

By Donald W. Ricketts

The Ebb and Flow of Class Action Lawsuits

Despite their many controversies, class action lawsuits remain favored in California

Three years ago, Justice Gary V. Hastings of the California Court of Appeal signalled a change in attitude in California toward class action litigation. After pointing out that “as a general proposition” class actions are favored under both California and federal law, he opined, “but, the tide has turned.”¹ In support of his observation that “not all class actions are favored,” Justice Hastings cited federal legislation that more closely regulated class securities litigation.

One can, however, question whether this federal legislation is an appropriate barometer by which to measure the health of California class actions. Nearly 40 years after California expanded the use of class actions, they remain controversial, hotly contested, and continue to spawn appellate decision after appellate decision. But a trend remains elusive: Is the tide coming in or going out?

Before 1966, limited use of class actions was permitted in the federal courts under Rule 23 of the Federal Rules of Civil Procedure and, in California,

under its general joinder statute.² Then, in 1967, in *Daar v. Yellow Cab*,³ the California Supreme Court, following the lead of the federal courts, expanded the situations in which class actions could be maintained under the state’s joinder statute to include, among other suits, damage actions.

The *Daar* decision came one year after amendments to Rule 23 of the Federal Rules of Civil Procedure had expanded the use of class actions in federal courts. The amended rule set forth the elements for all class causes of action—numerosity, commonality, superiority, typicality, and adequacy—whether or not they sought damages or equitable relief. The requirements of federal Rule 23 were enacted into law in California in 1971 in the Consumers Legal Remedies Act⁴ which applied, however, only in limited situations and which contained requirements that further limited its use.

Four years later, in *Vasquez v. Superior Court*,⁵ the California Supreme Court did much more than express that class actions were favored “as a general proposition.” Justice Mosk, writing for a unanimous court, announced a broad, sweeping endorsement of class actions. The rationale and holding have never been criticized by an appellate opinion and stand yet today, still unimpaired as a statement of California public policy.

In making this sweeping

change, the court reached back to a 30-year-old commentary, published after the stock market crash of 1929, that advocated the use of class actions to vindicate shareholder rights. The court’s comments still resonate:

What was noteworthy in the milieu three decades ago for stockholders is of far greater significance today for consumers.... Frequently numerous consumers are exposed to the same dubious practice by the same seller so that proof of the prevalence of the practice as to one consumer would provide proof for all. Individual actions by each of the defrauded consumers is often impracticable because the amount of individual recovery would be insufficient to justify bringing a separate action; thus an unscrupulous seller retains the benefits of its wrongful conduct. A class action by consumers produces several salutary by-products, including a therapeutic effect upon those sellers who indulge in fraudulent practices, aid to legitimate business enterprises by curtailing illegitimate competition, and avoidance to the judicial process of the burden of multiple litigation involving identical claims. The benefit to the parties and the courts would, in many circumstances, be substantial.⁶

In 1986, the California policy favoring class actions was chal-

lenged in *State of California v. Levi Strauss & Co.*⁷ A variation on the problem of identifying class members raised in *Daar* was how money judgments or monetary settlements could be distributed to unidentified or unidentifiable class members. The defendants argued that the inability to directly benefit class members rendered maintenance of a class action a futile exercise that did little more than consume the resources of the courts without providing any significant benefit to any significant number of the class-member plaintiffs. In class action terms, the action failed to meet the requirement of “manageability.” The countervailing argument was that, while compensation to the class members was a significant justification to allow class actions to proceed, equally compelling was the notion that such actions punished culpable defendants by requiring them to disgorge their ill-gotten gains. These two views were reconciled by the California Supreme Court through “the largely uncharted area of fluid recovery.”⁸

In approving the use of the fluid recovery concept, the court outlined several particular applications of the doctrine that might be employed once payments to identified class members (by claims or otherwise) had been made: escheat, price rollbacks, additional payments to class members, and, as interveners had sought, a consumer trust fund. The court concluded:

