CLASS ACTS: THE STAGE OF THINGS TO COME IN DEFENDING CLASS ACTIONS

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If there were any doubt as to the ongoing impact on business of class action lawsuits, consider the following items:

- A website bearing the name BIGCLASSACTIONS.COM serves as a clearing house, primarily for the plaintiff's bar and potential plaintiffs, of developments in class action litigation. The site's home page recently featured such diverse "Hot Issues" as claims arising from Oxycontin dependence, a promotional campaign for Snapple beverages, claims against brokerage houses for trading losses based on alleged conflicts of interest, and claims against an internet service provider for alleged overcharges.

- Melvyn Weiss, dean of the plaintiffs' class action securities bar, is quoted in a recent British publication as encouraging Europeans to enlarge their use of class action securities litigation. He also is reported to be "investigating tactics to bring European companies and claimants before the US courts."[2]

- Within recent years, the Illinois Appellate Court for the Fifth District (home to Madison and St. Clair Counties) has twice approved certification of nationwide classes for claims sounding under the Illinois Consumer Fraud Act applied to defendant businesses headquartered in Illinois, even where the vast majority of class members live outside the State. This issue is currently pending appeal to the Illinois Supreme Court.[3]

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[2] A. Collins, "Class Action Guru Tells UK Investors to Take to Courts," *Legalweek*, www.legalweek.com (November 13-20, 2003).

[3] *See Avery v. State Farm Mut. Auto. Ins. Co.*, 312 Ill.App.3d 269, 746 N.E.2d 1242 (5th Dist. 2001) (class of automobile policyholders challenging practice of only approving repairs with non-OEM parts), *app. allowed*, 201 Ill. 2d 560, 786 N.E.2d 180 (2001); *Clark v. TAP Pharma. Prods., Inc.*, 798 N.E.2d 123 (Ill. App. 5 Dist. 2003) (class of persons and businesses who paid Medicare deductibles or copayments for drug Lupron challenging marketing practices that allegedly inflated pricing fraudulently).

The Illinois Appellate Court for the First District reached the opposite conclusion in *Oliveira v. Amoco Oil Co.*, 311 Ill. App. 886, 726 N.E.2d 51 (1st Dist. 2000), but that portion of its decision was vacated by the Illinois Supreme Court because, having properly concluded that the named

In this climate where creative plaintiffs' counsel are using the threat of class action litigation as a remedy for every conceivable loss or damage, it is more important than ever that corporate defense counsel be aware of the most recent developments in class action law, including changes in rules, statutes, and case law. In that vein, we discuss below current developments both in the courts and legislatures relating to class action litigation.

I. CHANGES TO FEDERAL RULE 23, EFFECTIVE DECEMBER 1, 2003

The most recent amendments to Rule 23 of the Federal Rules of Civil Procedure will become effective on December 1, 2003.[4] The last major revision to Rule 23 was in 1966. The amendments are mostly procedural and are intended to improve protections for class members, enhance judicial oversight and discretion, and promote the objectives of class actions as a procedural mechanism for managing disputes. The amendments to Rule 23 "focus on four areas: the timing of the certification decision and notice; judicial oversight of settlements; attorney appointment; and attorney compensation."[5]

A. Class Certification

1. Determination "At An Early Practical Time"

Amended Rule 23(c)(1)(A) provides for a certification determination "at an early practical time." It had previously provided that the certification determination shall be made "[a]s soon as practical after the commencement of an action brought as a class action . . . ."

The new language is designed to allow courts to make certification decisions after the court has had an opportunity to become sufficiently informed to make a reasoned determination on certification and define the class, if one is certified. The Rule is not intended to allow undue delay or promote unnecessary discovery. Rather, to the extent discovery is permitted in connection with a motion for certification the authoritative guidance makes clear such discovery should be limited to issues impacting certification. The timing of certification may be affected by considerations or procedural issues such as motions to dismiss or for summary judgment or appointment of class counsel.

The amendment permits courts to take a flexible approach to class-action litigation, recognizing the importance of the certification stage of class action litigation. It neither requires a quick decision on certification, nor precludes the court from allowing discovery on issues that

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plaintiff failed to state a claim, the lower court should not have ruled on issues of class certification. *See Oliveira*, 201 Ill. 2d 134, 776 N.E.2d 151 (2002).

[4] In addition, Rules 51, 53, 54, 71A have been amended, as have Forms 19, 31 and 32.

[5] This Section is based directly on the Advisory Committee Notes and Report of the Judicial Conference Committee on Rules of Practice and Procedure in an effort to make the guidance and information therein more discrete and available.

affect certification, issues for trial, common evidence considerations, and trial-management problems that may be presented.

Amended Rule 23(c) anticipates the need for active judicial supervision to balance the need for a timely and informed certification determination and concerns about artificial and wasteful division between certification discovery and merits discovery. This is one reason why it would be beneficial to identify the issues impacting the class and trial at a relatively earlier point in the proceedings. *See* Manual For Complex Litigation Third, §§ 21.213, 30.11 & 30.12.

