, SERIAL NO. 121, 105th Cong., 2d Sess. (June 18, 1998); *Interstate Class Action Jurisdiction Act of 1999: Hearing before the House Comm. on the Judiciary*, 106th Cong, 1st Sess. (July 21, 1999); *The Class Action Fairness Act of 1999: Hearing before the Subcomm. on Administrative Oversight and the Courts*, SERIAL NO. J-106-22 (S. HRG. 106-465) 106th Cong., 1st Sess. (May 4, 1999); *The Class Action Fairness Act of 2000*, S. REP. NO. 106-420, 106th Cong., 2d Sess. (Sept. 26, 2000); *The Class Action Reform Act of 2001: Hearing before the House Comm. on the Judiciary*, SERIAL NO. 59, 107th Cong., 2d Sess. (Feb. 6, 2002); *Class Action Fairness Act of 2002*, H. REP. 107-370, 107th Cong., 2d Sess. (Mar. 12, 2002); *Class Action Fairness Act of 2002: Hearing before the Sen. Comm. on the Judiciary* (July 31, 2002).

year, thousands of class actions are filed in the United States – the vast majority in our state court system. The attorneys who file such lawsuits explicitly represent to the court that they are filing their actions on behalf of allegedly injured individuals and that they are assuming a fiduciary responsibility to fully vindicate those individuals' rights. But the record is now clear that all too frequently, the interests of the supposedly injured parties in those cases are not really represented at all. Indeed, in many instances, if those class actions produce any recovery, the money ends up in the pockets of the attorneys who bring the lawsuit – not in the hands of the supposedly injured parties they purport to represent.

Class action abuse is unjustifiably draining millions of dollars from our nation's economy by transferring large amounts of capital from companies to plaintiffs' lawyers with no commensurate benefit to society at large. It is also undermining public confidence in the law by suggesting to American citizens that our judicial system condones a perverse form of justice in which plaintiffs go without any real compensation, while their supposed lawyers walk away with millions in cash.

The good news is that unlike many other problems we confront as a nation, this one is relatively easy to fix. One major reason for the increase in class action abuse is the failure of some state courts to properly supervise these cases.² These courts readily satisfy the whims of the class counsel (while ignoring the due process rights of unnamed class members and defendants), and they serve as assembly lines for the mass production of settlements that benefit only the lawyers.

² It should be stressed that this is a problem only with a select number of state courts. Others handle class actions admirably. Unfortunately, as some of the studies cited later in this testimony demonstrate, class action counsel tend to file their cases in state courts that are more prone to tolerate or foster abuses.

As a result, they have become magnets for dubious class action filings in which plaintiffs' counsel extort settlements from frightened corporations familiar with the reputation of these courts.

The irony is that most class actions should not be in state court in the first place. When the Framers drafted the Constitution, they gave federal courts jurisdiction over disputes among persons residing in different states because they wanted to ensure that local bias and "uneven" justice would not interfere with the conduct of interstate commerce. Unfortunately, over the years, the contours of such federal diversity jurisdiction have been interpreted in a way that has prevented most interstate class actions from being heard in federal court.

H.R. 1115 is a modest bill that would both correct this jurisdictional anomaly and implement a "Class Action Consumer Bill of Rights," steps that would curb class action abuse and restore the integrity of our judicial process.

I. THE SCOPE OF THE PROBLEM: ABUSIVE CLASS ACTIONS AND COERCIVE SETTLEMENTS

The original purpose of the class action device was a noble one – to vindicate the rights of large groups of individuals who sought justice for civil rights violations and other wrongs but could not achieve such justice individually. Without question, that honorable intent has been fulfilled in many cases over the years. But today, the life cycle of a class action too frequently involves a very different scenario: A lawyer scans the newspaper or television, looking for articles and news programs about corporate practices that have attracted regulatory or press scrutiny – whether it is home video late fees, chicken processing techniques, or weight reduction program representations. Then, the lawyer hunts down someone who was the object of the allegedly suspect business practice to serve as a named

plaintiff in a class action challenging the practice. Sometimes, the plaintiff is a paralegal in the lawyer's office or the friend of a friend; other times, the lawyer simply places an advertisement in a local newspaper that is located in a county where the judges are reputed to be friendly to class actions and recruits a stranger. Once the lawyer has selected a plaintiff and a court, he or she files a state court class action on behalf of all persons across the United States supposedly affected by the challenged business practice. Then, the lawyer sits back and waits for the company, which is likely to be concerned about negative publicity and the risk of an astronomical jury verdict to a huge class (even though the legal challenge may be frivolous), to yield to counsel's demand to "settle cheap" – *i.e.*, to agree to a resolution that pays counsel handsomely, but provides little or nothing for the class members.

What's wrong with this form of so-called "private law enforcement"? It's analogous to permitting self-appointed "cops" to go out on the streets, set up speed traps, pull drivers over (whether they were speeding or not), and give them the option of either: (a) spending a few nights in jail, or (b) resolving the problem by paying the "cop" (for personal benefit) whatever he demands. No doubt, the "cops" would argue that this is a marvelous system – on the theory that it discourages speeding. But justifiably, the public would have no trust in – or respect for – such a system of law enforcement, since prosecutorial decisions would be driven (or at least have the appearance of being driven) by the overwhelming financial self-interest of the "cops" themselves.