[T]he sound approach of *Vasquez* continues to provide the proper framework. The trial courts

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should have the full range of alternatives at their disposal. In choosing the appropriate method, they should consider the amount of compensation provided to class members, the proportion of class members sharing in the recovery, the size and effect of the spillover to nonclass members, and the costs of administration.⁹

Representative Actions under the Unfair Competition Law

Even as *Daar*, *Vasquez*, and a host of other cases were settling and expanding California class action law, plaintiffs were increasingly exploring the use of California's Unfair Competition Law (UCL) as a vehicle for redressing a wide variety of wrongs encompassed by the act's broad description of condemned conduct—"any unlawful, unfair or fraudulent business act or practice."¹⁰ Increasingly, the act came to be viewed as a potentially easier form of representative action that might supplant class actions.

At the time of its enactment in 1933, the UCL provided only for actions seeking injunctions. But the California Supreme Court, in *People v. Superior Court*,¹¹ held that trial courts retained their inherent equitable power to order restitution under the UCL. The act was amended three years later to provide express authority to order restitution.

Most significantly, the UCL explicitly abolished any standing requirement—a requirement that the plaintiff must have been damaged by a defendant to sue it—by providing that an action under the act could be brought by "any person."¹² Viewed in class action terms, the representative plaintiff need not possess a claim typical of the members of the class. Equally significantly, the act provided that the court "may make such orders or judgments...as may be necessary to restore to any person in interest any money or property, real or personal, which may have been acquired by means of such unfair competition."¹³ On its face, "any person" could seek "restitution" on behalf of a class, even if he, she, or it had not been damaged by the defendant, without giving notice to the class, and without the right to opt out.

The first major challenge to the increasing use of the UCL was on its radical "no standing" provision. In 1980 an appellate court affirmed that the words "any person" did, indeed, dispense with traditional standing requirements:

Defendants argue below that this section does not enlarge the number of persons who may seek injunction to prevent unlawful business practices, and that traditional concepts of standing must be read into the statute.

Respondents point out that no cases have been litigated under this section wherein the plaintiff, suing on his own behalf and as a public attorney general, was not personally damaged by the conduct sought to be enjoined. Our research, too, has failed to disclose any such cases. However, we read the statute as expressly authorizing the institution of action by any person on behalf of the general public.¹⁴

The apparent limitation on the ability of a court to award damages under the act, which denominated the economic remedy available under it as "restitution," was also largely swept away. The California Supreme Court held, in *Cortez v. Purolator Air Filtration Products Company*, "The concept of restoration or restitution, as used in the UCL, is not limited only to the return of money or property that was once in the possession of that person....[R]estitutionary awards encompass quantifiable sums one person owes to another...."¹⁵

In a companion case decided the same day, *Krause v. Trinity Management Services Inc.*,¹⁶ the California Supreme Court defined "restitution" with even more expansive language: "all money obtained through an unfair business practice" and "all profits earned as a result of an unfair business practice"¹⁷—definitions that, if not synonymous with "damages," are very close.¹⁸

But *Kraus* rejected the notion that the act allowed "any person" to seek disgorgement *qua* restitution on behalf of unrepresented third parties without alleging and satisfying the requirements of a class action (which would include that the named plaintiff have a typical claim—that is, standing) and explicitly held that fluid recovery, the means for disgorgement, was not a remedy available under the UCL, unless a class had been certified in the action.¹⁹

The court first hinted at such a holding in 1979 in *Fletcher v. Security Pacific National Bank*:

Although an individual action may eliminate the potentially significant expense of pretrial certification and notice, and thus may frequently be a preferable procedure to a class action, the trial court may conclude that the adequacy of representation of all allegedly injured borrowers would best be assured if the case proceeded as a class action. Before exercising its discretion, the trial court must carefully weigh both the advantages and disadvantages of an individual action against the burdens and benefits of a class proceeding for the underlying suit.²⁰