2. The Prerequisites of a Class Certifying Order

Amended Rule 23(c)(1)(B) identifies the parts that an order certifying a class action must contain – *i.e.*, definition of "the class and the class claims, issues, or defenses." The order also must "appoint class counsel under Rule 23(g)."

3. Conditional Classes are Eliminated, but Certification can be Amended

Amended Rule 23(c)(1)(C) deletes the provision for conditional class certification to make clear that class certification may not be granted on a tentative basis. Significantly, however, the court retains the power to subsequently redefine or decertify a class in its discretion.

Under Amended Rule 23(c)(1)(C) "[a]n order [granting or denying class certification] under Rule 23(c)(1) may be altered or amended before final judgment." This differs from the current rule, which only allows amendments until "the decision on the merits," even though this event may take place before there is a final judgment. This change was made to eliminate the ambiguity that had arisen from the phrase "the decision on the merits," in the former rule. It also recognizes that there may be a need for later proceedings to address issues such as the need to amend the class definition, subdivide the class, or account for issues presented by a proposed settlement.

4. Notice Now May Be Given in (b)(1) and (b)(2) Class Actions

Amended Rule 23(c)(2)(A) gives courts the authority and discretion to direct "appropriate notice" in (b)(1) and (b)(2) class actions. Although the advisory committee considered making notice in (b)(1) and (b)(2) class actions mandatory, it opted to leave the propriety of giving of notice in such actions to the district court's discretion. In addition, it noted that 23(c)(2)(A) notice is intended to serve more limited interests such as class members' interest in monitoring the progress of the action. The Committee Note also expressly cautions courts to exercise care in directing notice in (b)(1) and (b)(2) actions and to evaluate whether notice should be given "after balancing the risk that notice costs may deter the pursuit of class relief against the benefits of notice in the particular case." The court also has the discretion to direct notice made in a manner that differs from what would be required in a (b)(3) action, because (b)(1) and (b)(2) class members do not have the right to be excluded. Further, the manner of

notice may be affected by the costs of different methods of notice compared to their effectiveness and the court's determination as to the need for such notice.

Consistent with the practice reflected in the case law, Amended Rule 23(c)(2)(B) now expressly requires notice to be in "plain, easily understood language."

B. Settlement Review

The Rule 23 amendments focus on the court's review and approval of proposed settlements in class actions.

1. Procedures for Settlement Review and Approval

Amended Rule 23(e)(1)(A) requires that "[t]he court must approve any settlement, voluntary dismissal, or compromise of the claims, issues, or defenses of a certified class." In addition to making the need for approval clear, this language is also careful to specify that it only applies where a class has been certified. Thus, approval is not required for a resolution reached before a class is certified because class members would not be bound a resolution reached under those circumstances. Notice is required to be reasonable.

Amended Rule 23(e)(1)(C) expressly requires that a proposed settlement be "fair, reasonable, and adequate." This standard echoes existing case law. Rule 23(e)(1)(C) also requires the district court to hold a hearing and make findings to ensure that the settlement meets this standard. *See In re Prudential Ins. Co. America Sales Practice Litig. Agent Actions*, 148 F.3d 283, 316-24 (3d Cir. 1998); *see also* Manual for Complex Litigation, § 30.4. The Committee Note states that the court's findings "must be set out in sufficient detail to explain to class members and the appellate court the factors that bear on applying the standard."

Amended Rule 23(e)(2) requires settling parties to "file a statement identifying any agreement made in connection with the proposed settlement, voluntary dismissal, or compromise." The Advisory Committee notes that such side agreements can be important to understanding the agreed terms, but may not typically be disclosed to the court. There is concern that some side agreements "may have influenced the terms of the settlement by trading away possible advantages for the class in return for advantages for others." Side agreements do not automatically become discoverable but doubts are resolved in favor of disclosure. A court in its discretion may require partial or full production of a side agreement, subject to assertions of privilege or other protections. Counsel would be well-advised to be attentive to Amended Rule 23(e)(2) in negotiating all parts of a class action settlement at all stages of negotiation.

2. Second Opt-Out Opportunity After Settlement Announced

Amended Rule 23(e)(3) provides for a second opportunity to opt out of a (b)(3) class if a settlement is proposed after the initial opt-out period has expired. It is entirely within the court's discretion to allow a second opt-out opportunity. This provision allows a class member the opportunity to opt-out once the settlement terms become known on the theory that class members may be in a better position to determine whether or not to opt-out with a second, later

opportunity to do so than they might have been during the initial opt-out period. Notably, the court is not required to provide a second opt-out period. It may exercise its discretion to allow for one after a settlement has been reached. This amendment to Rule 23 recognizes that the information available to a class member may be substantively different after settlement terms have been negotiated and identified as compared, *e.g.*, to the information available at the time of class certification. Notably, this amendment is only meaningful in instances where the class has been certified and the initial opt-out period has expired before a settlement is achieved.

