CLASS ACTION WATCH

A PUBLICATION OF THE FEDERALIST SOCIETY'S LITIGATION PRACTICE GROUP AND ITS CLASS ACTIONS SUBCOMMITTEE

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In This Issue

Volume 4 Number 1
Fall 2005

Early Decisions Interpreting Class Action Fairness Act

Several months after its enactment on February 18, 2005, the Class Action Fairness Act ("CAFA") is beginning to generate a sufficient body of judicial interpretation to identify a number of key issues. Among others, litigants and courts are grappling with questions about which actions were "commenced" before the effective date of CAFA; how to calculate the amount in controversy for purposes of the statute; and what to make of the statute's provisions regarding calculation of attorneys' fees.

While CAFA provides that its jurisdictional and other provisions apply to all actions "commenced" on or after February 18, 2005, the meaning of the word "commence" has already generated significant debate. Some defendants have argued that an action is "commenced" for purposes of the statute on the date it is removed to federal court, regardless of how long the action may have been pending in state court. That position is not without support; several cases decided in connection with statutory amendments increasing the amount-in-controversy requirement of 28 U.S.C. § 1332 have held that the increased jurisdictional amount applied to cases that were removed after the increase took effect—regardless of when they were filed in state court—because the removal date was the date on which the action was "commenced."[1] The first appellate decision under CAFA, however, has declined to adopt that approach. In *Pritchett v. Office Depot, Inc.*,[2] the Tenth Circuit rejected a defendant's removal to federal court of a case that had

Continued on page 9

Reforms to California's Unfair Competition Law Alter Litigation Landscape

While all 50 states have some form of unfair and deceptive trade practices statute, California's Unfair Competition Law, Business and Professions Code Section 17200 *et seq.* (the "UCL"), was unique in that it permitted anyone to bring a claim as a "private attorney general" on behalf of the "general public"—regardless of whether the plaintiff himself had actually been affected by the challenged conduct. Thus, a plaintiff who had never done any business with the defendant, seen the defendant's advertising or used the defendant's products or services could pursue a UCL claim on a quasi-class-action basis without having traditional standing or satisfying any of the due process requirements for class action cases. Not surprisingly, California became the preferred forum for consumer class action litigation in large part because of the UCL; in some cases, plaintiffs' law firms went so far as to file UCL claims naming themselves as the plaintiffs.

On November 2, 2004, California voters approved Proposition 64, which reformed the UCL. Most importantly, Proposition 64 established two new requirements for UCL claims. First, it established a standing requirement for UCL claims, prohibiting private plaintiffs from prosecuting UCL claims unless they suffered "actual injury" and lost money or property. Thus, plaintiffs' lawyers must find a client who actually was harmed by the business practice at issue before they can bring a claim. Second, it requires plaintiffs to meet the class certification requirements of California Code of Civil Procedure Section 382 before they can obtain classwide relief. While there had been some progress by litigants seeking to impose class certification-like requirements on UCL claims, Proposition 64 resolved the question through statutory fiat. Proposition 64 took effect on November 3, 2004.

California Supreme Court To Review Proposition 64's Application To Pending Cases

Although Proposition 64

Continued on page 9

From The Editors

The Federalist Society publishes *Class Action Watch* periodically to apprise both our membership and the public at large of recent trends and cases in class action litigation. The class action lawsuit, defined as a civil action brought by one or more plaintiffs on behalf of a large group of others who have a common interest, is both criticized and acclaimed.

Critics have said that such actions are far too beneficial to the lawyers that bring them in that the attorney fees in settlements are often in the millions of dollars, while the individuals in the group that he or she represents receive *substantially* less.

Proponents of the class action lawsuit, on the other hand, see them both as a mechanism to consolidate and streamline similar actions that would otherwise clog the court system, and as a way to make certain cases attractive to plaintiffs' attorneys.

In this issue, we highlight a decision by the Seventh Circuit which affirmed the "Class Action by Estoppel" theory. In addition, the class action suit, *Pelman v. McDonald's Corp*., is discussed. The claims in *Pelman* allege that McDonald's misrepresented the nutritional value of its products and that "but for McDonald's alleged nutritional and health representations, they [plaintiffs] would not have eaten at McDonald's restaurants three to five times per week."

Future issues of *Class Action Watch* will feature other articles and cases that we feel are of interest to our members and to society. We hope you find this and future issues thought-provoking and informative.

The Re-Emergence of the Reliance Requirement in Federal Securities Class Actions

It is well-established that plaintiffs bringing private claims alleging violations of Section 10(b) of the Securities Exchange Act of 1934 (the "1934 Act") and Rule 10b-5 promulgated thereunder must prove that they relied on the statements or omissions they challenge as materially false or misleading.[1] It is equally well-established that in order to maintain a lawsuit on behalf of a class pursuant to Federal Rule of Civil Procedure 23(b)(3), plaintiffs must demonstrate that the common issues to be resolved on behalf of all class members predominate over any individual issues specific to particular class members, rendering class treatment the most efficient means of adjudication.[2] Taken together, these two requirements would effectively preclude class certification in all but a handful of purported class actions brought on behalf of a large number of purchasers or sellers of a company's publicly-traded securities; individual issues of reliance would nearly always predominate over any common issues to resolve on behalf of the purported class.

