

Schiff Hardin LLP Class Action Newsletter

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1. CONGRESS REVISES APPEAL PERIOD FOR CLASS ACTION REMAND ORDERS

SUMMARY

Effective December 1, 2009, the time in which to appeal from a class action remand order will be “no more than 10 days” after entry of the order in the district court. Statutory Time-Periods Technical Amendment Act of 2009, Pub. L. No. 111-16, § 6(2), 123 Stat. 1608, 1609 (2009) (amending 28 U.S.C. § 1453(c)(1)).

Section 1453(c)(1) currently provides for a deadline of “not *less* than 7 days.”

Background

The Class Action Fairness Act of 2005 (“CAFA”) provides for an expedited, discretionary appeal of an order “granting or denying a motion to remand a class action.” 28 U.S.C. § 1453(c)(1). The current deadline for application to the court of appeals is “not less than 7 days” after entry of the remand order. *Id.*

Did Congress *really* mean “not *less* than 7 days”?

Most courts have concluded that this language was a typographical error, and that the statute was intended to read: “not *more* than 7 days.” *See, e.g., Estate of Pew v. Cardarelli*, 527 F.3d 25, 28 (2d Cir. 2008); *Morgan v. Gay*, 466 F.3d 276, 277 (3d Cir. 2006); *Amalgamated Trans. Union Local 1309, AFL-CIO v. Laidlaw Trans. Servs., Inc.*, 435 F.3d 1140, 1146 (9th Cir. 2006); *Pritchett v. Office Depot, Inc.*, 420 F.3d 1090, 1093 n.2 (10th Cir. 2005); *Miedema v. Maytag Corp.*, 450 F.3d 1322, 1326 (11th Cir. 2006).

The Seventh Circuit, however, has concluded that “less” really did mean “less”: a notice of appeal that was filed prematurely (i.e., before the seventh day) “springs into effect when the decision becomes appealable” on the eighth day. But the time for appeal was not open-ended: under Federal Rule of Appellate Procedure 5(a)(2), when no time period is specified, the “default” 30-day period of Rule 4(a) applies. *Spivey v. Vertrue, Inc.*, 528 F.3d 982, 983, 985 (7th Cir. 2008); *see also In re U-Haul Int’l, Inc.*, No. 08-7122, 2009 WL 902414, at *2 (D.C. Cir. Apr. 6, 2009) (noting circuit split, but also courts’ agreement that petition filed prior to 7 days is either timely or ripens into timely application); *Bartnikowski v. NVR, Inc.*, 307 F. App’x 730, 733 n.5 (4th Cir. 2009) (noting circuit split, but holding that petition filed exactly 7 days after entry of order was timely).

The amendment clears up the confusion, and revises the time period to “not more than 10 days.”

The amendment will take effect on December 1, 2009.

2. FIRST CIRCUIT UPHOLDS REMAND UNDER CAFA'S "HOME STATE" EXCEPTION

SUMMARY

In a case of first impression for the First Circuit, the Court upheld a remand to state court under CAFA's "home state" exception. *In re Hannaford Bros. Co. Customer Data Sec. Breach Litig.*, 564 F.3d 75 (1st Cir. 2009). The Court rejected the defendant's argument that the plaintiff had carefully crafted his complaint in an attempt to avoid CAFA jurisdiction, in violation of congressional intent to expand federal jurisdiction over class actions of national importance.

The home-state exception requires a federal court to decline jurisdiction if "two-thirds or more of the members of all proposed plaintiff classes in the aggregate, and the primary defendants," are citizens of the forum state. 28 U.S.C. § 1332(d)(4)(B).

The First Circuit held that, under the complaint as drafted, the home-state exception clearly applied: all members of the putative plaintiff class, as well as the lone defendant, were citizens of the forum state. The Court declined to consider the citizenship of plaintiff class members in numerous other related federal class actions, which had been consolidated by the MDL Panel. The Court rejected the argument that the home-state exception requires a broader assessment of claims brought by others who do not fall within the complaint's class definition, or of the claims available to the class against other possible defendants.

The Proceedings Below

The plaintiff, a Florida resident, alleged that the defendant, a Florida-based retail grocery chain, had failed to implement adequate security measures to protect customers' debit and/or credit card information. 564 F.3d at 76-77. The plaintiff brought a putative class action in Florida state court on behalf of a class of Florida citizens. In fact, the class definition explicitly excluded "any persons and entities who are not citizens of the State of Florida." *Id.* at 77.