Unfortunately, that is what is occurring in the class action arena. A small number of lawyers have anointed themselves as "cops," and are making decisions about when and where to "enforce" the law based in many instances not on what

best serves the public interest or what will most effectively redress consumer injuries – but rather based on what will provide them with the largest direct revenue flow. Thus, class actions have become a big game in which lawyers seek to divert to themselves corporate revenues that would otherwise be paid to shareholders, often including the very consumers they claim to represent. And these lawyers are using the state court system as a means of achieving their own personal ends – rather than a means of achieving justice.

Let me make clear that it is difficult to blame defendants for entering into these settlements. They are caught in the “speedtrap” referenced previously – they have the choice of either paying off the counsel or putting their shareholders at risk of a substantial verdict before a pro-plaintiff court, even if the claim is frivolous, or (at best) borderline (as many of the foregoing claims appear to be).³

By now, I’m sure you have all heard of the *Bank of Boston* case settlement in which an Alabama state court judge approved a settlement that awarded up to \$8.76 each to individual class members, while the class counsel received more than \$8.5 million in fees. To pay off that fee award, the court ordered that money be debited from class members’ mortgage accounts, such that they ended up **losing money on the deal**. It has now been six years since one of the victims of that state court-sanctioned scam – Martha Preston – appeared before the Senate Judiciary Committee and expressed disbelief that “people who were supposed to be my

³ For example, the current issue of one financial magazine recommends that investors consider selling off any stock that they hold in companies that face class actions in certain “magnet” county courts, seemingly without regard for the subject matter or merits of those actions. See James B. Stewart, *The Perils of Litigation*, Smart Money, June 2003, at 50-51.

lawyers, representing my interests, took my money and got away with it.”⁴ And in the intervening years, millions of other Americans have gotten the short end of the stick in state court class actions.

Unfortunately, it would require little effort to fill up pages and pages of testimony with examples of class action settlements that provided few – if any – benefits to class members while enriching their lawyers. I will mention just a few:

- In the settlement of an Illinois state court class action, cable television customers received no compensation whatsoever for allegedly excessive billing. The cable operator did agree to change some billing practices prospectively, but **all** of the cash paid in the settlement – **\$5.6 million** – went to the class counsel.⁵
- In a class action settlement approved by a Texas state court last year, approximately 38.5 million customers nationwide who alleged that they were charged excessive video rental late fees by a national chain will receive \$1 coupons off future rentals. The lawyers? They are receiving a **\$9.25 million** award. Again, **all** of the cash went to the lawyers. Indeed, it seems that only the lawyers benefit from this arrangement. The settlement allows the defendant to continue its practice of charging customers for a new rental period when they return a tape late; experts predict that only a small percentage of class members will redeem the coupons; and the coupons are the sort of

⁴ *Class Action Lawsuits: Examining Victim Compensation and Attorneys' Fees: Hearing before the Subcomm. on Administrative Oversight and the Courts of the Senate Comm. on the Judiciary*, 105th Cong., 1st Sess. (Oct. 30, 1977) (statement of Martha Preston).

⁵ Final Order of Settlement, *Unfried v. Charter Communications, Inc.*, No. 99-L-48 (granted Dec. 21, 2000).

promotion that the defendant likely would have offered in any event.⁶

- The settlement in a class action involving souvenirs and merchandise sold at NASCAR Winston Cup stock car races gave consumers coupons toward the purchase of more merchandise. And the lawyers? They are eligible to receive more than **\$2 million**.⁷ Again, **all** of the cash goes to the lawyers. If coupons were adequate compensation for the allegedly injured class members, why didn't the class counsel agree to be paid in coupons instead of cash?
- In a California state court class action regarding representations about the size of computer monitor screens, the court approved a settlement that offered \$13 rebates to class members who purchased new monitors. Class members who did not need to buy new monitors or who wished to buy a different brand got absolutely nothing. And the lawyers? They received approximately **\$6 million** in fees.⁸ Again, **all** of the cash went to the lawyers.
- Under the settlement of an Illinois state court class action involving changes to an airline frequent flyer program, participants received vouchers good for \$25 to \$75 off the price of future travel, or a similarly valued reduction in the number of miles required for an award. And the lawyers? They received up to **\$25 million** – **all** of the cash paid in the settlement. When the settlement was announced,

⁶ *Judge OKs Blockbuster Plan On Fees*, Associated Press, Jan. 11, 2002.

⁷ *Lawyers Win Big in Class-Action Suits: Is It Justice or Greed?*, Charleston (S.C.) Daily Mail, June 19, 2001, at 4A.