This new provision has generated substantially different views about its potential impact. Some believe this provision will make defendants less likely to settle class actions over concerns that their deal could be impaired by post-settlement opt-outs. Others believe this amendment creates an opportunity for plaintiffs' counsel who are not counsel for the class to promote independent efforts to achieve more favorable settlements for class members. There are practical reasons that such potentialities do not necessarily present obstacles. For instance, fore-thinking settling counsel can include terms in their settlement agreements that allow defendants to walk away from deals if there are too many opt-out class members.

Amended Rule 23(e)(4) allows class members to object to "a proposed settlement, voluntary dismissal, or compromise" and provides that such an objection may be withdrawn only with the court's approval. This provision ensures that the court stays in the loop and understands the reasons for withdrawal of objections consistent with its obligation to approve settlement agreements.

C. Appointment Of Class Counsel

Paragraph (g), which is new to Rule 23, both creates a procedure for appointment of class counsel and delineates class counsel's responsibilities. Paragraph (g)(1)(A) provides that class counsel must be appointed when a court certifies a class "[u]nless a statute provides otherwise". Although not expressly stated in the Rule, the Committee Note states that this includes appointment of counsel for each subclass to represent divergent interests. Paragraph (g)(1)(B) "states that class counsel 'must fairly and adequately represent the interests of the class.'"

1. Criteria for Selecting Class Counsel

Paragraph (g)(1)(C) identifies the criteria that a court "must consider" in appointing class counsel.[6] These criteria include: work performed; experience; knowledge of applicable law; and available resources. The court may request counsel provide such additional information as it deems "pertinent to the appointment." This may include the proposed terms of an attorney fee award, thus encouraging an early discussion on the basis for any ultimate award of fees. In this way, paragraph (g)(1)(C) is designed to promote judicial control over attorney fee awards. As noted, this is one of the principal goals of the amendments to Rule 23. *See also* the discussion of Attorneys Fees, *infra*.

[6] Under paragraph (g)(2)(A), the court may appoint interim counsel during the precertification period as a case-management measure.

2. Other Considerations Effecting Selection of Counsel

Paragraph (2)(B) contemplates the possibility of multiple counsel vying to serve as counsel for the class. Anticipation of such competition may favor delaying appointment of class counsel. In any event, an applicant may only be appointed class counsel by satisfying the criteria identified in Rule 23(g)(1)(C). Where there are multiple applicants, the court is required to appoint the applicant who will best represent the interests of the class. An existing attorney-client relationship between the class representative and counsel may be a factor in the selection process.

While the Rule is geared principally toward plaintiffs' class counsel, the Committee Note recognizes that different considerations may apply in defendant class actions, including that the court may seek out appropriate class counsel, both individuals and firms, who have not sought appointment.

Paragraph (g)(2)(C) specifically authorizes the court to include provisions regarding attorney fees in the order appointing class counsel. Attorneys fees are addressed in more detail in new paragraph (h), which is discussed next.

D. Attorneys Fees

Amendments to Rule 23 regarding attorneys were prompted in recognition of the substantial importance of attorney fee awards in class action litigation. With the amendment to Rule 23, courts must assume significant responsibility for determining attorney fees and will not simply accept previously negotiated arrangements as a *fait accompli*. The amendment also provides for notice to the class of a motion for award of fees, addresses objectors' rights, and requires the court to make findings after a hearing in determining the amount of the fee award.

Under paragraph (h), a court may award attorney fees in a class action only if authorized by law or the parties' agreement. The award must be "reasonable," which is to be determined by the court consistent with any limitations placed on the award by applicable law.[7] The provisions addressing the court's duty to approve settlement and determine attorney fees are hallmarks of the new amendments. The court also must ensure that substantial fee awards are warranted by the results actually achieved for class members.

Notice of attorneys fee motions must be served "on all parties and . . . directed to class members in a reasonable manner." This provision parallels Rule 23(e)'s requirement for notice of a proposed settlement to the class. Where possible, notice of class counsel's petition for fees should accompany notice of a proposed settlement. It may be appropriate for the court to modify the notice to avoid undue expense in an adjudicated case. The Committee Note also observes that it may be appropriate to defer some amount of payment of the fee award until actual payouts to class members are known, while also recognizes that monetary compensation is not the sole

[7] *E.g.*, Private Securities Litigation Reform Act of 1995, 15 U.S.C. §§ 77z-1(a)(6) & 78u-4(a)(6) (fee award should not exceed a 'reasonable percentage of the amount of any damages and prejudgment interest actually paid to the class').

factor as to the results achieved for the class. *Cf. Blanchard v. Bergeron*, 489 U.S. 87, 95 (1989) (cautioning in an individual case against an "undesirable emphasis" on "the importance of the recovery of damages in civil rights litigation" that might "shortchange efforts to seek effective injunctive or declaratory relief").

