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Decline & Fall

As the golden age of consumer class actions ends, the question now is whether they have any future

By Edward F. Sherman

By 1995, the age of the consumer class action had reached its apogee. In October of that year, a *Fortune* magazine headline epitomized the fear and loathing that class actions engendered within the U.S. business community: “Lawyers from Hell: Slip Up and Guys Like These Can Bankrupt Your Company.”

However, by then the backlash had already started. Over the next decade, business organizations pursued an intensive campaign to sway public opinion, and to lobby Congress and state legislatures for changes in substantive and procedural law that would put the clamps on consumer class actions.

And now, opponents of class actions have gotten much of what they were looking for, culminating in the passage by Congress of the Class Action Fairness Act of 2005. Primarily through its diversity rules, CAFA in effect means that most class actions may be removed to the federal courts, which are more reluctant to certify plaintiffs classes than state courts.

But the passage of CAFA followed other actions that already had imposed restrictions on class actions. As a result, the consumer class action has reached a crucial juncture, and the direction that courts and legislatures take over the next few years will likely determine whether it has any kind of viable future.

Depending on one’s point of view, the class action is a powerful vehicle for protecting the rights of individuals confronting powerful corporations—or a legal version of Frankenstein’s monster. By allowing individuals to sue not only for themselves but also for others similarly situated, the class action can make defendants liable for a large number of individual claims that otherwise might not have been pursued.

1960s

Starting in the 1960s, class actions evolved into a powerful weapon for lawyers advocating the interests of consumers. But recent changes in the law have made it harder to bring class actions.

The rise and fall of consumer class actions is a cycle that began in 1966 when the scope of Rule 23 of the Federal Rules of Civil Procedure was expanded to allow class action suits for damages. That change helped trigger a wide spectrum of class actions based on product liability and consumer claims. Over time, class actions dogged businesses in the retail and manufacturing sectors along with such service industries as insurance, banking, mortgage lending, telecommunications and health care. Virtually every American has been a plaintiffs class member in some class action.

But in addition to causing consternation in the business sector, the increase in class actions ignited an intense debate over whether

1966: Amended Rule 23 of the Federal Rules of Civil Procedure permits class action lawsuits for damages.

1980s

Mid-1980s: Class actions become the basis for widespread consumer actions against defendants in various industries.

1990s

Mid-1990s: Federal circuits take a stricter approach to certifying classes, and plaintiffs lawyers increasingly turn to state courts.

1995: Congress passes the Private Securities Litigation Reform Act to restrict class actions in securities fraud cases.

2000s

2003: Amendments to Rule 23 set tougher rules on appointment of counsel and class representatives.

2005: Congress passes the Class Action Fairness Act to steer most class actions to federal courts and limit certain kinds of settlements.

the social benefits of class actions outweigh their costs.

The issue, noted a report released in 2000 by the Rand Institute for Civil Justice, is “a deeply political question, implicating fundamental beliefs about the structure of the political system, the nature of society, and the roles of courts and law in society.” (The report, titled *Class Action Dilemmas: Pursuing Public Goals for Private Gain*, is available on the Internet.)

Class actions offer economies for both sides by eliminating the possibility that the same issues would be tried again and again in separate cases and that similar individual suits might result in different outcomes. At the same time, class actions bolster the bargaining power of plaintiffs by allowing them to combine litigation efforts and resources.

Class actions also reflect the American preference for a “market approach” to addressing social and economic issues. For better or worse, the American political system has generally rejected extensive governmental regulation of business and has often failed to provide adequate funding for governmental regulatory bodies. That sometimes leaves a vacuum in enforcing laws, regulations and standards that may be filled by entrepreneurial plaintiffs lawyers.

In practice, states the Rand report, class actions “serve important public services by supplementing the work of government regulators whose budgets are usually quite limited and who are subject to political constraints.”

Class action suits have led to settlements in which corporate defendants have agreed to stop making unauthorized charges, change improper business practices, and withdraw misleading advertising and claims. Class actions for fraudulent marketing of securities and insurance policies have resulted in settlements in the billions of dollars.