⁸ Jerry Heaster, *Enough Already With Lawsuits*, Kansas City Star, July 10, 1999, at C10.

travel experts were quoted as saying that “the practical value of those discounts will be modest,” and the airline “could end up generating enough extra revenue to more than offset the cost of the offer.”⁹

- In a Georgia state court class action alleging that a manufacturer improperly added sweeteners to apple juice, the defendant was required to distribute coupons worth at least 50 cents each. The lawyers? They received *all* of the cash – **\$1.5 million** in fees and costs.¹⁰
- In a Texas state court class action settlement, telephone company customers who alleged overcharges received three optional phone services free for three months (or a \$15 credit if they already subscribed to those services). The lawyers? They pocketed **\$4.5 million** in hard cash.¹¹

The evidence on this point is not merely anecdotal. Empirical studies confirm that plaintiffs in state court class actions frequently come away with little or no money, while their lawyers take home bundles of cash. For example, in a study jointly funded by the plaintiffs’ and defense bar, the Institute for Civil Justice/RAND took a hard look at where the money goes in class settlements. That study indicates that in state court consumer class action settlements (*i.e.*, non-personal injury monetary relief cases), the class counsel frequently walk away with

⁹ *American Airlines Settles Lawsuits Over Frequent Flier Program*, Forth Worth Star-Telegram, June 22, 2000.

¹⁰ *Lawyers Get \$1.5 Million, Clients Get 50 Cents Off*, Fulton County (Ga.) Daily Report, Nov. 21, 1997.

¹¹ Editorial, *We All Pay Dearly For Costly Class Actions*, Corpus Christi (Tex.) Caller-Times, Jan. 8, 2001, at A7.

more money than all class members combined.¹² Another in-depth study found that this “lawyer takes all” phenomenon was *not* occurring in federal courts – “[i]n most [class actions handled by federal courts], net monetary distributions to the class exceeded attorneys’ fees by substantial margins.”¹³

Given how much money can be made from class action settlements, it should come as no surprise that more and more lawyers are getting in on the action. And given that state courts have been more receptive to these actions, it should also come as no surprise that these lawyers are concentrating their efforts in state courts (particularly in those courts that have been most receptive to nationwide class actions and coupon settlements). A number of research efforts have produced empirical evidence confirming these troubling trends:

- A preliminary report on a major empirical research project by RAND’s Institute for Civil Justice (“ICJ”) observed a “doubling or tripling of the number of putative class actions” that was “concentrated in the state courts.”¹⁴
- A survey indicated that while federal court class actions had increased somewhat over the past decade, the frequency of *state court class action filings* had **increased 1,315 percent** – with most of the cases seeking to certify nationwide or multi-state classes.¹⁵

¹² Deborah R. Hensler et al., CLASS ACTION DILEMMAS: PURSUING PUBLIC GOALS FOR PRIVATE GAIN 15 (1999).

¹³ Federal Judicial Center, EMPIRICAL STUDY OF CLASS ACTIONS IN FOUR FEDERAL DISTRICT COURTS 68-69 (1996).

¹⁴ See Deborah R. Hensler et al., PRELIMINARY RESULTS OF RAND STUDY OF CLASS ACTION LITIGATION 15 (1997).

¹⁵ *Analysis: Class Action Litigation*, Class Action Watch, Spring 1999, at 3 (Figure 2), available at <http://www.fed-soc.org/publications/classactionwatch/classaction1-2.pdf>.

- The final report on the RAND/ICJ class action study confirmed the explosive growth in the number of state court class actions and concluded that class actions “were more prevalent” in certain state courts “than one would expect on the basis of population.”¹⁶

I recently co-authored two studies regarding class actions based on research conducted by the Center For Legal Policy of the Manhattan Institute. The first study surveyed the dockets of three county courts with reputations as hotbeds for class action activity between 1998 and early 2001, and found exponential increases in the numbers of class actions filed in recent years.¹⁷ The second study went back to one of those courts, the Circuit Court of Madison County, Illinois, to determine whether the trends were continuing in 2001 and 2002.¹⁸ The results were quite dramatic. In Madison County, a small rural county that covers 725 square miles and is home to less than one percent of the U.S. population, the number of class actions filed annually grew from 2 in 1998 to 39 in 2000 – an increase of 3,650 percent.¹⁹ And the follow-up study found that the number of class actions filed in the county continued to grow dramatically in 2001 and 2002.²⁰

So, why are so many cases being filed in Madison County?

It isn't because Madison County is a hub of commerce. In fact, our study showed that none of the companies listed as defendants in the Madison County

¹⁶ Deborah R. Hensler et al., CLASS ACTION DILEMMAS: PURSUING PUBLIC GOALS FOR PRIVATE GAIN 15 (1999) at 7.

¹⁷ See John H. Beisner and Jessica Davidson Miller, *They're Making A Federal Case Out Of It . . . In State Court*, 25 HARV. J. L. & PUB. POL'Y 143 (Fall 2001) (“Federal Case”).

¹⁸ See John H. Beisner and Jessica Davidson Miller, *Class Action Magnet Courts: The Allure Intensifies*, 4 BNA CLASS ACTION LITIG. R. 58 (Jan. 24, 2003) (“Allure Intensifies”).

