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Common Themes and Unintended Consequences in Class Action Reform

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COMMON THEMES AND UNINTENDED CONSEQUENCES IN CLASS ACTION REFORM

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The reform pendulum has been swinging in the direction of limiting the scope and flexibility of the class action procedural device. The Private Securities Litigation Reform Act (PSLRA),[1] the Securities Litigation Uniform Standards Act (SLUSA),[2] the Class Action Fairness Act (CAFA),[3] Federal Rule of Civil Procedure 23 (Rule 23),[4] various state statutes and rules,[5] and a variety of state[6] and U.S. Supreme Court decisions[7] have included significant efforts to make class actions look more like traditional one-on-one litigation. These efforts have focused on five overlapping areas: public transparency, client control and attorney selection, attorney fees, suit selection, and an increased judicial role. At the same time, however, these reforms have generated unintended consequences that have the potential for creating new problems or undercutting the efficacy of the reforms themselves.

REFORM THEMES

The Private Securities Litigation Reform Act, the Securities Litigation Uniform Standards Act, the Class Action Fairness Act, recent amendments to Federal Rule of Civil Procedure 23, and recent U.S. Supreme Court decisions share a number of consistent themes. These reforms are designed to curb perceived abuses in Rule 23 practice by requiring class action cases to conform generally to a model more closely akin to traditional litigation. The explicit goal of the PSLRA and SLUSA is to place limitations on the excesses of securities litigation. The findings in CAFA

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1. Private Securities Litigation Reform Act of 1995, 15 U.S.C.A. § 78u *et seq.*
2. Securities Litigation Uniform Standards Act of 1998, 15 U.S.C.A. §§77p(a)-(f).
3. Class Action Fairness Act of 2005, Pub. L. No. 109-2, 118 Stat. 4 (to be codified at 28 U.S.C.A. §§ 1711–1715).
4. FED. R. CIV. P. 23.
5. *See, e.g.*, ALA. CODE, §§ 6-5-640 to 642 (LexisNexis Supp. 2004), AL. R. CIV. P. 23.
6. *See, e.g.*, Sw. Ref. Co. v. Bernal, 22 S.W. 3d 425 (Tex. 2000).
7. *See, e.g.*, Ortiz v. Fibreboard Corp., 527 U.S. 815 (1999); Amchem Prods., Inc. v. Windsor, 521 U.S. 591 (1997).

focus on a variety of abuses of the class action device, specifically in the areas of excessive attorney fees, inadequate recoveries, and conflicting or unfair outcomes in state courts. Recent amendments to Rule 23 have been directed toward the undemocratic empowerment of lead counsel, problems in the award of attorney fees, and difficulties in coping with objections. The latest U.S. Supreme Court cases have addressed the adequacy of representation, the fungibility of class members, and the appropriate role for the federal judiciary. The following list of five common themes and several illustrations of each theme suggests the overlapping approaches taken by these reform efforts.

1. Public Transparency. One of the more important themes in class action reform has been to increase the light of day in proceedings. Rule 23(e)(4)(A) provides that "[a]ny class member may object to a proposed settlement, voluntary dismissal, or compromise that requires court approval. . . ."[8] Once an objection is lodged, however, it "may be withdrawn only with the court's approval."[9] Apparently some class action lawyers decided to pay a premium to objectors rather than fight objections through the normal legal process. The rule change prevents such agreements unless the court approves.

The Class Action Fairness Act contains provisions requiring defendants who are proposing the settlement of a class action to notify appropriate federal or state officials of the complaint, fairness hearing, notice to class members, proposed settlement agreements with class counsel, and other relevant information about the proposed resolution.[10] The concept is that public officials who may have some interest in protecting the interests of the public would be able to deter unwise settlements. Alabama requires "a full evidentiary hearing on class certification" to avoid "drive-by" certifications.[11]

2. Client Control and Attorney Selection. One major concern about the use of the class action device has been the control exercised by lead counsel without adequate governance by the clients. The 2003 amendments to Rule 23 address this issue by separating the Rule 23(a)(4) consideration of adequacy of representation from the Rule 23(g) selection of lead counsel.[12] Rule 23(g) also lists a variety of specific factors that

8. FED. R. CIV. P. 23(e)(4)(A).
9. FED. R. CIV. P. 23(e)(4)(B).
10. Class Action Fairness Act of 2005 (CAFA), 28 U.S.C.A. § 1715 ("Notifications to appropriate federal and state officials.").
11. ALA. CODE § 6-5-641(d) (LexisNexis Supp. 2004).
12. FED. R. CIV. P. 23(g).