The defendant removed the case to Florida federal district court, but the Judicial Panel on Multidistrict Litigation transferred the case to the District of Maine, where twenty-four other related lawsuits (involving 4.2 million class members) had been consolidated against affiliates of the defendant. *Id.*

The district court granted the plaintiff's motion to remand, finding that the requirements of CAFA's "home state" exception were satisfied.

The First Circuit's Decision

The First Circuit affirmed.

The Court joined other federal courts of appeals by holding that, as the party relying on an exception to federal removal jurisdiction, the plaintiff had the burden of proving that the home-state exception applies. *Id.* at 78.

The Court then observed that, "at first blush," the home-state exception seemed clearly to apply here, since all plaintiff class members, and the sole defendant, were citizens of Florida. *Id.* The defendant argued, however, that the phrase "the members of all proposed plaintiff classes in the aggregate" in Section 1332(d)(4)(B) required the court to look beyond the "four corners" of the plaintiff's complaint and consider

“all previously filed class actions which arise from a core nucleus of operative facts such as to meet an ‘Article III case or controversy’ requirement.” *Id.* at 78.

The First Circuit rejected that argument as contrary to the plain language of Section 1332(d)(4)(B). *Id.* at 79. The Court held that the home-state exception’s “use of the plural ‘classes’ ” could simply refer to the fact that a single complaint may contain multiple proposed classes. *Id.*

The Court noted, however, that the “four corners” of the plaintiff’s complaint do not necessarily control the “home state” issue: “We can imagine situations—for example, if the plaintiff has omitted an indispensable defendant—where looking beyond the four corners of the plaintiff’s complaint may be necessary to determine whether the home state exception applies.” *Id.* But the Court concluded that this situation did not apply here.

The Court also rejected the defendant’s argument that giving effect to a plaintiff’s careful pleading around CAFA jurisdiction is contrary to congressional intent to expand federal jurisdiction over class actions of national importance. The Court noted that the home-state exception was “fairly narrow” and that plaintiffs “potentially sacrifice a great deal in terms of the parties they can sue and the claims they can bring by narrowing their pleadings to fit within the home state exception.” *Id.* at 80.

3. SEVENTH CIRCUIT UPHOLDS CAFA REMOVAL OF PRE-CAFA CASE WHEN DECERTIFICATION OF DEFENDANT CLASS INCREASED SOLE REMAINING DEFENDANT'S POTENTIAL LIABILITY

SUMMARY

CAFA applies to any civil action “commenced on or after the date of enactment of this Act”: February 18, 2005. But suits filed in state court even *before* CAFA’s effective date may be removed to federal court if events in the lawsuit effectively “commence” a new action *after* CAFA’s effective date.

In yet another twist on the “relation back” theory of CAFA commencement, the Seventh Circuit held that the decertification in state court of a defendant class, which increased the sole remaining defendant’s potential liability to the plaintiff class, did not “relate back” to the original state court complaint. *Marshall v. H&R Block Tax Servs., Inc.*, 564 F.3d 826 (7th Cir. 2009). Under these circumstances, the Court held, a new, post-CAFA case “commenced” against the remaining defendant, allowing the defendant to remove the case to federal court under CAFA.

The Proceedings Below

Before CAFA was enacted, the plaintiffs filed in state court a putative class action against a defendant class consisting of H&R Block and related companies, and alleged that the defendants had violated the Illinois Consumer Fraud Act by using deceptive practices to sell “Peace of Mind” insurance against mistakes by H&R Block. *Id.* at 827. An amended complaint added another H&R Block affiliate as well as H&R Block Tax Services, Inc. (“TSI”), the franchisor of H&R Block franchised retail tax offices. *Id.*

The state court then dismissed all defendants other than TSI, which was left as the sole representative of the defendant class. The state court certified three plaintiff classes (comprising persons in all 50 states and the District of Columbia), and, sometime after CAFA’s effective date, decertified the defendant class at TSI’s request, leaving TSI as the sole defendant. The state court also narrowed the three plaintiff classes to customers in 13 states. *Id.* at 827-28.