Class actions have forced large recalls of vehicles, food, pharmaceuticals, and home and industrial products. Class action settlements have resulted in payments to consumers for personal injuries, economic damages, and refunds of purchase price.

But a continuing criticism is that class actions result in windfall recoveries for plaintiffs at the expense of businesses.

Members of the business community maintain that the economic risk of class actions forces them to settle weak or frivolous suits—and some in the legal community agree with them.

In 1995, Judge Richard A. Posner of the Chicago-based 7th U.S. Circuit Court of Appeals decried the intense pressure on class action defendants to settle in his opinion in *In re Rhone-Poulenc Rorer Inc.*, 51 F.3d 1293. That pressure forces defendants “to stake their companies on the outcome of a single jury trial, or be forced by fear of the risk of bankruptcy to settle even if they have no legal liability,” wrote Posner.

The overtly entrepreneurial nature of some class actions particularly rankles critics.

There is no doubt that some class actions have been fueled by monetary incentives for plaintiffs firms, or consortia of firms, that recruit the representative plaintiffs and finance the costs of the suit.

Critics—and some consumers—further complain that individual class members often receive small portions of the total recovery or settlement while the plaintiffs lawyers receive millions of dollars in fees.

Without question, the fees in some actions are staggering. After a global settlement of suits by states against the tobacco companies, a relatively small number of plaintiffs firms were awarded fees of $3.4 billion in Florida, $3.3 billion in Texas and $1.4 billion in Mississippi.

In defense of those fees, the plaintiffs lawyers pointed to the $368.5 billion settlement they had achieved after as much as a decade of work, expense and risk.

Realistically, there have to be strong entrepreneurial incentives for lawyers to assume class action representation. And only a few lawyers, firms or consortia of firms are able and willing to take on class actions in which they front the costs and gamble on a fee that is contingent on the successful outcome of the case. Under those circumstances, it's hardly unfair that the lawyers who risk their time and finances should receive more money than any individual class member.

Moreover, it's important to recognize that class actions have dual objectives: compensation and deterrence. By and large, "negative value" cases, where the expected recovery for an individual is less than the cost of litigation, would not be filed if there were no class actions, and the wrongdoers might never have to answer for their conduct. However small the compensation an individual class member receives, he or she also has the satisfaction of knowing that the defendant will have to disgorge unlawful profits—and the hope that doing so will deter such conduct in the future.

WINNING THE BATTLE IN THE TRENCHES

While the philosophical debate over the merits and drawbacks of consumer class actions goes on, the business community clearly appears to be winning the battle in the legal trenches. Since 1995, restrictions have been steadily imposed on class actions through court interpretations of Rule 23, changes in the language of the rule itself, so-called tort reform laws adopted by state legislatures and acts passed by Congress, particularly CAFA.

The passage by Congress of the Private Securities Litigation Reform Act of 1995 was an early indication that the tide was turning.

The act took away the right of people filing securities fraud class actions to name themselves as the class representatives and their lawyers as the class attorneys. The act also requires publication of a notice that any person or entity can petition the court to be lead plaintiff. There is a rebuttable presumption in favor of those with the largest financial interest (which will normally be large institutional shareholders). The lead plaintiff will then select class counsel, who need not be the lawyers who filed the class action.

These restrictions have not been applied to class actions other than securities fraud, although the 2003 amendments to Rule 23 give judges the power to appoint class counsel other than the one who filed the suit. Still, the attorney who files the action often will be appointed "interim counsel" by the court and have a leg up on being appointed permanent counsel. Some courts, however, have

adopted an auction method of selecting class counsel, with all lawyers invited to submit their conditions and fee amounts, a consideration that will influence the selection of counsel.

The most damaging blow to consumer class actions came in 2005, when Congress passed (and President Bush signed) CAFA.

The most significant effect of CAFA has been to make multistate class actions a matter primarily for the federal courts.

Since the 1990s, there has been great variance among state and federal courts regarding the standards for certifying class actions. With federal courts generally taking a more restrictive approach, plaintiffs lawyers filed growing numbers of class actions in state courts.