courts "must consider" in appointing class counsel.[13] The 2003 amendments to the Texas class action rule mirror the federal rule.[14] The Texas Rules of Civil Procedure also provide that the "court may order the naming of additional parties in order to insure the adequacy of representation."[15]

The PSLRA and SLUSA go even further for courts to focus on the most adequate plaintiff and to select lead counsel based upon their representation of the party with the most significant financial interest.[16]

Amchem Products, Inc. v. Windsor and *Ortiz v. Fibreboard Corp.* address in some detail the necessity for class counsel not to have any conflict in connection with their representation.[17] If counsel is to represent a class, the class must be sufficiently homogenous that there are no class members who are disadvantaged because of minority interests that they might possess.[18]

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13. FED. R. CIV. P. 23(g):

(g) Class Counsel.

(1) Appointing Class Counsel.

(A) Unless a statute provides otherwise, a court that certifies a class must appoint class counsel.

(B) An attorney appointed to serve as class counsel must fairly and adequately represent the interests of the class.

(C) In appointing class counsel, the court (i) must consider: the work counsel has done in identifying or investigating potential claims in the action, counsel's experience in handling class actions, other complex litigation, and claims of the type asserted in the action,counsel's knowledge of the applicable law, and the resources counsel will commit to representing the class;

(ii) may consider any other matter pertinent to counsel's ability to fairly and adequately represent the interests of the class;

(iii) may direct potential class counsel to provide information on any subject pertinent to the appointment and to propose terms for attorney fees and nontaxable costs; and

(iv) may make further orders in connection with the appointment.

(2) Appointment Procedure

(A) The court may designate interim counsel to act on behalf of the putative class before determining whether to certify the action as a class action.

(B) When there is one applicant for appointment as class counsel, the court may appoint that applicant only if the applicant is adequate under Rule 23(g)(1)(B) and (C). If more than one adequate applicant seeks appointment as class counsel, the court must appoint the applicant best able to represent the interests of the class.

(C) The order appointing class counsel may include provisions about the award of attorney fees or nontaxable costs under Rule 23(h).

14. TEX. R. CIV. P. 42(g).

15. TEX. R. CIV. P. 42(c)(1)(c).

16. 15 U.S.C. § 77z-1(a)(3)(B)(iii)(I)(bb); 15 U.S.C. §§77p(b)-(c).

17. Amchem Prods., Inc. v. Windsor, 521 U.S. 591, 625 (1997); Ortiz v. Fibreboard Corp., 527 U.S. 815, 852 (1999).

18. *Amchem*, 521 U.S. at 627; *Ortiz*, 527 U.S. at 854.

3. Attorney Fees. Probably the most fervently expressed criticisms of class actions have been directed at the compensation of class counsel. CAFA addresses the attorney fee issue in several directions. It limits contingent fees in "coupon settlements" to the coupons that are actually redeemed rather than the total coupons offered to class members. In non-contingent fee coupon settlements, the court shall approve the amount of attorney fees.[19]

Rule 23(h) directs the court to consider attorney fees by motion in accordance with Rule 54(d)(2), to hold a hearing, and to make findings of fact and conclusions of law under Rule 52(a).[20] Texas, for example, amended its class action rule in 2003 to require an hourly rate calculation approach to the determination of attorney fees and a limitation on the lodestar range.[21]

4. Suit Selection. Reform efforts address suit selection by plaintiffs' attorneys in several ways. The PSLRA requires counsel to meet a threshold evidentiary requirement before being allowed to commence formal pre-trial discovery.[22]

Rule 23(c) provides that "the court must—at an early practicable time—determine by order whether to certify the action as a class action."[23] "Conditional" certification has been deleted.[24] There is also the opportunity to seek an appeal of a class certification decision to a court of appeals.[25]

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19. 28 U.S.C. § 1712(a)-(e) discusses attorney fees in the context of coupon settlements.
20. FED. R. CIV. P. 23(h).
21. TEX. R. CIV. P. 42(i):

    (i) Attorney's fees award.

    (1) In awarding attorney fees, the court must first determine a lodestar figure by multiplying the number of hours reasonably worked times a reasonable hourly rate. The attorney fees award must be in the range of 25% to 400% of the lodestar figure. In making these determinations, the court must consider the factors specified in Rule 1.04(b), Tex. Disciplinary R. Prof. Conduct.