TSI removed the case to federal court, claiming that the post-CAFA decertification of the defendant class increased TSI’s potential liability to the plaintiff classes, despite the narrowing of the plaintiff classes to residents from only 13 states. TSI estimated that its additional potential liability was \$60 million. *Id.* at 828.

The district court remanded the case to state court, ruling that only a formal amendment of the complaint could “commence” a new action for CAFA purposes. *Id.*

The Seventh Circuit’s Decision

The Seventh Circuit reversed.

The Court first noted that if, when TSI was a defendant class representative, it would have been jointly and severally liable for the unlawful acts of all defendant class members, then decertification of the defendant class would not have increased TSI’s potential liability. *Id.* But the Court noted that merely being named as a defendant would not render TSI jointly and severally liable for the acts of its affiliates, because “the doctrine of limited liability ordinarily insulates a corporation from the tort or other liabilities of its affiliates.” *Id.*

The Court also observed that TSI's mere status as a defendant class representative would not have created such derivative liability, either: "Defendant classes are certified in order to facilitate the economical resolution of common issues rather than to alter the substantive rights of parties or class members." *Id.*

And the Court also noted that even though the original and amended complaints generally alleged joint and several liability, it could not be assumed that, with three other defendants gone from the case, TSI's status was unchanged: "Illinois law requires that conspiracy or other concerted action be pleaded specifically." *Id.* at 829.

The Court then turned to the key issue: "whether the change in the scope of the plaintiffs' claim relates back to the original claim." *Id.* The Court held that the relevant federal and Illinois "relation back" criteria are the same, and focus on the elements of notice and unfair surprise: "the criterion of relation back is whether the original complaint gave the defendant enough notice of the nature and scope of the plaintiff's claim that he shouldn't have been surprised by the amplification of the allegations of the original complaint in the amended one." *Id.* (internal quotations omitted).

Here, the Court concluded, TSI's liability under the original claims "was significantly less extensive than the liability now claimed as a result of the decertification of the defendant class." *Id.* As a result, there was no "relation back": "from the standpoint of the original claim, the expansion of potential liability was a surprise." *Id.*

4. U.S. SUPREME COURT AGREES TO DECIDE WHETHER ARBITRATION AGREEMENTS THAT ARE “SILENT” ON CLASS ACTIONS PERMIT CLASSWIDE ARBITRATION

SUMMARY

The United States Supreme Court has agreed to revisit the vexing issue whether, under the Federal Arbitration Act, parties may be required to proceed to classwide arbitration when their arbitration agreement is “silent” on the issue. *Stolt-Nielsen S.A. v. AnimalFeeds Int’l Corp.*, 548 F.3d 85 (2d Cir. 2008), *cert. granted*, 77 U.S.L.W. 3562, 2009 WL 803120 (U.S. June 15, 2009) (No. 08-1198).

The case could resolve the conflicts among federal and state courts in the wake of the Supreme Court’s fractured decision in *Green Tree Financial Corp. v. Bazzle*, 539 U.S. 444 (2003). There, the Supreme Court granted certiorari to consider whether a South Carolina Supreme Court decision holding that a party can be ordered to classwide arbitration when the arbitration provision is silent as to class arbitration was consistent with the FAA.

The Supreme Court, however, did not definitively resolve whether the FAA prohibits imposing classwide arbitration when the arbitration agreements are silent on the matter. Instead, a plurality of the Court concluded that because the parties’ contract in that case contained “sweeping language concerning the scope of the questions committed to arbitration,” the decision whether arbitration could proceed on behalf of a class was a question of contract interpretation for the arbitrator to decide.

Since then, federal and states courts have divided sharply over the meaning of *Bazzle*, as well as the issue generally whether the FAA permits classwide arbitration absent an express agreement by the parties.

The District Court Proceedings

The plaintiffs filed a class action suit in federal court alleging that the defendants conspired to restrain competition for parcel tanker shipping services, in violation of federal antitrust laws. The defendants moved to compel arbitration. The district court denied the motion, but the Second Circuit reversed, holding that the parties’ transactions were governed by contracts with enforceable agreements to arbitrate and that the antitrust claims were arbitrable. 548 F.3d at 87-88.