¹⁹ *Federal Case* at 161.

²⁰ *Allure Intensifies* at 58-59.

class action cases was based locally.²¹

It isn't because the residents of Madison County are being singled out for corporate mischief. In fact, in well over 70 percent of the cases, counsel proposed to represent nationwide classes – that is, the classes encompassed claimants from all 50 states.²² Thus, in most instances, ***over 99 percent of the claimants in the case had no relationship to Madison County whatsoever.***

And it isn't because Madison County just happens to be home to a lot of lawyers. Most of the lawyers who bring these lawsuits also have nothing to do with Madison County. To be sure, the data show that there is a small group of local Illinois lawyers who regularly assist with the filing of these cases. But among the new class actions filed during the 1988-early 2001 period, ***85 percent*** of the plaintiffs' counsel listed on the complaints provided office addresses outside of Madison County, mostly from major legal markets like Chicago, New York, and San Francisco.²³

Of course, that leaves us with a curious mystery. Why are lawyers who live and practice in places like San Francisco, New York, or Chicago coming to a place like Madison County, Illinois, to file class action lawsuits on behalf of people who don't live in Madison County, Illinois, against defendants who don't reside in Madison County, Illinois, regarding events that didn't occur in Madison County, Illinois? It can't be because the law is better in Madison County. Class certification law should be the same in all Illinois state courts and does not differ radically from class action law nationwide. And the substantive law should come

²¹ *Federal Case* at 164.

²² *Id.* at 169.

²³ *Id.* at 164.

from the jurisdiction in which the claims arose – so that law should not be different in Madison County either. And it presumably isn't because of a perception that the juries are "better" in Madison County – it's hard to find a class action that has ever been tried in Madison County, consistent with the fact that class actions seldom go to trial anywhere.

The answer, of course, is a simple one. Lawyers think that if they go to Madison County, they'll be able to get a class certified quickly, scare defendants into a settlement, and take home a lot of money – even if they have very weak legal theories and do very little legal work.

None of this scam has been lost on American citizens – they are acutely aware that they are being short-changed by the existing state court class action system. In a national survey conducted by Penn, Schoen & Berland Associates, 73 percent of those surveyed expressed the opinion that lawyers benefit most from the current class action lawsuit system; only 7 percent thought that consumers who buy a company's products benefit most.²⁴ The vast majority also expressed the view that the U.S. legal system should be changed in this area.²⁵

At a time when we are seeing an erosion of public confidence in many institutions, class action abuse looms large as an area in which our legal system is failing the general public. Not only are members of the general public being used as pawns to make a few lawyers rich, they are also paying the tab in the end. While it is difficult to quantify the cost to society of class action abuse, recent

²⁴ See the website of the Institute for Legal Reform at www.litigationfairness.org/pdf/america_survey.pdf. Among the respondents, 45% thought that the "lawyers who represent the alleged victims" benefit most; 28% thought that "lawyers who represent the companies being sued" benefit most.

²⁵ *Id.*

reports have found that Americans pay a hefty “litigation tax” on goods and services, including such things as pharmaceuticals and insurance policies, because of excessive lawsuits in this country.²⁶ Further, the money that is paid to class counsel is siphoned away from corporate revenues that would otherwise go to shareholders – such as individual investors, mutual funds, pension funds, and charities. Thus, American consumers, whom class action lawsuits ostensibly seek to protect, end up paying for these costly settlements at the pharmacy, at the supermarket, in their retirement funds, and in their mutual funds – a cost to society that is hardly offset by the apple juice, cereal or cruise coupons they periodically receive from class action settlements.

II. H.R. 1115 IS A MODEST STEP THAT WOULD BOTH REDUCE CLASS ACTION ABUSE IN STATE COURTS AND FULFILL THE FRAMERS’ CLEAR INTENT REGARDING THE PROPER JURISDICTION OF FEDERAL COURTS.

A. The Law Governing Diversity Jurisdiction Generally Excludes Class Actions From Federal Court.

The Constitution provides for federal court jurisdiction over cases of a distinctly federal character – such as cases raising issues under the Constitution or federal laws – and generally leaves to state courts the adjudication of local questions arising under state law. However, the Constitution specifically extends federal jurisdiction to include one category of cases involving issues of *state law*: suits “between Citizens of different States,” which have come to be known as “diversity” cases.