    (2) If any portion of the benefits recovered are in the form of coupons or other noncash common benefits, the attorney fees awarded in the action must be in cash and noncash amounts in the same proportion as the recovery of the class.

22. 14 U.S.C. § 78u-4(b)(2):

    (2) Required state of mind

    In any private action arising under this chapter in which the plaintiff may recover money damages only on proof that the defendant acted with a particular state of mind, the complaint shall, with respect to each act or omission alleged to violate this chapter, state with particularity facts giving rise to a strong inference that the defendant acted with the required state of mind.

23. FED. R. CIV. P. 23(c)(1)(A).
24. FED. R. CIV. P. 23(c)(1)(C); *see* Advisory Committee notes.
25. FED. R. CIV. P. 23(f).

CAFA deals with the perceived problem of plaintiffs' counsel selecting unmeritorious cases by limiting the forum for those suits.[26] It provides original jurisdiction to federal courts where there is more than $5,000,000 in dispute and there is minimal diversity.[27] Federal district courts may decline to exercise jurisdiction when the proceeding involves more state-oriented, rather than national, claims.[28] The goal is to channel class actions to federal courts which have not been as hospitable to Rule 23 certification and to prevent these cases from re-emerging as state class actions.

The U.S. Supreme Court and courts of appeals have been skeptical of Rule 23 being used either for trial or settlement of personal injury cases.[29] Notwithstanding the asbestos,[30] IUD,[31] pharmaceutical,[32] and other personal injury mass torts[33] that were certified as classes at the end of the last century, the more recent jurisprudence in federal courts has not favored certification.[34] Some state supreme courts have limited the applicability of class actions based upon predominance and choice of law rationales.[35] Alabama allows a stay of discovery on the merits of a lawsuit pending a "rigorous analysis" on class certification.[36]

5. Increased Federal Judicial Role. All of the recent reforms share a propensity to increase the role of federal courts in handling class actions. The theme of the PSLRA, SLUSA, CAFA, Rule 23, and Supreme Court decisions seems to be that federal judges should be gatekeepers to insure that cases are not certified as classes unless the cases meet certain prerequisites. The SLUSA, for example, explicitly supplemented the PLSRA to allow for removal of cases that sound like a securities law claim.[37] This approach is driven in part by the problems defendants face in defending certified class actions, even if a lawsuit is subsequently determined to be unmeritorious.

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26. 28 U.S.C. § 1711 (providing for original jurisdiction in federal district courts).
27. *Id.* at § 1711(a)(2).
28. *Id.* at § 1711(3).
29. *See, e.g.*, Amchem Prods., Inc. v. Windsor, 521 US. 591 (1997); Ortiz v. Fibreboard Corp., 527 U.S. 815 (1999).
30. *See, e.g.*, Jenkins v. Raymark Indus., 831 F.2d 550 (5th Cir. 1987).
31. *See, e.g.*, *In re* A. H. Robins Co., 880 F.2d 709 (4th Cir. 1989).
32. *See, e.g.*, *In re* Diet Drugs Prods. Liab. Litig., Nos. 1203, 99-20953, 2000 WL 1222042, at *32–40 (E.D. Pa. Aug. 28, 2000).
33. *In re* Silicone Gel Breast Implants Prods. Liab. Litig., 174 F. Supp. 2d 1242 (N.D. Ala. 2001), *aff'd in part and rev'd in part*, United States v. Baxter Int'l, Inc. 345 F.3d 866 (11th Cir. 2003), *cert. denied*, 542 U.S. 946 (2004).
34. *See, e.g.*, *In re* Rhone-Poulenc Rorer, Inc., 51 F.3d 1293 (7th Cir. 1995).
35. Sw. Ref. Co. v. Bernal, 22 S.W.3d 425 (Tex. 2000).
36. ALA. CODE §§ 6-5-641(c) and (e) (LexisNexis Supp. 2004).
37. 15 U.S.C. §§ 77p(b).

