

Client Alert

Latham & Watkins
Litigation Department

The Third Circuit Clarifies the Class Action Fairness Act's "Local Controversy" Exception to Federal Jurisdiction

On March 26, 2009, the United States Court of Appeals for the Third Circuit decided *Kaufman v. Allstate New Jersey Insurance Co.*, 561 F.3d 144 (3d Cir. 2009). In *Kaufman*, the court clarified the standards applicable to two provisions within the Class Action Fairness Act's (CAFA) "local controversy" exception, under which a federal court may decline jurisdiction over an otherwise qualifying class action. Notably, with respect to the "significant basis" provision, which requires remand to state court where a local defendant's alleged conduct forms a significant basis for all the claims asserted, the tribunal held that the alleged conduct "must be an *important* ground for the asserted claims," and that a defendant's market share is not a determinative factor in the analysis.

In addition, the court also held that the party seeking to remand the matter to state court bears the burden of establishing that the local controversy exception applies. Moreover, the Third Circuit concluded that when a court analyzes whether, for purposes of the local controversy exception, a local defendant is involved in the class action, a court must conduct that analysis at the current point in the proceedings, not at the commencement of the action.

The Class Action Fairness Act

Prior to 2005, untold class actions of national significance were excluded from federal courts due to settled rules governing federal diversity jurisdiction. Specifically, the complete-diversity rule, which requires that no plaintiff be a citizen of the same state as any defendant,¹ and the rule against aggregating claims, which requires that each plaintiff seek recovery of more than \$75,000, exclusive of interest and costs,² often barred federal courts from exercising jurisdiction over sizable class actions of national magnitude.

Recognizing the incongruence of the diversity rules with modern class action litigation, and in an effort to provide for "[f]ederal court consideration of interstate cases of national importance under diversity jurisdiction,"³ Congress passed CAFA in 2005. In addition to a host of other reforms, CAFA created federal jurisdiction over class actions where the amount in controversy exceeds an aggregate of \$5 million, any class member and any defendant are citizens of different states, and there are 100 or more members in the putative class.⁴

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The Local Controversy Exception to Federal Jurisdiction

CAFA's broad grant of federal jurisdiction over large scale class actions contains limited exceptions that require a district court to decline jurisdiction where a controversy is local and does not affect multiple states. Paramount among the exceptions—and the exception at issue in *Kaufman*—is the “local controversy” exception, pursuant to which no federal jurisdiction exists where at least one significant defendant and a super majority of at least two-thirds of class members are “local,” or from the state in which the action was originally filed.⁵

Kaufman addressed two provisions of the local controversy exception—the “significant basis” provision and the “principal injuries” provision. The significant basis provision divests federal courts of jurisdiction where a local defendant “whose alleged conduct forms a significant basis for the claims asserted” is named in the complaint.⁶ Similarly, the principal injuries provision applies where the “principal injuries resulting from the alleged conduct or any related conduct of each defendant were incurred in the State in which the action was originally filed.”⁷

The *Kaufman* Case

In November 2007, nine plaintiffs filed a class action lawsuit against six insurance companies in New Jersey state court. Subsequently, the plaintiffs dismissed three New Jersey insurers from the cases, leaving only one New Jersey defendant in the litigation.

The plaintiffs asserted tort, contact and consumer fraud claims stemming from the defendants' alleged failure to pay their insureds for “diminished value” insurance claims (*i.e.*, claims for the loss of value to a car involved in an

accident notwithstanding its complete repair). According to the plaintiffs, that practice violated New Jersey law and the insurance contracts.

Following the timely removal of the action to federal court, the plaintiffs sought remand to state court based on CAFA's local controversy exception. The District Court concluded that the local controversy exception applied and remanded the action to New Jersey state court. The defendants appealed that ruling.

The Local Controversy Exception Generally

The Third Circuit began its analysis by elucidating some general rules applicable to the local controversy exception. First, the court held that the local controversy exception requires consideration of defendants currently in the action, not defendants formerly involved in the litigation. In so holding, the court rejected the time-of-filing rule under which diversity jurisdiction is determined based on the parties' citizenship at the commencement of the lawsuit. The court found the time-of-filing rule inapposite where the local controversy exception is implicated. According to the court, “[a]pplying the exception when no local defendant remains in the action, as could occur under the time-of-filing rule, would not comport with the exception's focus on discerning local controversies based, in part, on the presence of a significant local defendant.” The panel thus found the District Court erred in holding that a dismissed defendant's presence in New Jersey was a sufficient basis to invoke the local controversy exception.