For nearly two decades, plaintiffs who themselves never relied on the statements they challenge as materially false or misleading have been able to maintain class-action lawsuits by invoking the "fraud-on-the-market" doctrine. This doctrine, endorsed by the United States Supreme Court in *Basic, Inc. v. Levinson*,[3] creates a rebuttable presumption that plaintiffs who purchased or sold securities on the open market did so in reliance on the integrity of the market price to reflect all available information regarding those securities. Armed with the benefit of this presumption, plaintiffs have been able to overcome the hurdle of demonstrating that common issues predominate over individual ones in actions alleging fraud in connection with publicly-traded securities.

In the last year or so, however, courts have increasingly recognized that the fraud-on-the-market presumption does not automatically apply to all allegations of fraud involving securities. This article discusses several recent cases that evidence a renewed emphasis on requiring plaintiffs who claim to have been deceived to demonstrate that they actually relied, either directly or through the market, on the misrepresentations or omissions forming the basis of their claims.

Overview of the Fraud-on-the-Market Doctrine

In *Basic*, the United States Supreme Court explained the basis for and benefits of a presumption of reliance based on the fraud-on-the-market theory. Recognizing that reliance is an essential element of a Section 10(b) claim, the Court nevertheless reasoned that the modern understanding of that element must evolve in order to reflect the differences between the "modern securities markets, literally involving millions of shares changing hands daily" and "the face-to-face transactions contemplated by early fraud cases."[4] In contrast to face-to-face transactions between buyers and sellers, the Court explained, "[w]ith the presence of a market, the market is interposed between seller and buyer and, ideally, transmits information to the investor in the processed form of a market price."[5] In open-market purchases, the market thus "act[s] as the unpaid agent of the investor, informing him that given all the information available to it, the value of the stock is worth the market price."[6] Noting that Congress itself "expressly relied on the premise that securities markets are affected by information, and enacted legislation to facilitate an investor's reliance on the integrity of those markets," and prompted by "considerations of fairness, public policy, and probability, as well as judicial economy," the Court agreed that "an investor's reliance on any public material misrepresentations . . . may be presumed" for purposes of a Section 10(b) claim.[7]

However, the Court was careful to note that the presumption that plaintiffs relied on the integrity of the market is not conclusive, and may be rebutted by "[a]ny showing that severs the link between the alleged misrepresentation and either the price received (or paid) by the plaintiff, or his decision to trade at a fair market price."[8] Upon such a showing, "the basis for finding that fraud had been transmitted through the market price [is] gone."[9]

Plaintiffs Bear the Burden of Demonstrating the Propriety of a Presumption of Reliance

Several recent cases have made clear that plaintiffs who allege fraud in connection with the purchase or sale of publicly-traded securities cannot simply invoke the fraud-on-the-market theory as justification for class treatment. Instead, plaintiffs must demonstrate an entitlement to the presumption by showing "(1) that the defendant made *public* misrepresentations; (2) that the misrepresentations were *material*; (3) that the shares were traded on an *efficient market*," and that the plaintiffs purchased the shares after the misrepresentations but before the truth was revealed.[10]

Furthermore, plaintiffs' bare allegations will not suffice to establish these requirements, even at the class certification stage. Instead, the district court must conduct a "rigorous analysis" and take a "close look" at relevant matters to determine whether plaintiffs have satisfied the prerequisites to certification.[11] As the Fourth Circuit put it:

> We must not lose sight of the fact that when a district court considers whether to certify a class action, it performs the public function of determining whether the representative parties should be allowed to prosecute the claims of absent class members. Were the court to defer to the representative parties on this responsibility by merely accepting their assertions, the court would be defaulting on the important responsibility conferred on the courts by Rule 23 of carefully determining the class action issues and supervising the conduct of any class action certified.[12]

The Alleged Misrepresentations Must Be Public

Whether or not phrased as a "rigorous analysis" or a "close look," recent cases also have made clear that courts will scrutinize plaintiffs' allegations and evidence before permitting class certification to rest on the fraud-on-the-market doctrine. For example, in *West v. Prudential Securities, Inc.*,[13] the Seventh Circuit rejected plaintiffs' bare allegations that the fraud-on-the-market doctrine could apply to non-public statements. Plaintiffs in *West* alleged that a stockbroker working for Prudential told eleven of his customers that a company was "certain" to be acquired, at a big premium, in the near future, and that he reiterated those statements over a seven-month period.[14] Invoking the fraud-on-the-market theory, plaintiffs sought certification of a class of all open-market purchasers of the company's stock—*not* the eleven customers to whom the broker allegedly made the statements.[15]

The Seventh Circuit reversed the certification order, reasoning that because the statements allegedly made to the eleven customers never became public, there was no basis for a presumption that fraud was transmitted through the market:

> [F]ew propositions in economics are better established than the quick adjustment of securities prices to public information. [citation omitted] No similar mechanism explains how prices would respond to non-public information, such as statements made by [a broker] to a handful of his clients. These do not come to the attention of professional investors or money managers, so the price-adjustment mechanism just described does not operate.[16]

The Alleged Misrepresentations Must Be Material

Two recent opinions in actions against investment banking firms regarding allegedly false or misleading research reports by analysts suggest that the materiality element of the fraud on the market presumption requires plaintiffs to make a showing the certification stage that the allegedly false statements had a measurable impact on the market price of the securities. For example, the Second Circuit questioned the application of the fraud-on-the-market doctrine to certify a class in an analyst case arising out of the collapse of WorldCom.[17] Among the claims asserted by the plaintiffs in *Hevesi v. Citigroup* was a Rule 10b-5 claim against Citigroup, its investment banking subsidiary, and its former telecommunications research analyst, Jack Grubman, over allegedly false statements in research reports about WorldCom issued by Grubman from 1999 to 2002. The District Court certified the claims against Citigroup and Grubman as a class action, employing the fraud-on-the-market doctrine to presume reliance and conclude that class issues predominated in the case over individual issues.[18]

The Second Circuit exercised its discretion to hear an interlocutory appeal because the case "presented an issue that is 'of fundamental importance to the development of the law of class actions.'"[19] "That question is whether a district court may certify a class in a suit against a research analyst and his employer based on the fraud-on-the-market doctrine, without a finding that the analyst's opinions affected the market prices of the relevant securities."[20] In its order accepting jurisdiction over the appeal, the Court noted that the Citigroup defendants had mounted a "substantial legal argument" in support of the position that the fraud-on-the-market doctrine cannot support class certification in analyst cases without a specific finding that the analyst's report affected the market prices.[21] Unfortunately for those hoping for definitive pronouncements on *Hevesi's* "fundamental question" and "substantial legal argument," the parties in *Hevesi* reached a settlement before the Second Circuit could rule on the merits of the controversy, leaving district courts in the Second Circuit and elsewhere to come to their own conclusions for the time being.

In *DeMarco v. Lehman Brothers Inc.*, Southern District of New York Judge Jed Rakoff agreed with the position advanced by Citigroup in *Hevesi*, holding that the fraud-on-the-market doctrine and the consequent presumption of reliance can justify class certification in an analyst case only if the plaintiff adduces evidence that makes a *prima facie* showing that the analyst's opinion actually affected the market price of the securities.[22] The Court based its decision on the "qualitative difference between a statement of fact emanating from an issuer and a statement of opinion emanating from a research analyst."[23] As the Court explained:

A well-developed efficient market can reasonably be presumed to translate the former into an effect on price, whereas no such presumption attaches to the latter. This, in turn, is because statements of fact emanating from an issuer are relatively fixed, certain and uncontradicted. Thus, if an issuer says its profits increased 10%, an efficient market, relying on that statement, fixes a price accordingly. If later it is revealed that the previous statement was untrue and that the profits only increased 5%, the market reaction is once again reasonably predictable and ascertainable.

By comparison, a statement of opinion emanating from a research analyst is far more subjective and far less certain, and often appears in tandem with conflicting opinions from other analysts as well as new statements from the issuer. As a result, no automatic impact on the price of a security can be presumed and instead must be proven and measured before the statement can be said to have "defrauded the market" in any material way that is not simply speculative.[24]

The Court found that the plaintiff had failed to present evidence sufficient to make such a *prima facie* showing and denied class certification.[25]

The Subject Securities Must Trade on an Efficient Market

Finally, the opinion of the Fourth Circuit in *Gariety* emphasizes that plaintiffs must make at least a *prima facie* showing that the subject securities in fact traded on an efficient market. *Gariety* arose from the demise in 1999 of the First National Bank of Keystone, whose stock plaintiffs held. As evidence that Keystone's shares traded on an efficient market, the district court cited a drop in the price of those shares during the days after regulators announced that Keystone was insolvent.[26] The Fourth Circuit concluded that this "single piece of information, standing alone, does not represent adequate evidence" of an efficient market.[27] Instead, the Court reasoned, a district court faced with a motion to certify a class should "consider factors such as, among others, whether the security is actively traded, the volume of trades, and the extent to which it is followed by market professionals."[28]

Judge David Godbey of the U.S. District Court for the Northern District of Texas similarly relied on the absence of an efficient market to deny class certification in *Bell v. Ascendant Solutions, Inc.*[29] There, plaintiffs alleged that the defendant and its executives issued false and misleading statements regarding sales, revenues and business model around the time of the company's public offering, thus artificially inflating its stock price.[30] The court held that because plaintiffs failed to establish the efficiency of the market for the company's stock, plaintiffs would have had "to establish individual reliance for each individual plaintiff—thus foreclosing class certification."[31] Because individual reliance could not be presumed, "the Rule 23 requirement of predominance is not established."[32]

Fraud-On-The-Market: What Next?