Kraus was more explicit in holding that fluid recovery was available under the UCL only when a class action was certified:

In sum, the Legislature has not expressly authorized monetary relief other than restitution in UCL actions, but has authorized disgorgement into a fluid recovery fund in class actions.... Therefore, we decline to read the grant of equitable power in section 17203 as encompassing the authority to fashion a fluid recovery remedy when the action has not been certified as a class action.²¹

This limitation on the use of fluid recovery in UCL actions did not, however, represent a turning of the tide in the development of class action litigation. Indeed, *Kraus* and *Cortez* actually extended the use of the broad UCL tort of "unlawful, unfair and fraudulent business practices."

Ebb or Flow?

The introduction of the so-called Class Action Fairness Act in Congress in 2003 represented a clear attempt to turn the tide against class actions.²² The legislation was sponsored by business interests, including the tobacco industry, which perceived the federal courts as offering more favorable venues for class actions than state courts. The bill's goal was to allow removal of class actions filed in state court to federal court by expanding the diversity jurisdiction of the federal courts.

The legislation provided that for class actions there need not be complete diversity between plaintiffs and defendants, and it sought to reverse early class action decisions holding that the monetary value of individual class members' claims could not be aggregated to reach the minimum federal jurisdictional amount. In an effort to gain additional support, it tempered that restriction, somewhat, by providing that the aggregate value of the claims must be \$5 million or more, an increase from the \$2 million initially provided in the bill.²³

In July 2003, the bill passed in the House by a vote of 253-170. However, despite an intense lobbying effort, proponents failed by one to get the necessary votes to invoke cloture and allow the bill to come to a vote in the Senate. While it can be assumed that the proposal's supporters will attempt to pass the bill in this session of Congress, it will probably be difficult to do so in an election year.

In contrast to their failure to pass legislation last year, those who would turn the tide on class actions were more successful in 1995 and 1998 when securities litigation reform measures were passed and then amended,

providing the specific examples that Justice Hastings cited to support his observation that “the tide has turned.” The Private Securities Litigation Reform Act,²⁴ passed in 1995, imposed stricter pleading requirements, limited precertification discovery, and limited the number of actions in which a person may be a lead plaintiff. Amendments adopted in 1998 prohibited class actions by private parties (with certain exceptions) based on state statutory or common law.²⁵ This legislative activity may well suggest that the tide has ebbed in the limited area of federal securities class action litigation.

The tide may have ebbed as well in California in one other area: national class actions. The U.S. Supreme Court first approved national class actions in *Phillips Petroleum Company v. Shutts*,²⁶ a case in which a Kansas trial court certified a national class and applied Kansas law to resolve all the claims. The Supreme Court first swept away constitutional and jurisdictional objections to the maintenance of a national class action in state court. It held that a forum state may “assume jurisdiction over the claims of plaintiffs whose principal contacts are with other States” so long as the forum state affords due process—notice and the right to opt out.²⁷ But the Supreme Court held that when there are conflicts between the law of the forum state and the laws of the states where the claims arose, the forum state must have a “significant contact or significant aggregation of contacts” to the claims asserted by each member of the plaintiff class, contacts “creating state interests,” before a state court may apply its own law. This is designed to ensure that the choice of the forum state’s law is “not arbitrary or unfair.”²⁸ Thus national classes may be certified in state court and have been.

In *Washington Mutual Bank v. Superior Court*, the California Supreme Court affirmed that “if the relevant laws of each state are identical, there is no problem and the trial court may find California law applicable to class claims.”²⁹ The rock upon which national class actions most often founder appears when the court must apply multiple, conflicting state laws to resolve all the claims. In this situation it is likely that individual legal issues, raised by the various applicable state laws, will predominate over common issues, and the class will not be certifiable.