Paragraph (h)(2) allows any class member or party from whom payment is sought to object to the attorneys fee motion. The Committee Note points out that the court may direct discovery depending on the completeness of the support for the fee motion. The Note also states that broad discovery is not normally allowed with respect to fee motions.

Paragraph (h)(3) calls for findings under Rule 52(a) and authorizes the court to determine whether to hold a hearing on the motion. In settled class actions, the hearing might well be held in conjunction with proceedings under Rule 23(e), and in other situations there should be considerable flexibility in determining what suffices as a hearing. The findings requirement provides important support for meaningful appellate review. The Committee Note sets out the factors that may affect a determination of a "reasonable" fee. The amendments to Rule 23 do not express any view as to the propriety of lodestar or percentage approaches to fee awards.

As commonly occurs, defendants may wish to include provisions in settlement agreements both capping fee awards and allowing the agreement to be terminated in the event the court awards an amount that exceeds the parties expectations as expressed in the settlement agreement.

Finally, under section (h)(4), issues related to the fee award may be referred to the magistrate judge or special master as provided in Rule 54(d)(2)(D). It should be noted that Rule 53 also has amendments that will become effective December 1, 2003.

II. FEDERAL LEGISLATIVE EFFORTS

During 2003, the Bush Administration made revisions to the federal scheme for class action litigation a cornerstone of its "tort reform" legislation. Late last month, however, the Senate was unable to muster the 60 votes necessary to overcome a filibuster that prevented the legislation from reaching the floor of the Senate for a vote.[8] It is widely accepted that the any federal legislative changes to class action procedures are unlikely to be achieved until after the 2004 presidential election.[9]

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[8] The vote to end the filibuster was predictably on party lines, with only one Republican, Senator Shelby of Alabama, declining to support an end to the filibuster. Eight Democrats – Senators Bayh (Ind.), Carper (Del.), Feinstein (Cal.), Kohl (Wis.), Lieberman (Conn.), Lincoln (Ark.), Miller (Neb.), and Nelson (Neb.) – as well as the Independent Senator Jeffords of Vermont, joined the Republican majority in the vote for cloture. Democratic presidential candidates, Senators Kerry and Edwards, did not vote. *See* S. Stolberg, "Bill Changing Class-Action Law Appears Dead for Now" (N.Y. Times Oct. 22, 2003) http://nytimes.com.

[9] *Id. See also* J. Holland, "Democrats Block GOP Move on Class Actions" (Assoc. Press Oct. 22, 2003) http://story.news.yahoo.com.

While efforts to legislate change in class action practice on the federal level may be stalled for the time being, it still is worth being aware of the major changes that had been passed by the House and voted out of committee by the Senate, as these reforms are likely to be the starting point for any future legislative changes.

A. Expanding Federal Jurisdiction over Class Actions

Perhaps, most significantly, the proposed legislation would have relaxed the requirements for obtaining federal subject matter jurisdiction over class actions based solely on state law causes of action. Under current law, federal diversity jurisdiction is available for such claims only if there is complete diversity in citizenship between all of the named plaintiffs, on the one hand, and each defendant, on the other. Further, the federal Circuits are split on whether each named plaintiff must independently satisfy the $75,000 amount-in-controversy requirement, without aggregation of his or her claims with other class members, or whether federal jurisdiction is met so long as at least one named plaintiff does so.[10] Under this current jurisprudence, considerable judicial resources are devoted to litigating claims of "fraudulent joinder," by which defendants who perceive that the federal courts are a more hospitable venue for their claims than the state courts seek to disregard certain parties so as to satisfy the standards for diversity jurisdiction.

Under the House Bill, the federal courts would have had subject matter jurisdiction over cases filed as class actions where:

- the amount in controversy in the aggregate exceeded $5 million;
- there were at least 100 class members;
- at least one named plaintiff was of diverse citizenship from one defendant; and
- at least two-thirds of the plaintiff class members were of diverse citizenship from a "primary defendant."[11]

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[10] *See, e.g., Kessler v. National Enterprises, Inc.*, 2003 WL 22455216 at *3 n.3 (8th Cir. Oct. 30, 2003) (summarizing leading cases and holding that each named plaintiff must individually meet the amount-in-controversy). Currently, the Third, Eighth, and Tenth Circuits require that each named plaintiff separately satisfy the jurisdictional amount when diversity is invoked, whereas the Fourth, Fifth, Seventh, Ninth, and Eleventh hold that it suffices if one named plaintiff can meet that amount, with other claims being joined under the doctrine of supplemental jurisdiction. *Id.*

[11] *See* H.R. 1115, 108th Cong. § 4 (2003). Because it was actually passed by the House, we limit our discussion in this article to the provisions of the House Bill. The Senate Bill was not dramatically different.