Courts seem to be suggesting that the fraud-on-the-market doctrine is not a perpetually green light for certification of class actions brought under the securities laws. Recent decisions show that courts are beginning to turn back cases that fail to satisfy the doctrine's basic assumptions. Whether these decisions reflect a significant change in direction or a minor detour remains to be seen. Given the myriad securities class actions working their way through the court system in the wake of the post-1999 stock market decline and the corporate scandals brought to light in the early part of this decade, however, continued rapid development of the law in this field over the next few years seems likely.

Footnotes

[1] *See, e.g.*, Ernst & Ernst v. Hochfelder, 425 U.S. 185, 206 (1975).

[2] *See* Fed. R. Civ. P. 23(b)(3). Plaintiffs who contend that a defendant's misrepresentations artificially affected the open market price of a company's securities typically attempt to certify classes under (b)(3), and not under Rule 23(b)(1) (addressing class certification where adjudication would prejudice rights of absent parties or create the risk of inconsistent adjudications establishing incompatible standards of conduct) or Rule 23(b)(2) (addressing class certification where plaintiffs seek primarily injunctive or declaratory relief).

[3] 485 U.S. 224 (1988).

[4] *Id.* at 243-44.

[5] *Id.* (quoting *In re LTV Secs. Litig.*, 88 F.R.D. 134, 143 (N.D. Tex. 1980)).

[6] *Id.*

[7] *Id.* at 245-46.

[8] *Id.* at 249.

[9] *Id.*

[10] Gariety v. Grant Thornton LLP, 368 F.3d 356, 364 (2004) (emphasis added) (citing *Basic*, 485 U.S. at 248 n.27).

[11] *Id.* at 365.

[12] *Id.* at 366-67.

[13] 282 F.3d 935 (7th Cir. 2002)

[14] *Id.* at 936.

[15] *Id.* at 936-37.

[16] *Id.* at 938; *see also Gariety*, 368 F.3d at 369 (instructing district court on remand to "address more completely whether Grant Thornton made a public misrepresentation for which it may be found primarily liable").

[17] *See* Hevesi v. Citigroup, Inc., 366 F.3d 70 (2d Cir. 2004).

[18] *See In re* WorldCom, Inc. Sec. Litig., 219 F.R.D. 267 (S.D.N.Y. 2003).

[19] *Hevesi*, 366 F.3d at 80 (quoting *In re* Sumitomo Copper Litig., 262 F.3d 134,

140 (2d Cir. 2001)).

[20] *Id.*

[21] *Id.* at 79.

[22] 222 F.R.D. 243, 247 (S.D.N.Y. 2004).

[23] *Id.*

[24] *Id.*

[25] *But see* DeMarco v. Robertson Stevens, Inc., Case No. 03 Civ. 590 (GEL), 2005 WL 120233 (S.D.N.Y. Jan. 20, 2005) (declining to require a showing of measurable impact at the class certification stage of another analyst case, but noting that such a showing would be required on the merits to meet the materiality element of the fraud-on-the-market presumption).

[26] *See* 368 F.3d at 368.

[27] *Id.*

[28] *Id.*

[29] 2004 U.S. Dist. LEXIS 12321 (N.D. Tex. July 1, 2004).

[30] *Id.* at *1.

[31] *Id.*

[32] *Id.*

SEVENTH CIRCUIT AFFIRMS "CLASS CERTIFICATION BY ESTOPPEL" THEORY; SUPREME COURT DENIES REVIEW

The Supreme Court in January declined to review a Seventh Circuit decision holding that a defendant's support of a proposed class settlement estops the defendant from later opposing certification of a litigation class in the event the proposed settlement is not approved. The defendants had argued that such a result—handed down in *Carnegie v. Household Int'l, Inc.*[1]—would "discourage the settlement of class actions." Rejecting that suggestion, the Seventh Circuit (Posner, J.) noted that "[t]he pressures for settlement of class actions are enormous and will be not be lessened significantly by our upholding the class certification."

Carnegie involved two consolidated challenges to an income tax refund anticipation loan program offered by Household International and H&R Block. On behalf of a nationwide class, the plaintiffs alleged that Household and H&R Block failed to disclose that, under the programs, the tax preparer defendants received referral fees from the bank defendants that originated the refund anticipation loans. This nondisclosure was said to constitute mail and wire fraud, and thus to create liability under RICO, the federal racketeering statute.

After nine years of litigation, the defendants and one of the named plaintiffs entered into a "global settlement" intended to resolve all pending class actions on a classwide basis in exchange for a $25 million settlement payment. As part of the proposed settlement, the defendants joined with the named plaintiff in representing to the district court that the settlement class was certifiable under Fed. R. Civ. P. 23, and the district court duly approved the settlement. The Seventh Circuit reversed, however, finding that the settlement was collusive. On remand, the district court followed the Seventh Circuit's directive, refused to approve the settlement, and appointed new counsel for the plaintiffs. "[R]ather than require the new plaintiff to move for certification[,] the [district] judge asked the defendants for their objections to certification, and they responded." After considering the defendants' class certification objections, the district court then certified a class for litigation—"the same class that had been contemplated by the rejected settlement."