The parties then agreed, among other things, that the arbitrators would be bound by Rule 3 of the AAA’s Supplementary Rules for Class Arbitrations, which provided, in relevant part:

Upon appointment, the arbitrator shall determine as a threshold matter, in a reasoned, partial final award on the construction of the arbitration clause, whether the applicable arbitration clause permits the arbitration to proceed on behalf of or against a class (the “Clause Construction Award”).

Id. at 88. The plaintiffs then filed a demand for class arbitration. The arbitration clause was silent on the issue of classwide arbitration, but instead provided that “[a]ny dispute arising from the making, performance or termination” of the contract must be arbitrated. *Id.* at 89.

The arbitration panel took evidence on whether the arbitration clause was intended to permit class arbitration, and issued a “Clause Construction Award” holding that the agreement *did* permit classwide

arbitration. The panel based its decision largely on the fact that in all published clause construction awards issued under AAA Rule 3, the arbitrators had interpreted a “silent” clause to permit classwide arbitration. *Id.* at 89-90.

The district court vacated the Clause Construction Award, holding that the Award was made in “manifest disregard of the law.” *Id.* at 90. The district court concluded that the dispute was governed by federal maritime law, that federal maritime law requires that the interpretation of charter parties be dictated by custom and usage, and that the defendants had demonstrated that maritime arbitration clauses were never subject to class arbitration. *Id.*

The Second Circuit’s Decision

The Second Circuit reversed.

The Court emphasized that arbitral awards are entitled to “great deference,” and that the defendants had the “heavy burden” of proving that the Clause Construction Award was “in manifest disregard of the law.” *Id.* at 90-91. (The Court also concluded that the “manifest disregard” doctrine survived the Supreme Court’s decision in *Hall Street Associates, L.L.C. v. Mattel, Inc.*, ___ U.S. ___, 128 S. Ct. 1396 (2008). See 548 F.3d at 93-95.)

In upholding the Clause Construction Award, the Court acknowledged the decisions of other federal courts that do not permit classwide arbitration unless it is expressly authorized in the arbitration agreement. See *id.* at 99-100. The Court concluded, however, that these decisions were “abrogated” by the Supreme Court’s decision in *Bazzele*. The Second Circuit held that there was nothing in federal maritime law, or New York contract law, that foreclosed interpreting “silent” arbitration clauses to permit classwide arbitration.

5. JAMS REVISES PROCEDURES ON CLASS ACTION ARBITRATION

SUMMARY

Judicial Arbitration and Mediation Services (“JAMS”), one of the major providers of ADR services, has enacted new rules, effective May 1, 2009, regarding “class action waiver” provisions in arbitration agreements. The new rules make clear that JAMS will not administer a demand for class action arbitration when the arbitration agreement “contains a preclusion clause, or its equivalent,” unless a court orders the matter to proceed to classwide arbitration. See http://www.jamsadr.com/rules/class_action.asp.

Background

In November 2004, JAMS announced that it would not enforce “class action waiver” clauses in class action arbitrations involving consumers, unless the consumer waived any such rights to a class action in an individual case.

After several months of protests by corporations and defense counsel (some of whom dropped JAMS as an ADR provider), JAMS withdrew this policy, but still retained the authority to determine the validity of class action waivers.

The new rules, effective May 1, 2009, make clear that JAMS will not administer a demand for classwide arbitration if the arbitration agreement contains a “class preclusion clause, or its equivalent,” unless a court orders the matter to classwide arbitration.

6. CALIFORNIA SUPREME COURT IN “*TOBACCO II CASES*” HOLDS THAT UCL STANDING REQUIREMENTS APPLY ONLY TO CLASS REPRESENTATIVE, NOT PUTATIVE CLASS MEMBERS

SUMMARY

In a long-awaited ruling, the California Supreme Court held that the standing requirements of California’s Unfair Competition Law (“UCL”) apply to the putative class representative, but not to the putative class members. *In re Tobacco II Cases*, 46 Cal. 4th 298, 207 P.3d 20 (2009). Moreover, the Court held that the UCL standing provisions require that a class representative “demonstrate actual reliance on the allegedly deceptive or misleading statements, in accordance with well-settled principles regarding the element of reliance in ordinary fraud actions.”

