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SOUTHERN DISTRICT CIVIL PRACTICE ROUNDUP

BY EDWARD M. SPIRO

Recent Class-Certification Decisions

The aftermath of the dot-com stock market bubble has focused increased attention on the class action as a vehicle for litigating claims of numerous potential plaintiffs.

While class actions often present complicated issues of organization and administration, they offer a mechanism for resolving many claims that might otherwise never be brought because of financial considerations. They also provide an efficient vehicle for resolving other claims, which if brought individually, would threaten to inundate the federal courts. Because the stakes for defendants increase exponentially when a class is certified, motions for class certification are frequently among the most hotly contested issues in such cases — generating a significant and substantial body of case law interpreting almost every aspect of Federal Rule of Civil Procedure 23.

We discuss below a number of recent class-certification decisions from courts in the U.S. District Court for the Southern District of New York.

Basic Requirements of Rule 23

Most disputes over class certification focus on the requirements of Rule 23(a), which contains four elements that a proposed class and its representatives must meet, and Rule 23(b), which contains the exclusive list of the types of cases which may be maintained as class actions under the rule.

Rule 23(a) requires:

(1) that the proposed class be so numerous that joinder of all members is impracticable (numerosity);

(2) that there be questions of law or fact common to the class (commonality);

(3) that the claims or defenses of the representative parties be typical of the class's claims or defenses (typicality); and

(4) that the representative parties fairly and adequately protect the interests of the class (adequacy).

In addition to satisfying each of the 23(a) requirements, a class action must meet the conditions for one of the "maintainable" categories of actions described in Rule 23(b). The two most common types of class actions are for injunctive relief under 23(b)(2) and for damages under 23(b)(3).

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Numerosity

There is no precise minimum number of potential class members below which a class action may not be maintained, but courts in the U.S. Court of Appeals for the Second Circuit have recognized a presumption that the numerosity requirement will be satisfied where there are more than 40 class members.[1] Courts look to a number of factors in evaluating numerosity, including: judicial economy; the geographic dispersion of the individual class members; their financial resources and ability to institute individual actions; the amount of their individual claims; knowledge of the potential class members' names and existence; and whether they have already joined other actions. Applying these factors in *Bayridge Volvo American, Inc. v. Volvo Cars of North America Inc.*,[2] Judge Richard M. Berman found that a plaintiffs' proposed class consisting of at most 30 franchised Volvo dealerships did not meet the numerosity requirement of Rule 23(a)(1). He noted that the small number of potential class members, even though they were dispersed throughout New York State, did not make joinder impracticable. He also found that the financial resources of the proposed class members (automobile dealerships) and the relatively large amount of each dealership's claims (based on inadequate reimbursement for parts used in warranty repairs) also weighed against certification, stressing that one of the goals of class certification is to permit small claimants a method for obtaining redress for claims that would otherwise be too small to litigate.

Ascertainability

In some putative class actions, the question is not whether there are enough potential class members to qualify for class-action status, but rather, whether the members of the class can be meaningfully ascertained. This ascertainability requirement, which is not expressly contained in Rule 23, has been recognized by a number of courts as an implied requirement that the class be identifiable and that its membership be ascertainable by reference to objective criteria.

In her recent, lengthy decision in *In re Initial Public Offering Securities Litigation*,[3] Judge Shira A. Scheindlin held that ascertainability required honing the class definition to exclude potential class members who would not be entitled to recovery because of their knowing participation in the complex fraudulent scheme alleged in that case. That "laddering" scheme involved actions taken by the defendant underwriters to inflate artificially the share prices of stocks by requiring investors who received IPO allocations to purchase additional shares in the aftermarket, in some instances at pre-arranged, escalating prices, and to pay inflated and undisclosed compensation to the underwriters. Recognizing that investors who knowingly participated in this alleged scheme could not have been defrauded, and thus had no right to recover, Judge Scheindlin rejected the defendants' assertion that identifying which of the thousands of investors in those offerings should be excluded would be a "massive undertaking." She held that "[a]scertainability, not ascertainment, is a prerequisite to class certification," concluding that it was sufficient at the class-certification stage that the definition of the plaintiff class broadly exclude those investors who knowingly participated in the alleged scheme. This was accomplished by excluding those who engaged in the acts which drove up the securities prices, and who also exhibited their knowledge of the scheme by selling their shares for a profit before the effects of the fraud dissipated.[4]

Typicality

In *Davis v. Lenox Hill Hospital*,[5] the named plaintiff, a registered nurse (RN), sought to bring claims on behalf of all private duty nurses working at Lenox Hill Hospital for refusal to pay overtime wages and improper payroll deductions. Because some of those nurses (including the named plaintiff) were members of an Elite Corps of RNs, subject to special wage guarantees and benefits, and others were non-Elite Corps RNs, and less-skilled licensed practical nurses and nurse's aids, Judge Denise Cote concluded that the named plaintiff's claims were typical of only the handful of other Elite Corps RNs (whose numbers were too few to satisfy numerosity) and not to the proposed class as a whole, because the remaining categories of nursing jobs were governed by different pay and benefits policies. Judge Cote therefore denied class certification under Rule 23.