The business community was especially irked that an undue proportion of multistate class actions were filed in “magnet venue” state courts, such as Madison County in Illinois and certain counties in the Rio Grande Valley of Texas, where the judges—usually elected—were more likely to certify a class action and the juries tended to be pro-plaintiff. In addition, corporations that do business in multiple states complained that they were subjected to multistate class actions in state courts that could establish legal standards governing their activities throughout the country.

The result of concerted business lobbying over a six-year period, CAFA expanded federal court jurisdiction to cover class actions involving “minimal diversity”—which is satisfied so long as any plaintiffs class member is a resident of a different state than any defendant.

Consumer class actions typically involve minimal diversity, so a key result of CAFA is that defendants may remove most multistate class actions to federal court.

There are limited exceptions to CAFA’s minimal diversity rule. When two-thirds of the class members and the primary defendant or defendants are from the forum state, for instance, the class action does not have to be removed to federal court. But the two-thirds exception does not describe the typical consumer class action, which seeks to involve consumers in many states who have the same complaint.

In their efforts to stay out of federal court, plaintiffs lawyers can bring state-only actions, but multiple actions on the same matter may not be financially viable. In a report issued in April, the Federal Judicial Center cited an increase in federal class actions due to both original filings and removals from state courts.

FORUM-SHOPPING OPTIONS

So, after CAFA, the federal courts are really the only game in town for multistate class actions. But while the act essentially “federalized” multistate class actions, it doesn’t mean forum-shopping has come to an end. Instead, plaintiffs lawyers may engage in forum-shopping at the federal level, searching for courts with favorable precedents in their circuits primarily on the issue of “predominance.”

Rule 23 of the Federal Rules of Civil Procedure requires that a court must find “that the questions of law or fact common to the members of the class predominate over any questions affecting only individual members, and that a class action is superior to other available methods for the fair and efficient adjudication of the controversy.”

The purpose of the predominance requirement is to determine whether there is sufficient

cohesiveness among class members so a trial can be conducted primarily on common issues rather than be broken down into separate trials for individuals.

Predominance is more likely to be found if the class members' claims arise out of the same event—a plane crash, a product flaw, an environmental condition or course of conduct. In consumer cases, a common policy or course of conduct—like using the same deceptive method of computing interest rates or cell phone call charges or insurance policy premiums—can establish predominance.

Consumer class actions are often based on breach of contract or warranty, defects in products or services, state consumer protection laws, or federal or state statutes prohibiting particular conduct. They sometimes fail because there are too many differences as to how class members contracted, purchased or came into contact with the product or service, or how the service was carried out or how they were injured.

These variations raise individual issues—exposure, causation, identity of contract terms, circumstances of breach, and injury—that might be found to predominate in a particular case.

Most claims are based on state common-law fraud and consumer protection statutes and require proof of an individual's reliance on the deception or falsehood. Many courts hold that reliance constitutes an individualized issue under state law that predominates and prevents class certification.

In the mid-1990s, a number of federal circuit courts reversed class action certifications for lack of predominance. *In Castano v. American Tobacco Co.*, 84 F.3d 734 (1996), the New Orleans-based 5th Circuit denied a class action on behalf of nicotine-addicted smokers due to differences in their individual circumstances.

The Cincinnati-based 6th Circuit, in *In re American Medical Systems Inc.*, 75 F.3d 1069 (1996), rejected a class of men suffering from defective penile implants because a variety of different models were used. And in *Andrews v. American Telephone & Telegraph Co.*, 95 F.3d 1014 (1996), the Atlanta-based 11th Circuit found a lack of predominance in a class action by victims of a 900-number phone scam due to the variety of circumstances under which they were induced to participate.

NO CONSENSUS ON CHOICE OF LAW

Other courts, however, have held that individual differences in contract and consumer protection cases do not predominate when there is a common course of conduct or a common policy or practice. In *Smilow v. Southwestern Bell Mobile Systems Inc.*, 323 F.3d 32 (2003), the Boston-based 1st Circuit allowed a class action for cell phone customers challenging unauthorized charges for incoming calls.

They all were subjected to the same policy, although under different circumstances.