On appeal, the defendants attacked the class certification procedure followed by the district court, arguing that the district court had improperly shifted the burden of persuasion to the defendants by requiring them to show cause why class certification should *not* be granted, and that the district court failed to address the significant manageability issues involved in trying the claims of a multimillion member class. The Seventh Circuit held that the defendants' previous support for a class settlement barred them from challenging certain aspects of class certification. Said the court:

> In the previous round of this protracted litigation the defendants had urged the district court to accept the giant class as appropriate for a global settlement, had prevailed in their urging, and so are precluded by the doctrine of judicial estoppel . . . from challenging its adequacy, at least as a settlement class (the significance of this qualification will appear in due course). It is true that we reversed the district court's approval of the settlement, but a reversal need not affect the application of judicial estoppel . . .. [T]he defendants benefited from the temporary approval of the settlement, which they used to enjoin other [refund anticipation loan] litigation against them; and having reaped a benefit from their pertinacious defense of the class treatment of the case for purposes of settlement they cannot now be permitted to seek a further benefit from reversing their position.[2]

The Seventh Circuit further noted that while the defendants were entitled to challenge two aspects of class certification (manageability and adequacy of representation) notwithstanding their previous support for a certified settlement class, the defendants had failed to proffer a sufficient evidentiary basis for their arguments on those points.

Depending on how it is received in other circuits, *Carnegie* could prove to be a watershed in class action settlement strategy. The immediate significance of *Carnegie* is that, in the Seventh Circuit, defendants that support class certification in the settlement context will need to be particularly careful about ensuring that the requisites of settlement certification under Fed. R. Civ. P. 23(e) are satisfied, since a failure to obtain settlement approval will preclude many objections to later certification of a litigation class. More broadly, *Carnegie* suggests that defendants should be chary of entering into class settlement negotiations before the plaintiff's motion for certification of a litigation class has been decided.

Footnotes

[1] 376 F.3d 656 (7th Cir. 2004), *cert. denied sub nom.* H&R Block, Inc. v. Carnegie, 2005 U.S. LEXIS 465 (Jan. 10, 2005).

[2] *Id.* at 660 (citations omitted).

Second Circuit Reinstates Obestity Class Action Against McDonald's Corp., Rejects Application of Heightened Pleading Standard for Consumer Fraud Claims

The Second Circuit Court of Appeals has reversed a decision of a New York district judge that had dismissed class action claims alleging that McDonald's Corp. deceived its customers into consuming "certain of its foods [that were] substantially less healthy than represented." The decision—*Pelman v. McDonald's Corp.*[1]—may revive obesity class actions against a variety of defendants that some have dubbed the latest incarnation of "lifestyle litigation."

The plaintiffs in *Pelman* had alleged violations of the New York Consumer Protection Act in a five-count class-action complaint. The plaintiffs first alleged that the "combined effect" of McDonald's advertising over a 15-year period "was to create the false impression that its food products were nutritionally beneficial and part of a healthy lifestyle if consumed daily." The plaintiffs' second count alleged that McDonald's had failed to disclose that its use of certain additives and its method of food processing rendered certain foods "substantially less healthy than represented." Next, the plaintiffs alleged that McDonald's had failed to make good on promises to provide nutritional information to its customers. The plaintiffs further alleged that, but for McDonald's alleged nutritional and health representations, they would not have eaten at McDonald's restaurants three to five times per week. Finally, the plaintiffs alleged that their frequent consumption of McDonald's food over a period of years caused a variety of health problems, including obesity, diabetes, cancer, and high blood pressure.

The district court dismissed the plaintiffs' claims, which were brought under N.Y. Gen. Bus. Law §§ 349 and 350. The court held that the plaintiffs' failure specifically to allege that they had relied to their detriment on the alleged McDonald's representations was fatal to their claims based on N.Y. Gen. Bus. Law Section 350. While claims under Section 349 do not require proof of reliance, the district court nonetheless dismissed the plaintiffs' claims under that provision for failure to allege an adequate causal connection between their consumption of McDonald's food and their alleged injuries. In granting dismissal, the district court found it critical that the plaintiffs' complaint failed to answer such questions as: "What else did the plaintiffs eat? How much did they exercise? Is there a family history of the diseases which are alleged to have been caused by McDonald's products?"

The Second Circuit reversed the district court's dismissal of the plaintiffs' claims under Section 349, holding that the district court had effectively imposed a heightened pleading standard that is incompatible with the notice pleading standard of Fed. R. Civ. P. 8. Although the plaintiffs' claims under Section 349 were based on alleged misrepresentations and omissions, the court nonetheless held that the heightened pleading standard of Fed. R. Civ. P. 9(b) does not apply to statutory consumer fraud claims because "[Section] 349 extends well beyond common-law fraud to cover a broad range of deceptive practices . . . and because a private action under [Section] 349 does not require proof of the same essential elements (such as reliance) as common-law fraud."