Similarly, in *Scott v. New York City District Council of Carpenters Pension Plan*[6] — an ERISA class action — Judge Richard Owen held that questions over whether the named plaintiffs had exhausted their administrative remedies were defenses unique to them that threatened to become the focus of the litigation, and that rendered their claims atypical and made them unsuitable representatives of the class.

By contrast, Judge Constance Baker Motley rejected a typicality challenge based on differences in the job descriptions of the proposed class members in *Cokely v. New York Convention Center Operating Corp.*[7] — a race discrimination case challenging, among other things, the promotion and work assignment practices at the Javits Center. She found that class certification was appropriate even though the claims relating to work opportunities for minority workers differed depending on the particular type of job at issue. Judge Motley held that factual backgrounds need not be identical, ruling that the root of the claims of the proposed class members turned on the allegation of pervasive subordination of minority employees — which she found sufficient to satisfy the typicality requirement.

Adequacy

The two primary considerations in the adequacy inquiry focus on whether the named plaintiffs have interests that are antagonistic to the class, and whether they are sufficiently familiar with the action to prevent abdication of control over the litigation to class counsel. Each of these considerations figured prominently in several recent cases in the Southern District.

Finding that the litigation "fairly brim[med] with ulterior motives," Judge Michael B. Mukasey refused to certify the proposed class in *Martinez v. Barasch*,[8] a suit alleging breach of fiduciary duties by the administrators of union employee benefits plans. He accepted the defendants' assertion that the plaintiffs were pawns of a rival union, recruited for the purposes of starting the lawsuit that was in fact spearheaded and funded by the rival union. In addition, some of the named plaintiffs were followers of the rival union. Judge Mukasey concluded that the named plaintiffs' association with the rival union made them antagonistic to the members of the class who continued to support the defendant union. He also found that the class representatives, who were largely unfamiliar with the defendants in the lawsuit, were excessively reliant on counsel for both legal and factual information pertaining to the litigation, making them inadequate representatives. Similarly, in *Scott*, the ERISA litigation discussed above, Judge Owen found the named plaintiffs inadequate on the basis of their "alarming lack of familiarity with the suit, as well as little or nonexistent knowledge of their role as class representatives."

In certain circumstances, courts are more forgiving where named plaintiffs are uninformed about the details of the litigation. Recognizing that there was some question as to whether the named plaintiff in *Noble v. 93 University Place Corp.*[9] was familiar with the action and had the ability to at least minimally supervise class counsel, Judge Scheindlin concluded that these concerns did not require a finding of inadequacy. She noted that the named plaintiff in that action seeking overtime pay on behalf of a class of restaurant workers, understood that the action concerned overtime pay and had some basic familiarity with the legal system. She also stressed that despite his arguable inability to supervise class counsel, "rigid application of this requirement is inappropriate where, as here, the class comprises relatively low-skilled laborers … [and would] run counter to a principal objective of the class action mechanism — to facilitate recovery for those least able to pursue an individual action."

Predominance

Plaintiffs seeking certification of a class action for damages have an additional hurdle to overcome. Rule 23(b)(3) requires that questions of law or fact common to the class must predominate over questions affecting individuals. This predominance requirement has far more teeth than the commonality requirement of Rule 23(a), which requires only that common issues exist, not that they predominate. Where common issues predominate on the question of liability, a class action need not be "scuttled" simply because computation of damages requires individualized findings. In such cases, the court may bifurcate liability and damages, decertify the class for purposes of calculating damages, create damages subclasses or otherwise alter or amend the class following the liability phase.[10] But where individual questions must be resolved at the liability phase, such determinations are often fatal to the class certification.