The Framers established the concept of federal diversity jurisdiction to

²⁶ See William Worthington, *The “Citadel” Revisited: Strict Tort Liability and the Policy of Law*, 36 S. TEX. L. REV. 227, 250 (April 1995).

ensure that local biases would not affect the outcome of disputes between in-state plaintiffs and out-of-state defendants.²⁷ Diversity jurisdiction was designed not only to diminish the risk of uneven justice, but also to protect the reputation of our courts – “to shore up confidence in the judicial system by preventing even the appearance of discrimination in favor of local residents.”²⁸ The Framers were concerned that some state courts might discriminate against out-of-state businesses engaged in interstate commerce (the very same concerns that are being raised today with regard to class actions). They felt that such discrimination could be avoided by providing a fair, uniform and efficient forum for adjudicating interstate commercial disputes – *i.e.*, the federal courts.²⁹ Thus, since the nation’s inception, diversity jurisdiction has served to guarantee that parties of different state

²⁷ See *Barrow S.S. Co. v. Kane*, 170 U.S. 100, 111 (1898) (“The object of the [diversity jurisdiction] provisions . . . conferring upon the [federal] courts . . . jurisdiction [over] controversies between citizens of different States of the Union . . . was to secure a tribunal presumed to be more impartial than a court of the state in which one litigant[] resides.”); *Pease v. Peck*, 59 U.S. (18 How.) 518, 520 (1856); *Martin v. Hunter’s Lessee*, 14 U.S. (1 Wheat) 304, 307 (1816). See also The Federalist No. 80, at 537-38 (Alexander Hamilton) (Jacob E. Cooke ed. 1961) (“[I]n order to [ensure] the inviolable maintenance of that equality of privileges and immunities to which the citizens of the union will be entitled, the national judiciary ought to preside in all cases in which one state or its citizens are opposed to another state or its citizens. To secure the full effect of so fundamental a provision against all evasion and subterfuge, it is necessary that its construction should be committed to that tribunal which, having no local attachments, will be likely to be impartial between the different states and their citizens, and which, owing its official existence to the union, will never be likely to feel any bias inauspicious to the principles [up]on which it is founded.”).

²⁸ See James William Moor & Donald T. Weckstein, *Diversity Jurisdiction: Past, Present and Future*, 43 TEX L. REV. 1, 16 (1964). See also *Bank of United States v. Deveaux*, 9 U.S. (5 Cranch) 61, 87 (1809) (Marshall, C.J.) (“[Even if] tribunals of states will administer justice as impartially as those of the nation, to the parties of every description, . . . the Constitution itself . . . entertains apprehensions of the subject . . . , [such] that it has established national tribunals for the decision of controversies between . . . citizens of different states.”).

²⁹ John P. Frank, *Historical Bases of the Federal Judicial System*, 13 LAW & CONTEMP. PROBS. 3, 22-28 (1948); Henry J. Friendly, *The Historic Bases of Diversity Jurisdiction*, 41 HARV. L. REV. 483 (1928).

citizenship have a means of resolving their legal differences on a level playing field in a manner that protects interstate commerce. As one federal appellate judge noted:

No power exercised under the Constitution . . . had greater influence in welding these United States into a single nation [than diversity jurisdiction]; nothing has done more to foster interstate commerce and communication and the uninterrupted flow of capital for investment into various parts of the Union, and nothing has been so potent in sustaining the public credit and the sanctity of private contracts.”³⁰

So why aren't most class actions already being heard in federal court? The problem is that Congress enacted the first diversity jurisdiction statute back in the eighteenth century, long before the dawn of today's class actions. With that statute, Congress intended to ensure that federal courts could only hear “diversity” cases that were truly interstate in nature and involved substantial sums of money. (Understandably, they didn't want the federal courts to get bogged down in small claims cases between citizens of different states or cases that were primarily intrastate in nature.) Congress did this by placing two limitations in 28 U.S.C. § 1332, the diversity jurisdiction statute. First, an action is subject to federal diversity jurisdiction only where the parties are “completely” diverse (that is, where no plaintiff is a citizen of the same state where any defendant is deemed to be a citizen). And second, diversity jurisdiction is only applicable where each plaintiff asserts claims that exceed a threshold amount in controversy – currently set at \$75,000.

Unfortunately, many years later, when class actions entered the arena, federal courts interpreted the diversity statute to bar most class actions from being

³⁰ John J. Parker, *The Federal Constitution and Recent Attacks Upon It*, 18 A.B.A. J. 433, 437 (1932).

heard in federal court, by holding that “diversity” cases can be brought in federal court only if *each plaintiff’s* claims meet the jurisdictional minimum enacted by Congress regardless of how substantial the plaintiffs’ claims are in the aggregate – and if each plaintiff and defendant come from different states.

These judicial interpretations have provided a roadmap for plaintiffs’ lawyers seeking to evade federal jurisdiction and to litigate class actions in what they perceive as friendly state courts. After all, as long as they seek just \$74,999 in damages on behalf of each plaintiff or add a local entity to their suit as a defendant, they are virtually ensured that they will be able to remain in state court.

Last year, the Senate Judiciary Committee heard testimony from Hilda Bankston, a former pharmacy owner from Mississippi who has been joined as a defendant in numerous multi-plaintiff actions in Jefferson County, Mississippi against major out-of-state pharmaceutical companies for just this purpose – to ensure that the cases lack “complete diversity” and therefore cannot be heard in federal court. According to Mrs. Bankston:

[I]n 1999, we were named in the national class action lawsuit brought against the manufacturer of Fen-Phen. Let me stop here to explain why we were brought into this suit. While I understand that class actions are not allowed under Mississippi state law, what is permitted is the consolidation of lawsuits. These consolidations involve Mississippi plaintiffs or defendants who are included in cases along with plaintiffs from across the country. . . . By naming us, the only drugstore in Jefferson County, the lawyers could keep the case in a place known for its lawsuit-friendly environment. I’m not a lawyer, but that sure seems like a form of class action to me. . . .

