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Supreme Court Divide Hampers Nearly All Class Actions

Law360, New York (January 08, 2014, 6:09 PM ET) -- The U.S. Supreme Court has recently shown a great interest in the area of class actions and aggregate litigation. The decisions of the last term, as well as the cases currently on the docket, reveal a court deeply divided over the fundamental question of whether class actions are a valuable part of the legal system. The justices disagree, in increasingly strident tones, over the nature and quantum of proof required at the class certification stage; the policy consequences of enforcing class action waivers embedded in arbitration clauses; and the proper interpretation of the Class Action Fairness Act, among other matters.

While much of this jurisprudence lacks doctrinal consistency, one thing is clear: the court's recent decisions have made it far more difficult to certify, maintain or settle a class action. Nearly all major substantive areas of class action litigation are implicated by the court's recent decisions, as described in the case briefs below.

Securities Fraud Class Actions

Amgen v. Connecticut Retirement Plans and Trust Funds*, 133 S.Ct. 1184 (2013)*

Many observers expected that the Court in Amgen Inc. v. Connecticut Retirement Plans and Trust Funds would address the increasingly controversial question of whether plaintiffs in a securities fraud class action can properly rely on the "fraud-on-the-market" presumption at the class certification stage. See Basic v. Levinson, 485 U.S. 224 (1988). Under this theory, courts presume that all members of the putative class indirectly relied on the alleged misrepresentation in deciding whether to buy or sell the defendant's stock through their reliance on the stock's market price, so long as the lead plaintiff can show that the stock traded in an efficient market.

The Amgen plaintiffs alleged that the company had artificially inflated the price of its stock by knowingly and recklessly making material misrepresentations concerning the safety of two of its pharmaceutical drugs. At class certification the plaintiffs presented expert testimony to show that Amgen stock had been traded in an efficient market, but made no showing about the materiality of Amgen's alleged misstatements.

The defendant opposed class certification on the grounds that plaintiffs had failed to establish the materiality of the misstatements, and therefore could not base classwide reliance on the fraud-on-the-market theory. Amgen also argued that it should be allowed to rebut the presumption with proof that the market had already accounted for any alleged misstatements.

The district court certified the class, finding defendant's arguments went to the merits rather than class

certification; the Ninth Circuit affirmed. This underscored an existing circuit split between the Ninth and Seventh Circuits, and the Second Circuit, which had previously required a showing of materiality at class certification. See In re Salomon Analyst Metromedia Litig., 544 F.3d 474 (2d Cir. 2008).

The Supreme Court, in a 6-3 decision authored by Justice Ruth Bader Ginsberg, affirmed certification, but did not address the fraud-on-the-market theory directly, finding the issue was not properly before the court. Rather, the court's liberal wing, joined by Chief Justice John Roberts and Justice Samuel Alito, agreed with the courts below that materiality is ordinarily an issue to be decided at the merits stage: "Amgen … would have us put the cart before the horse. To gain certification under Rule 23(b)(3), Amgen and the dissenters urge, Connecticut Retirement must first establish that it will win the fray. But the office of a Rule 23(b)(3) certification ruling is not to adjudicate the case; rather, it is to select the 'method' best suited to adjudication of the controversy 'fairly and efficiently.'"

The majority also concluded that proof of materiality was not necessary to establish commonality under Rule 23(b)(3). While acknowledging that its decision in Wal-Mart Stores Inc. v. Dukes, 131 S.Ct. 2541 (2011), requires that class certification issues that overlap with the merits must be decided, the majority reiterated that merits questions may be considered only to the extent they are relevant to determining whether the plaintiff can satisfy Rule 23. Justice Ginsberg wrote: "Rule 23(b)(3) requires a showing that questions common to the class predominate, not that these questions will be answered on the merits, in favor of the class."

Justice Alito filed a one-paragraph concurrence to suggest that the fraud-on-the-market presumption may rest on faulty premises, such that "reconsideration of the Basic presumption may be appropriate."