Washington Mutual represents a careful attempt by the California Supreme Court to detail the analyses that a trial court must make to determine if there are conflict of laws/commonality problems. The decision seems to indicate that the burden is first on the defendant to demonstrate that there are conflicts of law that prevent an across-the-

board application of California law. Once the defendant does so, the burden shifts to the plaintiff to demonstrate that the class is still manageable, for example, by the use of subclasses.³⁰

Washington Mutual also represents an effort by the supreme court to reconcile two earlier appellate court decisions, but the decision fails to do so fully. First, in 1988, in *Osborne v. Subaru of America, Inc.*,³¹ the Third District affirmed an order denying certification of a national class upon among other grounds “that California has [no] special obligation that would fairly call for this state to assume the burden of adjudicating this nationwide class action.”³² It appears that the Third District was not referring to the “contacts” test of *Phillips Petroleum*, but what it is referring to is not entirely clear. The opinion speaks of the burdens on the court of adjudicating a national class and appears to be saying that these burdens justify a refusal to certify a national class unless the state has some unspecified “special obligation.” Carried to its logical conclusion, no state would ever have a special obligation to adjudicate a national class action and, because class claims cannot be aggregated to meet the federal court jurisdictional dollar minimum, one could never maintain a national class action in any court. In *Washington Mutual*, the California Supreme Court noted *Osborne’s* “special obligation” requirement but neither adopted nor repudiated it.

Ten years later, in *Canon U.S.A., Inc. v. Superior Court*,³³ the Second District had held that the propriety of national-class certification could be attacked at the pleading stage by a motion to strike (or, presumably, demurrer). While the California Supreme Court referred to the *Canon* holding in *Washington Mutual*, it neither explicitly affirmed nor disapproved it. But it did hold that the issues should be resolved at the class certification hearing.³⁴ It would appear, therefore, that the certification of national class actions in California will be the subject of further clarifying opinions.

Looking Ahead

These recent court decisions show that the tide of class actions unleashed in 1966 by the amendments to Rule 23 and the warm embrace given them by the California courts commencing a year later has not turned. But that is not to say that, at some point, the class action critics will not have their way and will be able to, if not turn the tide, make it recede a bit.

Ever since the amendments to Rule 23 were debated, critics have argued that class actions hold the potential for great abuse and that the almost exclusive beneficiaries of an

expanded use of these suits will be the attorneys who bring them. That argument was put forth vigorously in support of the Class Action Fairness Act of 2003, and it is not without merit. An obvious potential for abuse exists when class counsel simultaneously negotiates the substantive settlement on behalf of the class and the agreement with defendants to pay attorney’s fees. The danger is, of course, that trade-offs will be made that benefit counsel at the expense of his or her class clients. While the practice has not been condemned absolutely, it is a factor that the court must consider in evaluating the fairness of the settlement.³⁵

However, two other areas equally subject to abuse have been the subject of little comment by the appellate courts. Given the potential of class actions for huge damage awards, large corporations (who are most often the defendants) initially reacted to them by resisting them at all costs. But, as time went on, sophisticated defendants came to appreciate the value of the full *res judicata* effect that class actions presented and began to devise ways that would provide that benefit while minimizing the payout. Two commonly used tactics emerged: claims-made settlements and prospective-relief settlements.

Under a claims-made settlement, the defendant agrees, often without limitation, to pay claims that are presented by class members pursuant to the notice that they are given. The reality is that only a very small percentage of class members make claims and the major payout, usually dwarfing the payout for damages, is for attorney’s fees. Thus, both goals justifying class actions—compensation to the numerous damaged persons and disgorgement—are defeated. If the goal of broad compensation cannot be, and often is not met because the class cannot be identified except through claims, the goal of disgorgement could be met by approving claims-made settlements only if the defendant agrees to a specific reasonable minimum payout with fluid recovery employed to utilize undistributed funds.