The Second Circuit's ruling is significant in two respects. First, the revival of obesity litigation by an appellate court likely will spur further litigation against other industry participants, including restaurant chains, soft drink producers and distributors, snack food makers, and others. Second, and equally important, the Second Circuit's decision conflicts with decisions of numerous other courts that have held Rule 9(b)'s heightened pleading standard to apply to statutory consumer fraud claims.[2] The latter ruling likely will create further incentives for plaintiffs to bring statutory consumer protection claims because of the lax requirements necessary to sustain such claims relative to more traditional tort and contract claims.

Footnotes

1 396 F.3d 508 (2d Cir. 2005).

2 *See, e.g.,* Naporano Iron & Metal Co. v. American Crane Corp., 79 F. Supp. 2d 494, 510-11 (D.N.J. 1999) (citing cases and stating that "[a]pplying Rule 9(b) does not transform [statutory consumer fraud] claims into common law fraud – it merely requires [the plaintiff] to detail its fraud allegations to put defendants on notice, which is a principal rationale behind the 9(b) requirement.").

Class Action Fairness Act (cont. from pg. 1)

been filed in state court before February 18, 2005. The court held that the term "commenced," as used in CAFA, refers to the filing of a complaint (or similar initiating pleading), and not to the act of removal itself.

Given the large number of purported class actions filed on February 17, 2005 (apparently based on anticipation that the President would sign CAFA the next day), a number of defendants have argued that CAFA's "date of enactment" was February 17, 2005, the day on which the bill was passed by Congress, rather than February 18, 2005, the day on which the president signed the bill into law. The one court to release an opinion on the subject thus far has rejected that argument, invoking the lyrics of a song from a popular 1970s children's television program: "I'm just a bill/Yes, I'm only a bill/And if they vote for me on Capitol Hill/Well, then I'm off to the White House/Where I'll wait in a line/With a lot of other bills/For the president to sign/ And if he signs me, then I'll be a law/How I hope and pray that he will/*But today I am still just a bill*."[3] (Neither of these two decisions addresses other contested issues concerning the applicability of CAFA; among other things, litigants continue to debate whether CAFA applies to pre-February 18th cases that are amended to add parties after February 18th, to pre-February 18th cases that are amended after February 18th to include class allegations, etc.)

The first publicly available decision to interpret CAFA's modified amount-in-controversy provision suggests that removing defendants (and initiating plaintiffs) will continue to face challenges in establishing that removed cases involve sufficiently large amounts of potential damages or other relief. While CAFA eliminates any doubt that the amount in controversy in putative class actions is to be calculated in the aggregate (thus abolishing previous precedents that had relied on *Snyder v. Harris* and *Zahn v. International Paper* to require each individual class member to satisfy the jurisdictional amount requirement), it still appears that defendants will need to do more than simply assert that a large amount is at issue. In *Holland v. Cole Nat'l Corp.*,[4] the plaintiff in an action originally filed in federal court argued that CAFA's jurisdictional requirements were met because the case involved "many thousands of class members," and because the defendant generated revenues of more than $50 million from the sale of the challenged products and services.[5] The district court rejected this argument, thus suggesting the possibility that federal courts will continue to scrutinize the amount-in-controversy requirement with some rigor.

Finally, the first publicly aailable decision interpreting the lass-settlement provisions of AFA suggests that courts will not be reluctant to reduce attorneys' fee awards where they are out of proportion to the actual benefit received by settlement class members. In *Fears v. Wilhelmina Model Agency, Inc.*,[6] the district court relied in part on CAFA (which was not technically applicable, since the action predated the effective date of the statute) to hold that plaintiffs' counsel was entitled to a fee award based only on a percentage of class claims actually submitted and approved for payment, and not based on a percentage of the total settlement fund made available to class members.

Footnotes

[1] *See, e.g.,* Lorraine Motors, Inc. v. Aetna Case. & Sur. Co., 166 F. Supp. 319, 323-24 (E.D.N.Y. 1958); Hunt v. Transp. Indem. Ins. Co., 1990 U.S. Dist. LEXIS 16555 (D. Haw. July 30, 1990).

[2] 404 F.3d 1232 (10th Cir. 2005).

[3] Berkowitz v. Transfirst Health Servs., Inc., 2005 U.S. Dist. LEXIS 9604, at *2 n.1 (E.D. Missouri May 19, 2005) (emphasis in opinion).

[4] 2005 U.S. Dist. LEXIS 9862 (W.D. Va. May 24, 2005).

[5] *Id.* at *46.

[6] 2005 U.S. Dist. LEXIS 7961 (S.D.N.Y. May 5, 2005).