Justice Clarence Thomas, joined by Justices Anthony Kennedy and Antonin Scalia, wrote the principal dissent, arguing that the majority's approach was doctrinally incoherent. For the dissenting justices, without demonstrating materiality at class certification, plaintiffs could not establish Basic's fraud-on-the-market presumption, and without the presumption, plaintiffs could not demonstrate that the otherwise individual questions of reliance would predominate. Justice Scalia separately dissented, contending that the Basic decision could not be extended to allow certification of all market-purchase and market-sale class action cases.

***Erica P. John Fund Inc. v. Halliburton**, 13-317 (2013)*

On Nov. 15, 2013, the Supreme Court granted review of Erica P. John Fund Inc. v. Halliburton. The justices first reviewed this case in 2011, 131 S.Ct. 2179, unanimously finding that plaintiffs do not have to prove "loss causation" to certify a securities fraud class action. To a large extent, the earlier decision has been interpreted as a reaffirmation of the presumption of classwide reliance under the fraud-on-the-market theory. This time, the case provides an opportunity to re-examine, as Justices Alito and Scalia proposed in Amgen, the continuing viability of the Basic v. Levinson rule.

If the court eliminates Basic's fraud-on-the-market presumption altogether, then each member of a proposed class will be required to prove that he, she or it actually relied on a defendant's alleged misrepresentations, and common issues will likely no longer predominate. In short, courts will deny certification of class actions in securities actions where reliance is an essential element of the claim — which is all or nearly all securities class action cases. Argument is set for March 5, 2014.

Notably, there are a number of related cases on the current docket relating to the Securities Litigation Uniform Standards Act (SLUSA). See Chadbourne & Parke LLP v. Troice, 12-79; Willis of Colorado v.

Troice, 12-86; Proskauer Rose LLP v. Troice, 12-88 (all argued Oct. 7. 2013).

Antitrust Class Actions

Comcast Corp. v. Behrend, 133 S.Ct. 24 (2012), may be a major victory for the defense side and for critics of class actions. The 5-4 decision, authored by Justice Scalia, held that an antitrust damages class action cannot be certified unless plaintiffs present a damages model linked to the theory on which liability is premised establishing that damages are capable of measurement on a classwide basis.

The underlying case was brought on behalf of two million cable subscribers alleging various anti-competitive practices. At the class certification stage, plaintiffs proposed four theories of antitrust impact but only one model for calculating classwide damages, which did not isolate damages resulting from any one theory of antitrust impact. (Comcast did not object to this report or seek to challenge the analysis under Daubert). Comcast opposed class certification, arguing that the plaintiffs had not established predominance under Rule 23(b)(3) with regard to the methodology for classwide damages. The district court accepted one of plaintiffs' theories of antitrust impact, but rejected the rest.

The district court certified the class after a multiday evidentiary hearing. A divided Third Circuit affirmed, finding the plaintiffs could prove antitrust impact using evidence common to the class and the resulting damages were capable of measurement through plaintiff's expert's damage model without labyrinthine individual calculations. The majority suggested that Comcast's attack on the plaintiffs' expert methodology was premature; such challenges belonged at the merits stage rather than at class certification.

Instead, at this preliminary stage, a court need only determine whether the proposed damages model "could evolve to become admissible evidence"; here, the district court had been correct in accepting the plaintiffs' assurances that it could. On this point, the court noted that the Supreme Court's decision in Wal-Mart only "require[d] a court to evaluate whether an expert is presenting a model which could evolve to become admissible evidence, and not requiring a district court to determine if a model is perfect at the certification stage."

The Supreme Court granted review and reversed on the grounds that the damages model presented by the plaintiffs' expert had failed to measure classwide damages based on the specific theory of antitrust impact adopted below. The majority reiterated that it may be necessary, in some cases, for a court to resolve merits issues that overlap with class certification questions.