Second, the Honorable D. Brooks Smith, writing for a unanimous court, held that the party seeking remand to state court bears the burden of establishing that the local controversy exception applies. In so holding, the Third Circuit followed

the lead of other courts of appeal that have uniformly concluded that where jurisdiction under CAFA exists in the first instance, “the burden shifts to the party objecting to federal jurisdiction to show that the local controversy exception should apply.”⁸

The Significant Basis Provision

The significant basis provision of the local controversy exception requires that the class action include at least one local defendant whose alleged conduct forms a significant basis for all of the claims asserted in the lawsuit. In a question of first impression, the Third Circuit held that the significant basis provision does not require *every* member of the putative class to assert a claim against the local defendant. Rather, according to the court, the provision requires only that the local defendant’s alleged conduct form a significant basis of all of the claims asserted. In so holding, the court declined to establish a quantitative requirement. Instead, the court opined that a substantive comparison of the local defendant’s alleged conduct to the alleged conduct of all the defendants is required.

In reaching this conclusion, the Third Circuit rejected the District Court’s reliance on the local defendant’s market share to determine whether the conduct formed a significant basis of the class action. Thus, a local defendant’s status as “a major player in a particular market” is not dispositive.

The Third Circuit also rejected the District Court’s articulation that a local defendant’s conduct forms a significant basis where it is “more than trivial or of no importance.” Rather, the court held that the local defendant’s conduct “must be an *important* ground for the asserted claims in view of the alleged conduct of all the [d]efendants.”

The Principal Injuries Provision

Finally, the court addressed the “principal injuries” provision of the local controversy exception. That provision applies where the “principal injuries resulting from the alleged conduct or any related conduct of each defendant were incurred in the State in which the action was originally filed.”⁹ One of the *Kaufman* defendants argued that the provision requires that both the principal injuries resulting from the alleged conduct *and* any related conduct of each defendant be incurred in the state in which the action was filed. The court, however, disagreed and declined to read the statutory “or” in the conjunctive. Instead, the court adhered to the statutory language and held that the provision “is satisfied either 1) when principal injuries resulting from the alleged conduct of each defendant were incurred in the state in which the action was originally filed, ‘or’ 2) when principal injuries resulting from any related conduct of each defendant were incurred in that state.”

Conclusion

In addressing a host of issues related to CAFA’s local controversy exception to federal jurisdiction, the Third Circuit provided guidance to litigants sparring over the appropriate forum for large scale class actions that may implicate some local concerns. In so doing, and by eschewing the time-of-filing rule, the Third Circuit discouraged the practice of creative pleading of class actions to prevent removal to federal courts. Moreover, the Third Circuit placed the burden of establishing the applicability of the local controversy exception squarely on the party seeking remand to state court.

Furthermore, by interpreting both the significant basis and principal injuries provisions of CAFA, the court provided

much needed guidance to litigants regarding a statute whose meaning is still, and likely will continue to be, the subject of much debate and litigation. Specifically, by declaring that a defendant's "market share" is of little, if any, significance and holding that a defendant's conduct "must be an *important* ground for the asserted claims," the court indicated that requests for remand of large class actions to state court will be subject to a rigorous analysis.

Endnotes

- ¹ See 28 U.S.C. § 1332(a)(1); *Strawbridge v. Curtiss*, 7 U.S. 267, 267 (1806).
- ² See 28 U.S.C. § 1332(a); *Zahn v. Int'l Paper Co.*, 414 U.S. 291, 301 (1973).
- ³ CAFA § 2, Pub. L. 109-2, 119 Stat. 4.
- ⁴ See 28 U.S.C. § 1332(d)(2), (5).
- ⁵ See 28 U.S.C. § 1332(d)(4)(A).
- ⁶ 28 U.S.C. § 1332(d)(4)(A)(i)(II)(bb).
- ⁷ 28 U.S.C. § 1332(d)(4)(A)(i)(III).
- ⁸ See, e.g., *Serrano v. 180 Connect, Inc.*, 478 F.3d 1018, 1024 (9th Cir. 2007); *Hart v. FedEx Ground Package Sys. Inc.*, 457 F.3d 675, 680 (7th Cir. 2006); *Frazier v. Pioneer Ams. LLC*, 455 F.3d 542, 546 (5th Cir. 2006); *Evans v. Walter Indus., Inc.*, 449 F.3d 1159, 1165 (11th Cir. 2006).
- ⁹ 28 U.S.C. § 1332(d)(4)(A)(i)(III).

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