Since then, Bankston Drugstore has been named as a defendant in hundreds of lawsuits brought by individual plaintiffs against a variety of pharmaceutical manufacturers. Fen-Phen. Propulsid. Rezulin. Baycol. At times, the bookwork became so extensive that I lost track

of the specific cases. And today, even though I no longer own the drugstore, I still get named as a defendant time and again. . . .³¹

In addition to naming local defendants, plaintiffs' counsel also evade federal jurisdiction by limiting the damages sought in class actions to less than \$75,000. It is not uncommon to see class action complaints in which plaintiffs seek a total of \$74,999 on behalf of each plaintiff – a sum which, when multiplied by the number of potential class members – can reach tens of millions of dollars (resulting, of course, in a far more substantial claim than an individual action seeking \$75,001 in damages). Such damages limitations showed up repeatedly in the two Madison County surveys; in one typical case involving telephone company charges, for example, the complaint sought damages “in no event exceeding \$75,000 per plaintiff or class member.”³²

Thus, judicial interpretation of the diversity statute, coupled with the pleading shenanigans engaged in by plaintiffs' lawyers, has led to an anomalous result. Under current law, federal courts have jurisdiction over a state law claim arising out of a slip-and-fall by a Maryland plaintiff at a Virginia gas station – as long as the plaintiff alleges medical bills, lost wages and other damages amounting to \$75,001. But at the same time, federal jurisdiction does *not* encompass large-scale, interstate class actions involving thousands of plaintiffs from multiple states, defendants from many states, the laws of several states, and hundreds of millions of dollars – cases that have obvious and significant implications for the national economy. This clearly was not the intent of the Framers and the first Congress.

³¹ Testimony by Ms. Hilda Bankston, Senate Committee on the Judiciary, July 31, 2002.

³² *Allure Intensifies* at 63.

B. Proposed Legislation Would Cure This Jurisdictional Anomaly

H.R. 1115 would correct this anomaly by amending the diversity statute to allow some of the larger class actions to be heard in federal court, while continuing to preserve state court jurisdiction over cases that involve smaller sums of money or truly interstate matters. This bill would allow federal courts to adjudicate class actions, as well as mass joinder actions (of the type in which Mrs. Bankston was frequently sued) with large numbers of plaintiffs, in which *any* of the named plaintiffs or defendants come from different states. Moreover, it would change the amount-in-controversy threshold to allow class actions into federal court as long as the *aggregate* claims exceed a substantial threshold amount. Significantly, however, the bill would not extend federal jurisdiction to encompass “*intra-state*” class actions, in which the majority of the plaintiffs and the primary defendants are citizens of that state. H.R. 1115 therefore allows federal courts to exercise jurisdiction over substantial interstate class actions with significant nationwide commercial implications, while retaining exclusive state court jurisdiction over more local class actions that principally involve parties from that state and application of that state’s own laws.

I urge the members of this Committee to support H.R. 1115 for a number of reasons:

First, H.R. 1115 would fulfill the intent of the Framers when they established diversity jurisdiction. As I noted earlier, class actions squarely implicate the Framers’ concern with protecting interstate commerce through the exercise of diversity jurisdiction. In fact, if Congress were starting anew to define what kinds of cases should be included within the scope of diversity jurisdiction, large-scale interstate class actions would surely top the list, since they typically

involve the largest amounts in controversy, the most people, and the most substantial interstate commerce implications. Moreover, there can no longer be any question that some local judges are exhibiting bias against out-of-state defendants in class actions – the very type of bias that led to the creation of diversity jurisdiction in the first place. Thus, H.R. 1115 is not only a constitutional solution to the class action problem; it would actually comport with the Framers’ intent far more than the current state of affairs, which allows federal courts to adjudicate interstate fender-benders, while leaving nationwide class actions that involve thousands of plaintiffs and millions of dollars in county courts of the lawyers’ choosing.

As the *Washington Post* put it, class action cases are:

disproportionately filed in selected counties where judges are elected – meaning that a judge accountable to a single county can make decisions regulating products distributed nationwide. . . . It is a bad system – one that irrationally taxes companies in a fashion all but unrelated to the harm their products do and that provides nothing resembling justice to victims of actual corporate misconduct.”³³ In short, the existence of such “magnet” courts and troubling settlements, which undermine public confidence in our judicial system, would be greatly reduced if federal courts had jurisdiction over interstate class actions.

Second, H.R. 1115 would promote federalism principles. One of the principal objections to H.R. 1115 has been that the proposed legislation would undermine federalism interests by limiting the ability of states to experiment with class action lawsuits. In fact, however, the critics have it backwards: a key reason for **supporting** H.R. 1115 is that it would **protect** federalism by restricting state courts from dictating the laws of other states.