The court found that the Third Circuit had failed to do so when it refused to hear Comcast's arguments challenging the plaintiffs' damages model. And, because the plaintiffs' damages model did not measure damages attributable to the only remaining theory of liability, there was insufficient proof to establish predominance as required by Rule 23(b): "Calculations need not be exact … but at the class-certification stage (as at trial), any model supporting a plaintiff's damages case must be consistent with its liability case, particularly with respect to the alleged anti-competitive effect of the violation."

In dissent, Justices Ginsburg and Stephen Breyer, joined by Justices Sonia Sotomayor and Elena Kagan, claimed that the majority opinion broke no new ground on the standard for certifying a class action under Rule 20(b)(3). The dissent argued that individual damage calculations do not preclude Rule 23(b)(3) class certification, and that plaintiffs can certify a class where common issues predominate over individual damages calculations.

Circuit Court Decisions After Comcast

Whirlpool Corp. Front-Loading Washer Prods. Liability Litigation, *722 F.3d 838 (6th Cir. 2013).*

This was a single-state damages class action alleging that various Whirlpool front-loading washing machine models had a design defect which caused mold and mildew to develop inside the barrel. The defendant opposed class certification on the grounds that not all class members had experienced the mold or mildew, there were 21 different models, and consumers' laundry habits and experiences are too diverse so that Rule 23(b)'s commonality had not been met. The district court certified a liability-only class reserving proof of damages for individual determination, and the Sixth Circuit affirmed.

The case was GVR'ed by the Supreme Court after Comcast, 133 S. Ct. 1722 (2013) (mem.), and, on remand, the Sixth Circuit reaffirmed. The Whirlpool II panel determined that, under Ohio law, all washing machine owners were injured at the point of sale upon paying a premium price for the washing machines as designed, even those who had not experienced a mold problem, and Whirlpool's negligent failure to disclose the washing machines' propensity for mold similarly injured all washing machine owners. Further, the court relied on Amgen's ruling that plaintiffs "need not prove that each element of a claim can be established by classwide proof" in upholding certification of a liability class only.

Butler v. Sears, Roebuck & Co.*, 727 F.3d 796 (7th Cir. 2013).*

This case, which also involved defective washing machines manufactured by Whirlpool sold under Sears' Kenmore brand, was brought on a breach of warranty theory and was similarly remanded after Comcast. 133 S. Ct. 2768 (2013) (mem.). In this case, too, the court had initially certified a liability class but not a damages class.

Writing for the Seventh Circuit, Judge Richard Posner distinguished Comcast: "Unlike the situation in Comcast, there is no possibility in this case that damages could be attributed to acts of the defendant that are not challenged on a class-wide basis; all members of the mold class attribute their damages to mold." Further, Judge Posner rejected the defendant's argument that class certification requires common proof of damages, asserting it would "drive a stake through the heart of the class action device…to require every member of the class to have identical damages."

For Judge Posner, "the issues of liability are genuinely common issues, and the damages of individual class members can be readily determined in individual hearings, in settlement negotiations, or by creation of subclasses." Any greater requirement would allow defendants to "escape liability for tortious harms of enormous aggregate magnitude but so widely distributed as not to be remediable in individual suits."

In re US Foodservice Inc. Pricing Litigation*, 729 F.3d 108 (2d Cir. 2013).*

In this case, alleging violations of RICO and other claims, the defendant challenged class certification on the grounds, among others, that damages could not be reliably ascertained on a classwide basis. The Second Circuit, in a decision authored by Judge Livingston, affirmed class certification, finding that plaintiffs could rely upon classwide evidence to prove damages. On classwide damages, plaintiffs could show the difference between what each class member actually paid and the amount they were billed, which was directly linked to their underlying theory that misrepresentations on the invoices caused overpayments.