A similar thrust exists with the selection of counsel, the fairness of settlement, and the award of attorney fees. Not only are judges to scrutinize these issues carefully, but they must also justify their decisions which are subject to appellate review.[38]

UNINTENDED CONSEQUENCES

Be careful what you ask for because you might get it. These reform themes are now confronting the innovativeness of the plaintiffs' bar and the future is filled with unforeseeable ramifications. Although the authors of reform have the advantage of defining the rules of the game, there is the related disadvantage of being a stationary target. The range of options to circumvent stable rules is continuously subjected to the inventiveness of counsel. Given sufficient financial incentives or a narrowing range of alternative litigation opportunities, the marketplace of litigation has been fertile ground for unpredictable outcomes. By preferring plaintiffs under the PSLRA to be large financial entities,[39] there are now extremely aggressive institutions with enormous political power leading cases rather than anonymous individual investors.[40] At the same time, those sophisticated financial institutions seem to be selecting the same plaintiffs' securities firms who were ubiquitous in the pre-PSLRA era.[41]

The involvement of public officials, particularly state attorneys general, into the class action arena seems to be creating a new dynamic that may have seemingly perverse effects.[42] This will particularly be true if state attorneys general follow the tobacco model of contracting out to private plaintiffs' lawyers the task of seeking redress of public wrongs through the use of class action.[43]

Class action defendants have always been schizophrenic about Rule 23. They generally are opposed to class certification, but once a case is certified, they prefer the ability of a class action to achieve finality. Facing large numbers of individual claims with the concomitant transaction costs presents a defendant with a dilemma. Resolving all the claims in a class

38. FED. R. CIV. P. 23.

39. 15 U.S.C. § 77z-1(a)(3).

40. Gretchen Morgenson, *Morgan Accord Over WorldCom Costs $2 Billion*, N.Y. TIMES, Mar. 17, 2005, at A1.

41. *See* Stephen J. Choi, Jill E. Fisch, & A.C. Pritchard, *Do Institutions Matter? The Impact of the Lead Plaintiff Provision of the Private Securities Litigation Reform Act*, 83 WASH. U. L.Q. 869 (2005).

42. Stephen Labaton & Steve Lohr, *U.S. and Some States Split on Microsoft, Risking New Delay*, N.Y. TIMES, Nov. 6, 2001, at C1.

43. Peter Katel, Spoils of Law, NEWSWEEK, Dec. 8, 1997, at 53.

action may be a far more attractive outcome from a business perspective than proceeding with the traditional litigation model. Eliminating the availability of class actions for global resolution may narrow a defendant's exit strategies in unanticipated ways.[44]

Probably the most interesting ramifications of these themes in class action reform relate to the judiciary. The assumption underlying CAFA, for example, is that the current lack of hospitality for class actions in federal courts will be a persistent phenomenon. If federal courts are the only game in town because state courts have been removed from the class action arena, will we find compelling facts creating more hospitality? The pressure of more work for federal courts could lead to procedures that were not envisioned by the CAFA authors.

Another area of judicial uncertainty arises from the tendency of the Supreme Court to favor principle over pragmatism in its class action decisions.[45] There is a proud tradition of bottom-up reform in the judicial process where trial courts perceive a need to resolve cases even if it means using innovative procedures. Oftentimes appellate courts are initially resistant to variations in traditional approaches, but when the pressure to resolve cases intensifies, new procedures can evolve.[46] Appellate courts always face the perfect being the enemy of the good. One argument to explain the recent phenomenon of the "vanishing" federal trial is that the federal courts are producing a product that litigators no longer want to buy.[47] The war of attrition strategy pursued by counsel in most major litigation is in part a result of the federal courts' requirements for expensive dispute resolution. Will the pressures for more economical and streamlined litigation lead to new judicial procedures? Or will the need for legal redress manifest itself in unpredicted manners?

CONCLUSION

Recent reforms in class actions have been directed at common themes of public transparency, client control and attorney selection, attorney fees, suit selection, and an increased judicial role. Reactions to those reforms are beginning to emerge, some of them in unexpected fashions. The

44. *See generally* Francis E. McGovern, *Settlement of Mass Torts in a Federal System*, 36 WAKE FOREST L. REV. 871 (2001); Francis E. McGovern, *The Defensive Use of Federal Class Actions in Mass Torts*, 39 ARIZ. L. REV. 595 (1997).

45. *Id.*

46. Jenkins v. Raymark Indus., 831 F.2d 550 (5th Cir. 1987).

47. *See generally* Symposium, *The Civil Trial: Adaptation and Alternatives*, 57 STAN. L. REV. 1255 (2005) (entire issue).

innovativeness of the plaintiffs' bar in circumventing stationary statutory targets, and the reactions of the federal judiciary to its new responsibilities and duties will continue to be fertile ground for the ebb and flow in class action procedure.