With respect to class actions where between one-third and two-thirds of the class members were of diverse citizenship from a "primary defendant," the courts would have discretion whether to exercise federal jurisdiction based on enumerated statutory considerations. Class actions in which less than one-third of the plaintiff class was diverse from the "primary defendants" would not be subject to federal jurisdiction.[12]

Further, the House Bill would have expanded the provisions for removal of class actions compared to removal of other diversity matters. First, even defendants who are citizens of the state in which the class action were filed would have been permitted to remove to federal court, unlike the usual practice, in which only out-of-state defendants are permitted to remove to cases arising in diversity to federal court. Second, unlike the provisions usually applied to remand orders by District Courts – which are absolutely immune from appellate review (except by mandamus) – orders remanding a class action to state court would have been automatically subject to an interlocutory appeal.[13]

B. Changes to Procedures for Approving Class Settlements

The proposed legislation, as passed by the House of Representatives, also enacted certain provisions that would have restricted the district court's discretion in entering fairness findings with respect to class settlements. With respect to settlements where class members only receive coupons or non-cash remuneration that would require expending their own funds to benefit from the settlement, for example, the district court would have been required to make a written finding that the settlement was "fair, reasonable, and adequate as to class members."[14]

The House Bill also would have outlawed any sort of "bounty" or premium paid to named plaintiffs, compared to the settlement offered to other class members. A settlement still could provide for compensating the named plaintiff for time and expenses incurred in serving as such, however.[15]

C. Interlocutory Appeals of Rulings on Class Certification

Since the addition of Rule 23(f) to the Federal Rules of Civil Procedure in 1998, the federal Courts of Appeals *in their discretion* are permitted to grant interlocutory appeal of orders granting or denying motions for class certification. Pursuant to the proposed House Bill, the

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[12] *Id.*

[13] *Id.* § 5 (creating a new 28 U.S.C. § 1453).

[14] *Id.* § 3. (creating a § 1711).

[15] *Id.* (creating a § 1714).

interlocutory appeal from such orders would have been *as of right*, pursuant to the provisions of 28 U.S.C. § 1292(a).[16]

Moreover, whenever such an interlocutory appeal were pending, all discovery would have been stayed except on a finding of the district court "that specific discovery is necessary to preserve evidence or to prevent undue prejudice to that party."[17]

III. CLASS ACTIONS AND ARBITRATION CLAUSES

Businesses in recent years have increasingly inserted arbitration clauses into contracts relating to consumer, employment, and financial transactions, and the courts having become increasingly willing to enforce such arbitration agreements.[18] Inevitably, the trend of the plaintiff's bar to expand usage of class action litigation has come face-to-face with the growing reliance by business upon arbitration to control the expense and unpredictability of civil litigation. Indicative of these trends is the adoption last month by the American Arbitration Association of rules to govern "Class Arbitrations." In the face of these trends and the AAA's adoption of rules expressly addressing class arbitrations, businesses must consider when they draft arbitration clauses whether to include language that expressly provides for arbitration of class claims, expressly bars class claims, or is silent on that subject.

A. The Supreme Court's Decision in *Green Tree*

In *Green Tree Financial Corp. v. Bazzle*, 123 S. Ct. 2402 (2003), the United States Supreme Court addressed the arbitrability of class claims. In *Green Tree*, the Supreme Court was called upon to determine whether class claims arising out of commercial lending contracts were subject to arbitration where the arbitration agreement was silent as to whether class claims were to be arbitrated. Earlier in the litigation, the South Carolina Supreme Court had decided that, in the face of such silence in the parties' contract, the class claims were subject to arbitration.

In a fractured decision, with no single opinion commanding a majority, the plurality of the Court held that the issue of arbitrability of class claims was itself a question that in the first instance should be decided by an arbitrator, not the courts because the contracts did not clearly forbid or authorize arbitration of class claims. Accordingly, the Court vacated the lower court

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[16] *Id.* § 6.

[17] *Id.*

[18] *See, e.g., Pacificare Health Syst., Inc. v. Book*, 123 S. Ct. 1531 (2003) (compelling arbitration of RICO claims although arbitration agreements prohibited awards of punitive or exemplary damages, which arguably barred trebling under RICO).

decision, remanding with directions that the issue of arbitrability of class claims be referred to the arbitrator.[19]

Since then, at least one state appellate court has declined to order an arbitrator to determine whether a dispute should proceed on behalf of a class, holding that this was an issue for the trial court. *In re O'Quinn*, 2003 WL 21468619 (Tex. App. - Tyler June 25, 2003), arose out of one lawyer's standard-form contingency fee agreement for legal services on behalf of plaintiffs in breast-implant litigation.[20] Certain plaintiff-clients filed class action claims alleging that the lawyer's practice of deducting a flat percentage of any recovery as compensation for expenses was in violation of the retention agreement. The contingency fee agreements contained an arbitration clause providing for arbitration under the AAA Commercial Rules then in effect. At the time, the AAA had no provisions in its rules for the administration of class claims. On that basis, the court held that the trial court, not the arbitrator, should determine the question of class certification. The appellate court reasoned that, because the scope of the agreement to arbitrate incorporated by reference the AAA rules and because the AAA had no procedures at the time to adjudicate the question of class certification, the parties had not intended for that question to be submitted to arbitration. *Id*. at *5. In view of the AAA's recent adoption of rules for class arbitration, the decision in *O'Quinn* must be considered of limited relevance, at least where the arbitration clause directs that the parties submit to AAA arbitration or some other body that administers class-wide arbitrations.