***In re Rail Freight Surcharge Antitrust Litigation**, 725 F.3d 244 (2013).*

A group of shippers brought an antitrust suit against the four major freight railroads accusing them of engaging in a price-fixing conspiracy to impose rate-based fuel surcharges. The court of appeals reversed class certification and remanded for consideration of an issue not initially addressed by the district court: whether plaintiffs' expert's damages model was unreliable because it detected injury where none could exist (a false positive); that is, it yielded similar results showing injury to shippers who were bound to rates before any conspiratorial behavior was alleged to have occurred as to shippers during the alleged conspiracy period. The court concluded, "It is now clear ... that Rule 23 not only authorizes a hard look at the soundness of statistical models that purport to show predominance — the rule commands it."

Class Action Fairness Act Decisions

***Standard Fire Ins. Co. v. Knowles**, 133 S.Ct. 1345 (2013).*

A unanimous court, in a brief decision, rejected a putative class plaintiff's effort to avoid having his case removed to federal court. The Class Action Fairness Act of 2005 gives federal district courts original jurisdiction over class actions in which the matter in controversy exceeds $5 million; the statute further provides that, in order to determine whether a matter exceeds that amount, the "claims of the individual class members must be aggregated." See 28 U.S.C §§ 1332 (d)(2), (5), (6). The plaintiff here brought a class action and stipulated that he and the class would seek less than $5 million. The district court accepted plaintiff's stipulation and remanded to state court; the Eighth Circuit denied appeal.

The court, in a decision authored by Justice Breyer, reversed, finding that "a plaintiff who files a proposed class action cannot legally bind members of the proposed class before the class is certified." Stipulations must be binding to have effect; yet the plaintiff here lacked authority to "speak for those he purports to represent."

***Mississippi ex rel. Hood v. AU Optronics Corp.**, 133 S.Ct. 2736 (2013).*

The attorney general of Mississippi brought a parens patriae suit in state court against manufacturers of LCD televisions alleging a price-fixing conspiracy. The defendants removed the case to federal court, arguing that it was either a class or a "mass action" under CAFA. Pursuant to that statute, a state court mass action in which monetary damages are sought based on the claims of 100 or more people is subject to removal to federal court. The Fifth Circuit determined the case was a mass action and ordered removal. 701 F.3d 796 (5th Cir. 2012).

At oral argument before the Supreme Court on Nov. 6, 2013, the two sides disagreed over whether the real party in interest is the state or the residents on whose behalf the attorney general is seeking damages. Mississippi argued that it was the sole plaintiff in the case, and its claims were based on state law — which the attorney general has authority to pursue on behalf of Mississippi consumers. The parties also quarreled over the proper interpretation of the "public litigation" exception in CAFA. See 28 U.S.C. § 1332(d)(11)(B)(ii)(III) (action not removable where "all of the claims in the action are asserted on behalf of the general public (and not on behalf of individual claimants or members of a purported class) pursuant to a State statute specifically authorizing such action").

Chief Justice John Roberts's questions concerned the asymmetry of state court parens patriae suits, which are nearly identical to private class actions, but which cannot be removed to federal court and

consolidated with similar litigation. He opined that "[i]t would make no sense for a defendant in a class action brought by consumers to ever settle the case [because a defendant is] going to have to pay twice" — both to consumers and the state.

Rule 68

***Genesis Healthcare v. Symczyk**, 133 S.Ct. 1523 (2013).*

An employee brought a collective action under the Fair Labor Standards Act of 1938 on behalf of herself and "other employees similarly situated." 29 U.S.C. § 216(b). She did not respond to petitioner's offer of judgment under Federal Rule of Civil Procedure 68. The district court, finding that no others had opted into her suit and that the Rule 68 offer had fully satisfied her claim, concluded that the employee's suit was moot and dismissed it for lack of subject-matter jurisdiction. The Third Circuit, in an opinion by Judge Anthony Scirica, reversed, finding the employee's individual claim was moot, but her collective action was not. 656 F.3d 189. The panel explained that allowing defendants to "pick off" named plaintiffs before certification with calculated Rule 68 offers would frustrate the goals of FLSA collective actions.