Proposition 64 (cont. from pg. 1)

clearly applies to actions filed on or after November 3, 2004, it does not expressly state whether it applies to actions filed prior to its enactment. Not surprisingly, trial courts have been inundated by motions seeking the dismissal of pending UCL actions, primarily on three grounds. First, the language of Proposition 64 and its prefatory section describing its intent and purpose arguably suggest that it should be applied to all UCL actions, including pending cases.[1] Second, the repeal of a statutory right of action immediately terminates pending actions based on that right.[2] Third, Proposition 64's new standing and class action requirements are procedural in nature and apply to pending actions because they do not impair vested rights or impose new, additional or different liabilities based on past conduct.[3] In response, plaintiffs are contending, among other things, that Proposition 64 does not expressly provide that it applies to pending actions and that the right to prosecute a UCL action vests when it is filed and cannot be impaired.

Because numerous UCL cases were on appeal when Proposition 64 was enacted, the Courts of Appeal have been quick to provide guidance on this issue. As of the date this article was completed, six published cases have held that Proposition 64 applies to pending actions[4] and one has held that it does not.[5] The first published case, *Californians for Disability Rights v. Mervyn's, LLC*,[6] decided by the First District, held that Proposition 64 did not apply to a case pending on appeal because it would "deny parties fair notice and defeat their reasonable reliance and settled expectations," particularly given the commitment of substantial resources in pursuing the claim. Since *Californians for Disability Rights*, however, there have been five published decisions reaching the opposite conclusion, all of which focused on the "statutory right repeal doctrine." These cases all held that, because the right to assert a UCL claim is wholly statutory—and not based on the common law—such right can be repealed at any time. Under the rationale of these cases, Proposition 64 must be applied to pending cases, including those on appeal.

Not surprisingly, given the split of authorities, the California Supreme Court has granted review of a number of Proposition 64 cases to decide the applicability of Proposition 64 to pending cases.[7] A decision is expected later this year.

The Fallout: Other Issues to be Litigated

Proposition 64 raises other questions that are being and will be litigated in California. First, when a UCL claim is dismissed based on the plaintiff's lack of standing, can the plaintiff's counsel amend the complaint to substitute an injured plaintiff? The published decisions discussed above and trial courts have reached different conclusions on this issue,[8] most allowing leave to amend based on traditional notions of liberality, while some have denied leave. Importantly, however, no court appears to have addressed the obvious policy question, which is why the plaintiff's counsel should be permitted to continue litigating a case as if he or she owned the claim.[9] Proposition 64 was intended to preserve the right of injured parties to retain counsel to prosecute their UCL claims, not the right of attorneys to find clients to represent in such actions.[10] A countervailing argument is that, because a claim was being prosecuted on behalf of the "general public," possibly causing members of the general public to rely on the pendency of a UCL action, it is equitable to permit the case to continue after substitution of a proper plaintiff. While these arguments have been raised principally at the trial court level at this point, they should be determined at the appellate level shortly.

Second, if a plaintiff without standing is allowed to amend his complaint to substitute an injured plaintiff, do the claims of absent class members relate back to the filing of the claim by the unaffected plaintiff? Similarly, if a plaintiff can amend a complaint to add class allegations, do the claims of absent class members relate back to the filing of the claim by the individual on his or her own behalf or on the behalf of the general public?

Third, what will be the impact of Proposition 64's new injury and causation requirements on the previously used definitions of "unlawful," "unfair" and "fraudulent" conduct? California courts have repeatedly held that relief under the UCL is available without individualized proof of deception, reliance and injury.[11] Indeed, this has been the mantra of plaintiffs bringing suit under the UCL. Given the new injury and causation requirements, however, California courts will have to revisit the previous case law discussing whether certain conduct is "unlawful," "unfair" and/or "fraudulent," particularly where no resulting injury can be attributed to such conduct.

Fourth, can a plaintiff seek discovery, file motions or otherwise prosecute a UCL action while a dismissal motion based on Proposition 64 is pending?

Fifth, what will be the impact of Proposition 64's new injury and causation requirements on class certification proceedings? The UCL's new injury and causation requirements may assist defendants in defeating class certification of UCL representative actions that otherwise might have been certified with little hesitation. Prior to Proposition 64, California courts had determined that, because a UCL claim premised on "fraudulent" or deceptive conduct does not require proof of actual reliance or damages, problematic issues regarding commonality and typicality in these respects had no bearing on class certification. For example, in *Massachusetts Mutual Life Insurance Co. v. Superior Court,*[12] the Court of Appeal affirmed class certification of a UCL claim based on alleged non-disclosure of certain terms relating to the sale of "vanishing premium" life insurance policies. Although defendant argued that class treatment was not suitable because each plaintiff would be required to make an individual showing of the representation that he or she received,[13] the Court rejected this argument, reasoning that under the "unique scope" of UCL, plaintiffs were not required to prove individualized deception, reliance and/or injury.[14] Based on Proposition 64, however, *Massachusetts Mutual*, and other cases following its rationale, may no longer be applicable.

While there is no shortage of issues to be litigated in the aftermath of Proposition 64, there can be no question that significant reforms have taken place. Not only has California reduced the allure of legal bounty-hunting in its courts, but it also has eliminated the ability of plaintiffs' lawyers to gain settlement leverage by pleading UCL claims in routine cases. Going forward, plaintiffs' lawyers will need to find injured clients before they can sue, and they must meet the requirements of due process before obtaining classwide relief. Stay tuned; further reforms are in the planning process.