B. The AAA Rules for Class Arbitrations, as of October 2003

Since the decisions in *Green Tree* and *O'Quinn*, the AAA has in fact developed rules for class arbitrations.[21] The principal features of the new AAA rules for class arbitrations are:

- At least one member of the arbitral panel will be appointed from a national roster of "class arbitration arbitrators" maintained by the AAA.[22]

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[19] *See also Pecor Mgmt. Co. v. Nations Personnel of Tex. , Inc.*, 343 F.3d 355, 359 (5th Cir. 2003) (applying the "holding" of *Green Tree* by examining the rationales set forth in the four-Justice plurality opinion and Justice Breyer's separate concurrence).

[20] The *O'Quinn* decision, like many of the 2003 cases cited in this section in the article, has not yet been released for publication and is subject to revision. ***Before relying upon any of the recent cases cited in this article, it would be wise to double-check whether the decision has been modified.***

[21] *See AAA Supplementary Rules for Class Arbitrations* (effective October 8, 2003), available at www.adr.org

[22] *Id.* Rule 2. *See also* Rule 10, stating that all awards under the Supplementary Rules for Class Arbitrations are to be in writing and provide reasons.

- The arbitrator is required as a threshold matter to decide as soon as possible whether the arbitration clause permits arbitration of class claims. This decision is to be set out in a written "reasoned, partial final award." Once that award issues, all arbitral proceedings are stayed for at least 30 days to permit judicial confirmation or vacation of that award.[23]

- If it is determined that the agreement permits for class-wide arbitration, then the arbitrator is to decide the question of class certification using criteria similar to those set out in Rule 23(a) and (b) of the Federal Rules. In addition to those factors, the arbitrator must also consider whether each class member has entered into an agreement containing an arbitration clause that is "substantially similar" to that signed by the class representative. Satisfying the 26(a) criteria and the requirement that all class members have entered into a substantially similar arbitration clause are mandatory prerequisites to class-wide arbitration.[24]

- The arbitrator's determination of class certification must be set out in a written "partial final award" addressing each of the criteria for class-determinations set out in Rule 4 of the AAA Supplementary Rules. The award shall define the class, identify the class representative, and name class counsel, as well as setting out the procedures for class members to exclude themselves from the proceedings. Once this award issues, proceedings in the arbitration are stayed to permit judicial confirmation or vacation of the decision.[25]

- The AAA rules mirror the procedures of Rule 23 in its provisions of notice to class members and the procedures for approval of settlements or voluntary dismissals of arbitrations once they are certified on a class-wide basis.[26]

- Unlike other AAA arbitrations, there is no presumption of confidentiality applied to class arbitrations. Rather, all hearings and filings in such proceedings shall be made public, subject to a decision of an arbitrator to impose confidentiality where special circumstances warrant it.[27]

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[23] *Id.* Rule 3.

[24] *Id.* Rule 4, 10.

[25] *Id.* Rule 5.

[26] *Id.* Rules 6, 8.

[27] *Id*. Rule 9.

C. Drafting Arbitration Clauses with Respect to Class Issues

As suggested by the Supreme Court's decision in *Green Tree*, when a business drafts an arbitration clause, it essentially has three choices with respect to arbitrability of class claims: (a) an express provision that class claims are subject to arbitration; (b) an express bar to class claims, while requiring arbitration; or (c) silence as to whether class claims are to be arbitrated, which, under *Green Tree* will result in the arbitrator interpreting the contract to resolve that question.

Most businesses, with their distrust of class-wide litigation, might conclude that the best course would be to include a provision in the arbitration clause that barred class arbitration, while compelling arbitration of claims on an individual basis. Before taking that route, however, businesses need to be aware that courts are sometimes hostile to prohibitions on class claims contained in arbitration clauses, with the result that, rather than proceeding in arbitration, the case will remain in the court system as a class action. If a business does intend to include a bar on class claims as part of its arbitration clause, it needs to be familiar with the case law and circumstances in which courts have upheld or stricken those provisions, with an eye towards drafting a clause that will be enforced as written.

As early as 1991, the United States Supreme Court held that a contractual prohibition on proceeding on a class-wide basis did not automatically render an arbitration clause unenforceable. In *Gilmer v. Interstate/ Johnson Lane Corp.*, 500 U.S. 20, 32 (1991), the Court upheld the enforceability of an arbitration clause in an employment contract, as applied to a claim of federal age discrimination, despite a contractual bar on pursuing such arbitration on a class-wide basis.[28] In reaching that conclusion, the Court noted that, because the Equal Employment Opportunity Commission was also charged with enforcement of the Act and had the ability to assert claims on behalf of classes of employees, the bar on individual litigants pursuing such claims did not unduly interfere with the remedial purposes of the Act.[29]

While there is no *per se* bar to contracting parties including a prohibition on class claims as part of a compulsory arbitration clause, the courts have considered a number of factors in deciding whether to enforce those clauses. Challenges to such clauses typically derive from two sources:

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[28] In fact, the Court assumed, without deciding, that the arbitration procedures would not permit class-wide litigation. The body charged with the arbitration, the New York Stock Exchange, had rules that provided for "collective relief." The Court alternately suggested that such language might be interpreted as authorizing class-wide claims. 500 U.S. at 32.