Under a prospective-relief settlement, the defendant agrees to pay attorney’s fees and to modify its practices in the future (in effect, a consent decree), thus conferring a benefit on its future customers, though not necessarily on the same customers it damaged in the past. The problem with prospective relief settlements is that once the matter is concluded, no one is left to monitor whether the defendant is living up to its promises, which were sometimes illusory in the first place. A reporting requirement as a condition of settlement approval could ensure that prospective relief is meaningful.

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courts and parties to settle cases, and that pressure undoubtedly results in class action settlements that, but for attorney's fees provisions, are more shadow than substance. It remains to be seen whether such class action settlements will receive greater scrutiny by the courts. If they do not, it may be that mounting criticism will result in a legislative turning of the tide. ■

¹ Howard Gunty Profit Sharing Plan v. Superior Court, 88 Cal. App. 4th 572, 578 (2001).

² CODE CIV. PROC. §378.

³ Daar v. Yellow Cab, 367 Cal. 2d 695 (1967). Daar was brought on behalf of a class of overcharged taxicab patrons who could not be identified unless they individually stepped forward and identified ("ascertained") themselves. Daar held that "ascertainability" does not turn on the question of whether individual members of the class can be identified but rather on whether there exists a "community of interest among the class members in the questions of law and fact involved" so that "the judgment...will be res judicata as to all persons to whom the common questions of law and fact pertain." *Id.* at 706.

⁴ Consumers Legal Remedies Act (codified at CIV. CODE §1781).

⁵ Vasquez v. Superior Court, 4 Cal. 3d 800 (1971).

⁶ *Id.* at 807-08.

⁷ California v. Levi Strauss & Co., 41 Cal. 3d 460 (1986).

⁸ *Id.* at 479.

⁹ *Id.*

¹⁰ BUS. & PROF. CODE §§17200 *et seq.*

¹¹ People v. Superior Court, 9 Cal. 3d 283 (1973).

¹² BUS. & PROF. CODE §17204.

¹³ BUS. & PROF. CODE §17203.

¹⁴ Hernandez v. Atlantic Fin., 105 Cal. App. 3d 65, 71-72 (1980).

¹⁵ Cortez v. Purolator Air Filtration Prods. Co., 23 Cal. 4th 163, 178 (2000).

¹⁶ Kraus v. Trinity Mgmt. Servs., Inc., 23 Cal. 4th 116 (2000).

¹⁷ *Id.* at 127.

¹⁸ In *Korea Supply Co. v. Lockheed Martin Corp.*, 29 Cal. 4th 1134, 1149 (2003), the supreme court pulled back a bit to restore somewhat the traditional notions of restitution when it redefined UCL restitution as "funds in which [plaintiff] has an ownership interest."

¹⁹ Kraus, 23 Cal. 4th at 137.

²⁰ Fletcher v. Security Pac. Nat'l Bank, 23 Cal. 3d 442, 453-54 (1979).

²¹ Kraus, 23 Cal. 4th at 132.

²² Class Action Fairness Act, H.R. 2341, S. 1751, 108 Cong., 1st Sess. (2003).

²³ *Id.*

²⁴ The Private Securities Litigation Reform Act, 15 U.S.C. §§77a *et seq.* (1995).

²⁵ *Id.*

²⁶ Phillips Petroleum Co. v. Shutts, 472 U.S. 797 (1985).

²⁷ *Id.* at 812.

²⁸ *Id.* at 821-22 (quoting Allstate Ins. Co. v. Hague, 449 U.S. 302, 312-13 (1981)).

²⁹ Washington Mut. Bank v. Superior Court, 24 Cal. 4th 906, 920 (2001).

³⁰ *Id.*

³¹ Osborne v. Subaru of Am., Inc., 198 Cal. App. 3d 646 (1988).

³² *Id.* at 663.

³³ Canon U.S.A., Inc. v. Superior Court, 68 Cal. App. 4th 1 (1998).

³⁴ Washington Mutual, 24 Cal. 4th at 926.

³⁵ See *Owners v. Southland Corp.*, 85 Cal. App. 4th 1135, 1158-59 (2000).