Footnotes

[1] *See, e.g.,* Day v. City of Fontana, 25 Cal. 4th 268, 274 (2001) (holding that initiative's Findings and Declaration of Purpose may be considered by court in order to "test" its construction of initiative's unambiguous statutory language).

[2] *See, e.g.,* Younger v. Superior Court, 21 Cal. 3d 102, 109 (1978); Governing Board of Rialto Unified School District v. Mann, 18 Cal. 3d 819, 829 (1977); Cal. Gov. Code § 9606.

[3] *See, e.g.,* Tapia v. Superior Court, 53 Cal. 3d 282, 288 (1991); Brenton v. Metabolife Int'l, Inc., 116 Cal. App. 4th 679, 688 (2004).

[4] Thorton v. Career Training Center, Inc., 128 Cal. App. 4th 116 (Cal. App. 4th Dist., April 4, 2005) (holding that Proposition 64 applies to pending actions); Frey v. Trans Union Corp., 127 Cal. App. 4th 986 (Cal. App. 4th Dist., March 24, 2005) (same); Lytwyn v. Fry's Electronics, Inc., 25 Cal. Rptr. 3d 791 (Cal. App. 4th Dist., Feb. 22, 2005) (same); Bivens v. Corel Corp., 126 Cal. App. 4th 1392, 24 Cal. Rptr. 3d 847 (2005), petition for rev. filed (Mar. 29, 2005); Thomas Branick v. Downey Savings and Loan Assn., 126 Cal. App. 4th 828, 24 Cal. Rptr. 3d 406 (2005) (same), *petition for rev. filed* (Mar. 22, 2005); James Benson v. Kwikset Corp., 126 Cal. App. 4th 887, 24 Cal. Rptr. 3d 683 (2005) (same), *petition for rev. filed* (Mar. 21, 2005).

[5] Californians for Disability Rights v. Mervyn's, LLC, 126 Cal. App. 4th 386, 24 Cal. Rptr. 3d 301 (2005), *petition for rev. filed* (Mar. 14, 2005).

[6] 126 Cal. App. 4th at 397 (reasoning that the application of Proposition 64 to cases filed before the initiative's effective date "would deny parties fair notice and defeat their reasonable reliance and settled expectations.").

[7] *See* Californians for Disability Rights v. Mervyn's, LLC, 2005 Cal. LEXIS 4586 (Cal. Apr. 27, 2005); Benson v. Kwikset Corp., 2005 Cal. LEXIS 4587 (Cal. Apr. 27, 2005); Bivens v. Corel Corp., 2005 Cal. LEXIS 4601 (Cal. Apr. 27, 2005).

[8] Compare Branick, 126 Cal. App. 4th 828 (remanding case to trial court for determination as to whether the plaintiffs should be granted leave to amend the complaint to substitute an affected plaintiff to preserve the claims of the represented group) *with Benson,* 126 Cal. App. 4th 887 (remanding case only to permit plaintiff to demonstrate standing, and unlike the *Branick* Court, likely would not permit a new plaintiff with standing to intervene.).

[9] Keru Investments, Inc. v. Cube Co., 63 Cal. App. 4th 1412, 1425 (1998) ("Choses in action belong to the party who suffered the injury.").

[10] The effort to curtail persons without a valid cause of action from filing suit is not a new phenomenon. "At common law, barratry was 'the offense of frequently exciting and stirring up suits and quarrels' (4 Blackstone, Commentaries 134) and was punishable as a misdemeanor." Rubin v. Green, 4 Cal. 4th 1187, 1190 (1993). A statutory version of the crime survives today. Cal. Pen. Code §§ 158-159. "The modern successor of common law barratry, solicitation, is not only a misdemeanor when accomplished through the use of agents, but is also subject to discipline by the State Bar." *Rubin*, 4 Cal. 4th at 1190; *see also* Cal. Bus. & Prof. Code §§ 6152-6153; rule 1-400, Rules of Prof. Conduct of State Bar.

[11] Massachusetts Mut. Life Ins. Co. v. Superior Court, 97 Cal. App. 4th 1282, 1288 (2002) (citing numerous cases).

[12] 97 Cal. App. 4th at 1282.

[13] Defendant had presented to the Court numerous out-of-state authorities holding that vanishing premium claims were not suitable for class treatment, which the Court distinguished based on the broad scope of California's UCL jurisprudence. *Id.* at 1291.

[14] *Id.* at 1288-92; *see also* Corbett v. Superior Court, 101 Cal. App. 4th 649, 672 (2002) (noting that "[t]he refusal to certify a class on other claims is not dispositive on whether the UCL claim should be certified, because the UCL claim is materially different from the other causes of action. Relief under the UCL is available without individualized proof of deception, reliance and injury.").

Published by:
The Federalist Society for Law & Public Policy Studies
1015 18th Street, N.W., Suite 425, Washington, D.C. 20036.

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