[29] *Id.* More recently, in *EEOC v. Waffle House, Inc.*, 534 U.S. 279 (2002), the Supreme Court held that arbitration clauses in individual employee contracts could not prevent the EEOC from pursuing judicial class actions on behalf of such employees.

- **Arguments that the remedial scheme of a statute on which the substantive cause of action is founded requires that individuals be permitted to pursue their claims on a class-wide basis in private litigation:** Although the Federal Arbitration Act generally mandates the enforcement of arbitration agreements, if there is a countervailing federal statute that can be construed as outweighing that statutory mandate, then the courts will decline to enforce the arbitration clause. Plaintiffs often try to argue that the remedial scheme of the federal statute upon which their claim is founded is irreconcilable with an arbitration clause that bars class action claims. These arguments by plaintiffs rarely succeed. As discussed above, with respect to *Gilmer*, the federal courts are especially skeptical of such arguments where there is an administrative agency that has concurrent jurisdiction to enforce the statute. For example, in *Johnson v. West Suburban Bank*, 225 F.3d 366, 375 (3d Cir. 2000), the Court of Appeals reversed a trial court decision that declined to order arbitration of claims under the Truth in Lending Act; central to the appellate decision was the role given to the Federal Trade Commission and other federal agencies in enforcing TILA.[30]

- **Arguments that the arbitration clause is void for unconscionability:** Challenges by plaintiffs to arbitration clauses that prohibit arbitrability have been far more successful when founded on the argument that the clause is unconscionable. This is especially true in the state and federal courts of California, where hostility to arbitration has been particularly strong.[31]

Where the plaintiffs have succeeded in striking arbitration clauses that bar class claims on the grounds of unconscionability, the argument typically succeeds because the bar of class claims is just one of many procedural and substantive aspects of the agreement that the courts have considered unduly one-sided. For example, in *Walker v. Ryan's Family Steak House, Inc.*, 2003 WL 22533457 (M.D. Tenn. Oct. 2, 2003), the court refused to enforce an arbitration clause in a dispute arising under the Fair Labor Standards Act where the clause, *inter alia*, barred class claims. More significant than the bar on class claims, the arbitration clause stipulated that the arbitration would be conducted by a for-profit body, the Employment Dispute Services, Inc. ("EDSI"), that was wholly-funded by 12 employer-businesses, one of which was the defendant. In fact, the bar on class arbitration was not contained in the arbitration clause itself but, rather was a function of EDSI rules, which expressly barred such claims. It was the overall scheme of

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[30] *See also Pitchford v. AmSouth Bank*, 2003 WL 22282900 at *4-5 (M.D. Ala. Sept. 29, 2003) (applying reasoning of *Johnson* to Equal Credit Opportunity Act); *Bellavia v. First USA Bank, N.A.*, 2003 WL 22425008 (N. D. Ill. Oct. 22, 2003) (compelling arbitration of Truth in Lending Act claim despite bar to class claims because there was nothing in the Act that precluded arbitration).

[31] *See, e.g., Ting v. AT&T*, 319 F.3d 1126, 1150 (9th Cir. 2003) (declining to enforce arbitration clause that barred class claims to action brought by consumer of telephone services on grounds of unconscionability), *cert. denied*, 124 S. Ct. 53 (2003), *following Szetela v. Discover Bank*, 97 Cal. App. 4th 1094, 118 Cal. Rptr. 862 (2002), *cert. denied*, 537 U.S. 1226 (2003).

EDSI arbitration procedures and its supposed bias towards the defendant, more than the bar on class claims, that led to the finding of unconscionability.[32] Similarly, in *Circuit City, Inc. v. Mantor*, 335 F.3d 1101 (9th Cir. 2003), the court refused to enforce an arbitration clause that barred class claims in an employment agreement; the court also cited to one-sided provisions of the agreement relating to the statute of limitations, filing fees, cost-splitting, and the employer's unilateral right to amend or terminate the arbitration agreement, all of which were held as cumulatively rendering the arbitration clause unconscionable.

Where the arbitration remedy is drafted in a more even-handed fashion – even if contained in a form contract used in consumer or employment contexts – courts have enforced bars on class claims. [33] Important factors in this regard are provisions in the arbitration clause that require the business to absorb all or most of the fees of the arbitration and provisions that allow the arbitrator to award attorneys fees to the plaintiff if he or she is the prevailing party. Because the basic rationale for class action litigation is to create a mechanism that allows plaintiffs to vindicate rights, where the expenses of the litigation are disproportionate to the sums that any individual plaintiff might recover, an arbitration clause that provides for containment of the plaintiff's legal expense is likely to enhance a business's position that a bar on class-wide claims is enforceable.