³³ *Fixing Class Actions*, Washington Post, Mar. 21, 2002, at A34.

One of the most dangerous trends in state court class actions – and one that has had the biggest impact on the proliferation of “nationwide” lawsuits – is that many state courts are “federalizing” class actions. That is, when state courts preside over class actions involving claims of residents of more than one state (especially nationwide class actions) as they are increasingly inclined to do, they often end up dictating the *substantive* laws of other states, sometimes over the protests of officials in those other jurisdictions.

An example of this phenomenon is a nationwide insurance class action in Illinois that resulted in a \$1.3 billion judgment against State Farm. In that case, plaintiffs alleged that State Farm’s use of “aftermarket” parts for repairs (as opposed to parts made by the original manufacturer) was fraudulent. After certifying a nationwide class, the Illinois court applied Illinois law to claims from all fifty states and the District of Columbia even though states’ policies on the use of these parts differ and even though some state insurance commissioners testified that their states encourage or even *require* insurers to use aftermarket parts to reduce insurance costs. Nonetheless, the Illinois court approved the judgment and the court of appeals affirmed, effectively deciding the question for the entire nation.³⁴

So what exactly did this class action achieve? For starters, an Illinois state court decided effectively to overrule other states’ insurance laws, depriving the duly elected and designated regulators in those jurisdictions of their right to regulate insurance rates and policies for the citizens to whom they are accountable. In addition, auto insurance rates for most consumers likely will increase (as insurers are obliged to use more expensive OEM parts). Of course, with increased

³⁴ *Avery v. State Farm Mut. Auto Ins. Co.*, 746 N.E.2d 1242 (Ill. Ct. App. 2001).

rates will come an increase in the number of uninsured drivers on our roads (since more people will be priced out of the insurance market). And finally, for the kicker, because State Farm is a mutual insurance company, owned by its customers, the people on whose behalf this class action was filed will receive nothing. Instead, the award will come out of their pockets, since they are the company's owners. Indeed, the only winners in this lawsuit are the class lawyers, who stand to gain over \$500 million if the judgment is upheld and plaintiffs' lawyers are paid the 40 percent fee that some of the class counsel have said they will seek from the court. And who pays that half-billion dollar payday? Once again, the so-called winners are really the losers: the class members whom the lawyers supposedly represented ultimately will foot the bill for the lawyers' fees.

Of course, the danger posed by these efforts to federalize state law extends far beyond insurance. By way of example, the dockets of the three surveyed counties in the class action studies mentioned previously included numerous cases in which plaintiffs' counsel sought to have locally elected judges in county courts set policies in areas as diverse as warranties, land use rights, plumbing licenses, environmental protection, advertising campaigns, bank billing practices, employee investment plans, and numerous other broad-ranging issues for 49 other states in addition to their own.

H.R. 1115 would address this very serious federalism problem by expanding federal jurisdiction over interstate and nationwide class actions. Contrary to many state courts, federal courts have consistently concluded that in the case of a nationwide lawsuit, the laws of all states where purported class members were defrauded, injured, or purchased the challenged product or service must come into

play.³⁵ And in those very few instances in which a federal district court has toyed with the idea of engaging in “false federalism” (*i.e.*, applying a single state’s law to all asserted claims), that notion has been reversed on appeal almost immediately.³⁶

Third, H.R. 1115 would increase judicial efficiency, by enabling “copycat” cases to be consolidated in a single federal court, rather than leaving them to proceed in numerous state courts, as does the current system. Frequently, tens or even hundreds of overlapping or “copy-cat” class actions are filed in state courts across the country regarding the same controversy. Right now, that means that numerous state court judges around the country are duplicating each other’s work, resulting in enormous inefficiencies. Further, the class action device is being abused, as lawyers vie to certify or settle overlapping nationwide class actions as cheaply as possible. In contrast, when numerous duplicative class actions are filed in different federal courts, they are typically consolidated for pretrial proceedings in a multidistrict litigation proceeding under a federal statute that allows for such

³⁵ See, *e.g.*, *Georgine*, 83 F.3d at 627; *Zinser v. Accufix Research Inst., Inc.*, 253 F.3d 1180, 1187-90 (9th Cir. 2001); *Zapka v. Coca-Cola Co.*, No. 99 CV 8238, 2000 U.S. Dist. LEXIS 16552, at *11-13 (N.D. Ill. Oct. 26, 2000); *Fisher v. Bristol-Myers Squibb Co.*, 181 F.R.D. 365, 369 (N.D. Ill. 1998); *Dhamer v. Bristol-Myers Squibb Co.*, 183 F.R.D. 520, 532-34 (N.D. Ill. 1998); *Jones v. Allercare, Inc.*, 203 F.R.D. 290, 307 (N.D. Ohio 2001); *In re Ford Motor Co. Ignition Switch Prods. Liab. Litig.*, 174 F.R.D. 332, 346-54 (D.N.J. 1997); *Marascalco v. Int’l Computerized Orthokeratology Soc’y, Inc.*, 181 F.R.D. 331, 338-39 (N.D. Miss. 1998); *In re Ford Motor Co. Bronco II Prods. Liab. Litig.*, 177 F.R.D. 360, 369-71 (E.D. La. 1997); *In re Stucco Litig.*, 175 F.R.D. 210, 214, 215-217 (E.D.N.C. 1997); *Ilhardt v. A.O. Smith Corp.*, 168 F.R.D. 613, 619-20 (S.D. Ohio 1996); *Harding v. Tambrands Inc.*, 165 F.R.D. 623, 629-30, 631-32 (D. Kan. 1996); *Walsh v. Ford Motor Co.*, 130 F.R.D. 260, 271-75 (D.D.C. 1990); *Feinstein v. The Firestone Tire & Rubber Co.*, 535 F. Supp. 595, 608 (S.D.N.Y. 1982).