Based upon the court's ruling in Sosna v. Iowa, 419 U.S. 393 (1975), the Third Circuit also noted that, when a class representative's claim is mooted prior to class certification, courts may save similar claims by allowing other putative class members' claims to "relate back" to the original complaint. Finding little difference between FLSA collective actions and Rule 23 class actions in this context, the panel applied the relation-back doctrine and remanded the collective action to the district court for certification.

The Supreme Court granted certiorari. In a 5-4 decision authored by Justice Thomas, the majority assumed that the employee's individual claim had been mooted by the Rule 68 offer, so that the only question was whether "the mere presence of collective-action allegations in the complaint can save the suit from mootness once the individual claim is satisfied." The court found the collective action claims did not save the suit from mootness: once the individual's claim was rendered moot, the entire lawsuit was moot because the named plaintiff no longer had any interest in representing the action. Importantly, the majority held that any contrary mootness/relation-back principles derived from Rule 23 class action jurisprudence were inapt because class actions are "fundamentally different" from FLSA collective actions.

The dissenting opinion by Justice Kagan, joined by Justices Breyer, Ginsburg and Sotomayor, argued that the employee's individual claim had not been mooted by the Rule 68 offer, and that mootness doctrine did not defeat the action on behalf of others.

Importantly, because the majority simply assumed plaintiff's claim had been mooted and did not analyze the terms or timing of the defendant's Rule 68 offer, it failed to resolve a circuit split on whether the failure to accept a Rule 68 offer that fully satisfies a plaintiff's claim can, indeed, moot a claim.

Arbitration and Class Actions

***Oxford Health Plans LLC v. Sutter**, 133 S.Ct. 2064 (2013).*

In this case, an arbitrator interpreted an arbitration clause that required all disputes under an agreement to be submitted to arbitration and not to a court to permit a class arbitration. The defendant sought to vacate the decision under §10(a)(4) of the FAA, which authorizes a federal court to set aside

an arbitral award "where the arbitrator[] exceeded [his] powers." The district court denied the motion, and the Third Circuit affirmed.

In a unanimous opinion authored by Justice Kagan, the court upheld the arbitrator's construction of the arbitration clause to permit class arbitration, because "[t]he parties agreed that the arbitrator should decide whether their contract authorized class arbitration, and he determined that it did." The court noted that it would have faced a different issue if the defendant had argued that the availability of a class arbitration was a question of arbitrability, which is a "gateway matter" presumptively for courts to decide.

In the posture of the case before it, the defendant could not carry its heavy burden under FAA § 10 by merely showing the arbitrator "committed an error — even a serious error." But query how significant this specific ruling will prove, given that most companies have moved to insert specific contractual language prohibiting class arbitration in the wake of the court's 2010 decision in Stolt-Nielsen v. Animalfeeds Int'l. Corp., 130 S. Ct. 1758 (2010), which held that the FAA prohibited arbitrators from imposing class arbitration on parties who had never reached an agreement on class arbitration. (Oxford's arbitration clause predated Stolt-Nielsen.).

***American Express Co. v. Italian Colors Restaurant**, 133 S.Ct. 2304 (2013).*

Plaintiff-merchants brought an antitrust class action against American Express alleging illegal tying. The problem for these plaintiff-merchants was that they were subject to an arbitration clause in Amex's standard-form Card Acceptance Agreement which contained a broad class action waiver.[1] Not only did this waiver prohibit plaintiffs from bringing or participating in class actions in court or in the arbitral forum, it also barred any joinder of claims, prohibited the sharing of "any information relating to" any claim, and prevented claimants from seeking relief "on behalf of … other [merchants]."[2]