Class certification will not necessarily be prevented by damages incurred on an individual basis. Federal courts have permitted bifurcation of liability and damages, which involves a classwide trial of common issues, leaving damages—and even such individualized issues as causation, reliance and affirmative defenses—to be determined later in individual trials, mini-trials of groups of similar cases or administrative determinations. In recent years, however, several federal circuit courts have taken a dim view of such "phased trials."

The 7th Circuit in *Rhone-Poulenc*, and the 5th Circuit in *Castano*, raised constitutional issues when a case is bifurcated and a different jury decides later phases. Many courts have not followed this position, finding that "re-examination" of facts found by the first jury can be avoided, thus allowing

phased trials. Whether predominance can be satisfied may depend on the court in which the class action is sought. But it is clear that in some jurisdictions, such as the 5th Circuit, consumer class actions will rarely be approved.

Choice of law also is critical to a court's ruling on whether predominance exists to certify a class. If the laws of many different states apply, and there are variations within those laws, a single jury charge may be impossible, and the predominance requirement cannot be satisfied.

Some courts have been willing to overlook small differences in order to find a common standard for the jury charge. Some have determined that various state laws can be fit into a small number of categories, allowing a jury to apply the different standards by answering different interrogatories. *In re School Asbestos Litigation*, 789 F.2d 996 (3d Cir. 1986) and *In re Prudential Insurance Co. of America Sales Practices Litigation*, 962 F. Supp. 450 (D.N.J. 1997).

Other courts, however, have refused to meld disparate state laws. Reversing a nationwide class certification in *Rhone-Poulenc*, the 7th Circuit's Posner objected to the lower court's proposal "to substitute a single trial before a single jury instructed in accordance with no actual law of any jurisdiction—a jury that will receive a kind of Esperanto instruction, merging the negligence standards of the 50 states and the District of Columbia."

Some federal courts have found that, under the relevant state choice-of-law rules, the law of a single state can be applied, such as where the defendant manufactured the defective product or orchestrated the deceptive scheme.

But when, in a tire defect case, a district court in Indiana applied the law of the two states where Ford and Bridgestone/Firestone had their headquarters, the 7th Circuit decided that Indiana choice-of-law rules required application of the law of each state in which a class member's car tires had the claimed defect, and thus individual issues predominated. *In re Bridgestone/ Firestone Inc.*, 288 F.3d 1012 (2002).

Two years before Congress passed CAFA, amendments to Rule 23 went into effect that addressed one of the most controversial aspects of class actions: settlements.

Class action settlements sometimes have appeared to be "sweetheart deals" where the defendants got off lightly, the class attorneys received big fees—and members of the consumer class didn't get much. The 2000 Rand report noted that "the powerful financial incentives that drive plaintiff attorneys to assume the risk of litigation intersect with powerful interests on the defense side in settling litigation as early and as cheaply as possible, with the least publicity."

The 2003 amendments imposed strict judicial oversight over settlements. A court may approve a settlement only after a "fairness" hearing at which the history and terms of the settlement are examined to determine whether the settlement and attorney fees are reasonable. Any class member may object, and the court may require a new opportunity for class members to opt out after learning of the terms of the settlement (even though they didn't opt out earlier when they received notice of the class action suit). The parties have to reveal any side agreements made in connection with the settlement.

A notorious aspect of consumer class actions has been the use of "coupon settlements" in which plaintiffs class members receive discounts on future purchases from the defendant rather than cash. The 2003 amendments to Rule 23 did not directly address them, leaving them to be scrutinized by courts in accordance with their general oversight powers over settlements. CAFA does contain express limitations on coupon settlements.

But courts were starting to look askance at coupon settlements even before the Rule 23 amendments and CAFA went into effect.

Sometimes coupon settlements make sense. If the defendant's finances are shaky and a large cash settlement could drive it into bankruptcy, a coupon settlement may be the only way to get some value to the class members. There also are cases where the cash recovery for each class member would be small, and a coupon for future purchases of a product or service that class members continue to need—as in a suit for overcharges on utility bills—provides genuine value.

But a settlement that requires class members to buy the same product or service whose defect was the subject of the suit often is essentially a sales promotion for the defendant.