³⁶ See, *e.g.*, *In re Bridgestone/Firestone, Inc.*, 288 F.3d at 1024; *Szabo v. Bridgeport Machines, Inc.*, 249 F.3d 672, 674-75 (7th Cir. 2001); *Spence v. Glock, GES.m.b.H.*, 227 F.3d 308, 313-15 (5th Cir. 2000); *In re Am. Med. Sys.*, 75 F.3d 1069, 1085 (6th Cir. 1996); *Castano v. American Tobacco Co.*, 84 F.3d 734, 741-43, 749-50 (5th Cir. 1995); *In re Rhone-Poulenc Rorer, Inc.*, 51 F.3d 1239, 1302 (7th Cir. 1995); *Walsh v. Ford Motor Co.*, 807 F.2d 1000, 1017-19 (D.C. Cir. 1990).

coordination – 28 U.S.C. § 1407. By expanding federal jurisdiction over interstate class actions, H.R. 1115 would enable duplicative cases to be removed to federal court and then consolidated under federal multidistrict litigation procedures, thereby preventing the waste and abuse that flow from the litigation of duplicative suits in multiple state courts.

Fourth, H.R. 1115 would protect consumers from abusive settlements.

The growing public disgust with class actions is fed – and properly so – by a host of abusive settlement practices and by the dissemination of unintelligible class action notices. H.R. 1115 seeks to address those serious public concerns in two ways. First, as I noted earlier, federal judges have exhibited much more rigor in reviewing proposed class action settlements than some of their state court counterparts. That means the mere act of allowing more class actions to be heard in federal court will reduce class action abuse. Second, the bill includes a “consumer class action bill of rights” that affords additional protections to class action plaintiffs than those already in place in federal court. Under this section of the bill:

- Written notice of a proposed federal court class action settlement would have to be provided to class members in a clearer, simpler format;
- A federal court could not approve a coupon or other non-cash settlement unless it first holds a hearing and makes a written finding that the settlement is fair, reasonable and adequate;
- A federal court could not approve a settlement (like the Bank of Boston settlement) that results in a net loss for the class members unless it makes a written finding that non-monetary benefits to the class members outweigh any loss precipitated by the terms of the settlement; and

- A federal court could not approve a settlement that: (1) provides greater sums of money to certain class members because they are located in closer proximity to the court, or (2) provides a bounty to the class representatives.

Opponents of H.R. 1115 have suggested that Congress pass a bill that simply enacts these (or other) pro-consumer provisions, without expanding federal jurisdiction over class actions (or expanding it only slightly). (In fact, there are published reports that Senator Leahy plans to introduce such an alternative bill along these lines (although those reports also indicate that no bill has yet been drafted).) The problem with such alternative legislation is that any consumer provisions enacted by Congress will apply only to cases that are being litigated in *federal* court. Since that alternative legislation would leave the vast majority of interstate class actions in state court, few would be subject to these consumer protection provisions. Thus, the alternative legislation would achieve little or nothing: class action lawyers could continue to file duplicative cases, manipulate the pleadings to evade federal jurisdiction, and shop for courts willing to rubber-stamp self-serving settlement proposals.

* * *

In urging Congress to enact legislation to address the class action problem, the *Washington Post* editorialized:

[N]o component of the legal system is more prone to abuse. For unlike normal lawyers, who are retained by people who actually feel wronged, class counsel – having alleged a product deficiency that caused some small monetary damage to some discernible group of people – largely appoint themselves. The “clients” may not even be dissatisfied with the goods or services they bought, but unless they opt out of a class of whose existence they may be unaware, they become plaintiffs anyway. Class actions permit almost infinite venue shopping; national class actions can be filed just about anywhere and

are disproportionately brought in a handful of state courts whose judges get elected with lawyers' money. These judges effectively become regulators of products and services produced elsewhere and sold nationally. And when the cases are settled, the "clients" get token payments, while the lawyers get enormous fees. This is not justice. It is an extortion racket that only Congress can fix.³⁷

I respectfully add my voice to that of the *Washington Post* and numerous others in urging this Committee to act favorably on H.R. 1115 so that class actions will once again become a tool of justice, instead of a blemish on our legal system.

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³⁷ *Making Justice Work*, Washington Post, Nov. 25, 2002.