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In cases where causation must be proven for each plaintiff, the predominance requirement is often, but not inevitably, insurmountable. For example, in *In re Currency Conversion Fee Antitrust Litigation*,[11] Judge William H. Pauley III concluded that the plaintiffs' antitrust class could be certified, because they had articulated a methodology which allowed proving antitrust injury that was common to the entire class, while their state law deceptive trade practices claim could not be certified, because individual questions relating to causation would predominate. Specifically, under the state deceptive trade practices law, each plaintiff would have to show that Citibank's disclosure of its currency conversion fees was inadequate, causing the cardholder to be deceived into using the Citi bank card rather than other, more economical options. This inquiry would require examination of each cardholder's understanding, and whether it was justified — inquiries which would overwhelm the common questions on that claim.[12]

The Second Circuit's recent decision in *Hevesi v. Citigroup Inc. (In re WorldCom, Inc. Sec. Litig.)*,[13] raises important questions about the extent to which certain types of securities fraud claims will be stymied by the predominance requirement. In *Basic Inc. v. Levinson*,[14] the Supreme Court permitted securities fraud plaintiffs seeking class action status to use a "fraud-on-the-market" presumption rather than requiring them to show individual reliance on the misstatement of an issuer. The court reasoned that in an efficient securities market, misleading statements will affect the price of a security, and thus defraud the purchaser, even if the purchaser did not directly rely on the misstatement. *Basic* arose in the context of misleading statements by an issuer.

Judge Cote extended the fraud-on-the-market presumption to statements made by stock analysts in her decision certifying the class action in *In re WorldCom, Inc. Sec. Litig.*[15] In granting an interlocutory appeal of that order, the Second Circuit, in *Hevesi*, found that the defendants had raised a substantial legal argument challenging whether the *Basic* presumption could be extended to an analyst's opinions as opposed to an issuer's statement of fact, without some showing that the analyst's statement affected the market price. The appeal of the *WorldCom* class-certification order presumably has been mooted by the intervening settlement of that case[16] — but questions raised by the *Hevesi* opinion concerning application of the fraud-on-the-market presumption in analyst cases remain.

Relying on *Hevesi*, Judge Jed S. Rakoff recently held in *DeMarco v. Lehman Brothers, Inc.*[17] that the plaintiffs had not met their burden of adducing admissible evidence making a prima facie showing that an analyst's challenged recommendations had had a material and measurable impact on the market price of the subject security. Because plaintiffs failed to make this showing, they could not rely on the fraud-on-the-market presumption and would have to prove reliance individually, requiring denial of their motion for class certification.[18]

1. See, e.g., *Consol. Rail Corp. v. Town of Hyde Park*, 47 F3d 473, 483 (2d Cir. 1995); *Noble v. 93 University Place Corp.*, 224 FRD 330, 338 (SDNY 2004) (Scheindlin, J.).
2. 2004 WL 1824379 (SDNY Aug. 16, 2004).
3. 2004 WL 2297401 (SDNY Oct. 13, 2004).
4. See also *Noble*, 224 FRD 330.
5. 2004 WL 1926086 (SDNY Aug. 31, 2004) (Cote, J.).
6. 224 FRD 353 (SDNY 2004).
7. 2004 WL 1152531 (S.D.N.Y. May 21, 2004).
8. 2004 WL 1367445 (S.D.N.Y. June 16, 2004).
9. 224 F.R.D. 330 (S.D.N.Y. 2004).
10. *In re Initial Public Offering Securities Litigation*, 2004 WL 2297401, at *36-37, citing *In re VISA Check/MasterMoney Antitrust Litigation*, 280 F3d 124, 141 (2d Cir. 2001).
11. 2004 WL 2327938 (S.D.N.Y. Oct. 15, 2004).
12. Another interesting question addressed in this decision was whether arbitration agreements signed by putative class members barred them from participating in the class action litigation. Judge Pauley held that to the extent those arbitration clauses were added to cardholder agreements after the litigation had commenced, they were the result of impermissible contact with members of the putative plaintiff class for the purpose of altering the status of a pending litigation, and were thus unenforceable. Arbitration agreements entered into prior to the litigation were enforceable, but only against the bank with whom that agreement was made. Accordingly, cardholders who had signed such agreements were not estopped from litigating their claims against other banks based on collusive activity between the signatory and non-signatory banks.
13. 366 F3d 70 (2d Cir. 2004).
14. 485 US 224 (1988).
15. 219 F.R.D. 267 (S.D.N.Y. 2003).
16. 2004 WL 2591402 (S.D.N.Y. Nov. 12, 2004).
17. 222 F.R.D. 243 (S.D.N.Y. 2004).
18. See Leon P. Gold & Richard L. Spinogatti, "Class Certification in Fraud Cases Against Research Analysts," NYLJ, Aug. 11, 2004.