In a suit claiming a product defect in certain GM pickup trucks, for instance, class members were given a coupon for $1,000 off the purchase of a new GM pickup, which could also be exchanged for a $500 coupon transferable to someone else who wanted to buy a GM vehicle. But the Philadelphia-based 3rd Circuit refused to approve the settlement, finding it to be "a sophisticated GM marketing program" that had little benefit for class members. *In re General Motors Corp. Pick-Up Truck Fuel Tank Products Liability Litigation*, 55 F.3d 768 (1995).

There are some cases where the amount of damages to which each class member is entitled is so small that it would cost more to administer a claims process and mail out checks. Courts may then approve a "fluid recovery" that involves applying part or all of the damages to a project that is related to the injury done, such as making a polluter plant trees.

In 2003, a combination of individual compensation and fluid recovery was used in the settlement of a class action alleging price-fixing by the major producers of compact discs. People who affirmed under oath on a Web site that they had purchased at least one CD received $14. In addition, the defendants donated 5.6 million CDs to libraries and educational institutions. *In re Compact Disc Minimum Advertised Price Antitrust Litigation*, 216 F.R.D. 197 (D. Me.).

A DOUBTFUL FUTURE

The assaults on consumer class actions have not yet ended. The federal restrictions on class actions have been matched in many states by substantive law instigated by the tort reform movement, which is supported by many of the business interests that also have sought restrictions on class actions.

The results of efforts to change tort laws differ from state to state, but in general there has been an adverse effect on causes of action creating liability. One example is the adoption in some states of a requirement that individual reliance be shown to support claims of common-law fraud or misrepresentation, and claims of deceptive trade practices under consumer protection statutes. In addition to limiting liability, these requirements can undermine class actions because courts would be likely to find that individualized issues of reliance predominate.

Recent attempts to pre-empt state common-law remedies with federal administrative regulations also have a constricting effect on consumer class actions by altering substantive standards.

Under the Bush administration, a number of federal regulatory agencies have issued standards purporting to preempt state causes of action, but which consumer advocates maintain are inadequate. The Food and Drug Administration, for example, added a provision to its rule on prescription drug labels stating that FDA approval "pre-empts conflicting or contrary state laws." The battle over pre-emption is heating up in the courts.

On another front, business groups have proposed an “opt in” rule for class actions under which only individuals who affirmatively opt to join a suit would become class members.

Currently, individuals have a right to opt out if they don’t wish to participate in a class action. The decision to opt out normally requires some form of written notice.

The percentage of opt-outs is typically very small. Critics say this is an indication that many class members are not interested enough or just don’t bother to mail in the opt-out form. Consumer advocates say it reflects recognition by class members that staying in the class in hopes of getting something is their only viable option.

Finally, consumer class actions are threatened by arbitration clauses in consumer contracts that prohibit claims to be pursued on a class action basis.

Whether such prohibitions are enforceable is an increasingly controversial issue.

They have been challenged as unconscionable on grounds that they deny access to justice. The argument is that in small-dollar cases, consumers lack the financial ability or economic incentive to pursue arbitration individually, while arbitration conducted on behalf of a class of individuals would be viable.

Courts have differed on this issue, with federal courts often more ready to enforce the class ban than state courts. A number of states, including California and New Jersey, provide for classwide arbitrations, but it has been argued that the Federal Arbitration Act pre-empts such state law limitations on arbitration. It seems likely that the issue will ultimately have to be decided by the U.S. Supreme Court.

Class actions are a uniquely American legal mechanism, but even as they come under fire in their homeland, they are being scrutinized with growing interest in foreign jurisdictions. In today’s complex global economy, there is recognition that the claims of many individuals can arise from the same basic conduct, product or environmental condition, and that denying some form of group action may effectively deny individuals of any realistic legal recourse.

A 1998 European Union directive requires member countries to adopt some form of “group litigation,” and the EU consumer affairs commissioner is considering a new system of “collective redress” that would allow consumers to bring claims against providers of faulty goods or services. But requirements for EU group actions may provide that they be brought only by recognized consumer organizations and that class members opt in.

Meanwhile, the future of class actions in the United States is likely to depend largely on how the federal courts treat them in the new, post-CAFA world.

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