In the district court, plaintiffs opposed Amex's motion to compel arbitration on the ground that they would be unable to arbitrate their federal statutory rights under Amex's arbitration clause. Specifically, plaintiffs introduced an expert affidavit opining that an economic antitrust study would cost nearly $1 million, whereas the median plaintiff could only hope to recover $5,252 in trebled damages and the maximum would be $38,549. Applying a common-sense cost-benefit analysis, plaintiffs' expert concluded that "it would not be worthwhile for an individual plaintiff ... to pursue individual arbitration or litigation where the out-of-pocket costs, just for the expert economic study and services," would dwarf any individual claimant's recovery. Defendant did not contest this cost-based evidence, but the district court nonetheless granted the motion to compel arbitration, reasoning that plaintiff's challenge was for the arbitrator to decide. (S.D.N.Y 2006).

In Amex I, the Second Circuit reversed, finding that plaintiffs had met their heavy burden of proving the arbitration clause prohibited them from vindicating their federal statutory rights with evidence that they "would incur prohibitive costs if compelled to arbitrate" because the nonrecoverable, per-claimant costs of bringing their claims in arbitration (as opposed to aggregate proceedings in court) would exceed their expected individual recoveries many times over.

After the Supreme Court vacated the judgment and remanded for further consideration in light of Stolt-Nielsen, 559 U.S. 662 (2010) (mem.), the same panel (less Judge Sotomayor, since elevated to the Supreme Court) reiterated its conclusion in Amex II, writing that "the record evidence before us establishes, as a matter of law, that the cost of plaintiffs' individually arbitrating their dispute with Amex would be prohibitive, effectively depriving plaintiffs of the statutory protections of the antitrust laws."

634 F.3d 187 (2d Cir. 2011).

Then, in the wake of the Supreme Court's decision in AT&T Mobility v. Concepcion, the panel ruled for plaintiffs once more, finding Concepcion's preemption analysis inapplicable to the federal statutory vindication-of-rights challenge at issue in Amex. 667 F.3d 204 (2d Cir. 2012). After a fractious denial of en banc review, 681 F.3d 139 (2d Cir. 2012), the Supreme Court granted certiorari to squarely decide whether the cost-based evidence presented by plaintiffs was sufficient to make out a vindication-of-rights challenge to the arbitration clause.

In a 5-3 decision authored by Justice Scalia, the court reversed. The court reiterated that arbitration agreements must be rigorously enforced according to their terms, even for claims alleging violation of a federal statute. On this view, class action waivers embedded in arbitration clauses are enforceable even where proving the violation of a federal statute in an individual arbitration would prove too costly to pursue. Relying on a formalistic distinction, Justice Scalia wrote: "[T]he fact that it is not worth the expense involved in proving a statutory remedy does not constitute the elimination of the right to pursue that remedy."

Justice Kagan's sharp dissent, joined by Justices Breyer and Ginsburg (Justice Sotomayor was recused, having served on the Amex I, panel), asserted that the majority's response to the possibility that arbitration clauses could now be employed to immunize violators of federal law was "too darn bad." The dissenters argued that the vindication-of-rights doctrine should clearly apply wherever the arbitration clause thwarts federal law by making arbitration prohibitively expensive.

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[1] See In re American Express Merchants' Litigation, 554 F.3d 300, 306 (2009) (Amex I) ("If Arbitration is chosen by any party with respect to a claim, neither you nor we will have the right to litigate that claim in court or to have a jury trial on that claim…Further, you will not have the right to participate in a representative capacity or as a member of any class of claimants pertaining to any claim subject to arbitration…").

[2] Id. ("There shall be no right or authority for any Claims to be arbitrated on a class action basis or on any basis involving Claims brought in a purported representative capacity on behalf of the general public, other establishments which accept the Card (Service Establishments), or other persons or entities similarly situated. Furthermore, Claims brought by or against a Service Establishment may not be joined or consolidated in the arbitration with Claims brought by or against any other Service Establishment(s), unless otherwise agreed to in writing by all parties.").