IV. RECENT CASES SCRUTINIZING FAIRNESS OF CLASS SETTLEMENTS

The courts continue to scrutinize settlement of class claims and, while denial of approval of those settlements is the exception, rather than the rule, a brief discussion of some recent cases where approval was withheld illustrates the pitfalls of class settlements:

- In *Molski v. Gleich*, 318 F.3d 937 (9th Cir. 2003), the Court of Appeals reversed a district court's approval of a class settlement in a mandatory class action under Rule 23(b)(2) – i.e. for which opting out is not permitted. The claims were brought on behalf of a class of disabled individuals against service stations that allegedly had failed to implement accommodations required by law. The settlement consisted of:

    - entry of a consent decree by which the defendants agreed to undertake certain structural changes to the service stations over six years;

[32] The arbitration clause at issue in *Walker* has in fact been the subject of extensive litigation in multiple lawsuits involving the Ryan's Family Restaurants. As collected in footnote 4 of *Walker*, those cases reflect a split among the court as to the enforceability of the clause.

[33] *See, e.g., Livingston v. Assoc. Finance, Inc.*, 339 F.3d 553 (7th Cir. 2003) (where defendant-business offered to pay fees of arbitration and arbitrator was authorized to award prevailing plaintiffs statutory attorney's fees, there was no unconscionability in requiring arbitration of TILA claims despite class bar); *Hutcherson v. Sears Roebuck & Co.*, 342 Ill. App.3d 109, 124, 793 N.E.2d 886, 896 (1st Dist. 2003) (Ariz. law) ("Because the arbitration provision in this case provides financial protections to [plaintiff credit] card holders with the burden of costs falling primarily on [defendant] SNB, we do not find the no-class-action provision to be so one-sided or oppressive as to render the agreement unconscionable.").

- payment to the named plaintiff of $5,000;
- payment to class counsel of fees of $50,000; and
- payment of $195,000 to various disability rights organizations.

In exchange for this settlement, the class was releasing all claims that it had under both state and federal law relating to the alleged discriminatory practices. Despite the release of claims for money damages, individual notice of the class action and the settlement was not directed at class members because the primary relief sought in the suit was injunctive in nature; rather notice was limited to publication, postings at the service stations, and mailings to certain disability rights organizations. In disapproving of the settlement, the Court of Appeals particularly stressed that the releases had the effect that class members, who could not opt out, would be barred from pursuing claims under a California statute that would have entitled them to recover any actual damages, including emotional distress, arising from the alleged violations, with a statutory minimum of $1,000, and the possibility of trebling if intentional violations were shown.

- *Crawford v. Equifax Services, Inc.*, 201 F.3d 877 (7th Cir. 2000), similarly involved a class settlement of a "mandatory" class action, certified under Rule 23(b)(2), arising from claims asserted under the Fair Debt Collection Act. Under the settlement, only the class representative and his counsel would recover monetary relief – $2,000 to the class representative and $78,000 in fees to his counsel. In addition, the defendant would make a donation to a legal clinic that concentrated its efforts in support of consumers. The only class-wide benefit was the agreement of the defendant to cease using certain language in future collection letters. The Act authorizes plaintiffs to collect actual and statutory damages and the settlement ostensibly did not release such monetary claims on behalf of class members. However the settlement prohibited class members from pursuing such claims on a class basis and did not even contain an admission of liability by the defendant. As held by the Seventh Circuit, because the settlement therefore deprived the class members of the only efficient avenue for pursuing claims for damages, while failing to compensate them for those claims, the settlement was unfair.

- Likewise in *Staton v. Boeing Co.*, 327 F.3d 938 (9th Cir. 2003), the Court of Appeals reversed a district court's approval of a class settlement where there was a large disparity between the recovery for the named plaintiffs and certain other members of the class who had actively participated in the litigation compared to that of other class members. The suit involved claims of race discrimination in employment. The recovery paid to the named plaintiffs and certain class members was disproportionate to any reasonable "incentive" premium to reward them for their active participation or compensate them for any actual expense incurred in that regard.

As this discussion suggests, even with the failure of the recent legislation that would have restricted differential payments in settlements to named plaintiffs compared to other class members, litigants trying to settle class claims must be aware that such payments will trigger special scrutiny from the courts.

CONCLUSION

As this overview illustrates, practitioners in this field must stay alert to the ever-evolving law of class actions as it is enunciated in the Rules, legislative changes, and by the courts. Even in an area of the law where the statutory provisions have not changed in years – e.g., the Federal Arbitration Act, where the language of the Act has remained the same for decades – evolving business practices and case law can have a dramatic effect on the manner in which the courts will apply that Act in the context of class action litigation.