Prior to its 2004 amendment, the UCL permitted “any person” to sue for consumer fraud on behalf of “the general public,” regardless of whether the named plaintiff actually was injured by the challenged practice. In 2004, Proposition 64 amended the UCL to provide that “[a]ny person may pursue representative claims or relief on behalf of others only if the claimant meets the standing requirements of Section 17204”

The lower court interpreted Proposition 64 to require that all putative class members satisfy this standing requirement, and it decertified a class consisting of smokers who alleged that tobacco companies’ marketing and advertising practices were unfair and deceptive. The California Supreme Court disagreed, reversing the decertification and remanding for additional proceedings to determine whether the named plaintiffs could demonstrate UCL standing.

The Proceedings Below

The plaintiffs alleged that the tobacco industry defendants violated the UCL by engaging in a “decades-long campaign of deceptive advertising and misleading statements about the addictive nature of nicotine and the relationship between tobacco use and disease.” 207 P.3d at 25.

Before Proposition 64, the trial court had certified a California class action consisting of all persons who, while they were residents of California, smoked in California one or more cigarettes between June 10, 1993 to April 23, 2001, and who were exposed to the defendants’ advertising. *Id.* at 27-28.

After Proposition 64, the trial court granted the defendants’ motion to decertify the class on the grounds that each class member would be required to show “injury in fact,” consisting of lost money or property, as a result of the alleged unfair competition. *Id.* at 28.

The California Court of Appeal affirmed, and the California Supreme Court accepted review.

The California Supreme Court’s Decision

More than two years later, the California Supreme Court reversed.

- **The Bottom Line**

The Court succinctly summarized the two key questions presented and the Court’s rulings:

1. “First, who in a UCL class action must comply with Proposition 64’s standing requirements, the class representatives or all unnamed class members, in order for the class action to proceed?”

We conclude that standing requirements are applicable only to the class representatives, and not all absent class members.”

2. “Second, what is the causation requirement for purposes of establishing standing under the UCL, and in particular what is the meaning of the phrase “as a result of” in section 17204?”

We conclude that a class representative proceeding on a claim of misrepresentation as the basis of his or her UCL action must demonstrate actual reliance on the allegedly deceptive or misleading statements, in accordance with well-settled principles regarding the element of reliance in ordinary fraud actions. Those same principles, however, do not require the class representative to plead or prove an unrealistic degree of specificity that the plaintiff relied on particular advertisements or statements when the unfair practice is a fraudulent advertising campaign.”

Id. at 25. The Court therefore reversed the decertification order to the extent it was based on the conclusion that all class members were required to demonstrate “Proposition 64” standing, and it remanded for further proceedings to determine whether the class representatives “have, or can demonstrate,” standing. *Id.* at 26.

- **Proposition 64 and “Shakedown” Suits**

The Court acknowledged that Proposition 64 was intended to remedy abuses of the UCL by “unscrupulous” class action attorneys:

The specific abuse of the UCL at which Proposition 64 was directed was its use by unscrupulous lawyers who exploited the generous standing requirement of the UCL to file “shakedown” suits to extort money from small businesses. . . .

Id. at 32.

- **Only the Named Plaintiff Must Demonstrate “Standing”**

The Court, however, found no basis in Proposition 64 for requiring absent class members to demonstrate UCL standing, and also found that such a construction of Proposition 64 was not necessary to remedy the abuses to which the initiative was directed.

The Court noted that the references in Proposition 64 to the “person” and the “claimant” suing in a representative capacity—and who must meet the standing requirement—are in the singular: “The conclusion that must be drawn from these words is that only this individual—the representative plaintiff—is required to meet the standing requirements.” *Id.* at 32.

- **The Named Plaintiff's "Standing" Requirement**

The Court next analyzed the meaning of the standing requirement: a private enforcement action under the UCL may be brought only by "a person who has suffered injury in fact and has lost money or property *as a result of* the unfair competition."

The Court observed that the "as a result of" language was not defined in the statute or the Proposition 64 ballot materials. But given that "reliance is the causal mechanism of fraud," and "the overriding purpose of Proposition 64" was to limit private UCL enforcement actions, the Court agreed with the defendants that a named plaintiff challenging deceptive or misleading statements must "demonstrate actual reliance on [those] statements, in accordance with well-settled principles regarding the element of reliance in ordinary fraud actions." *Id.* at 25, 39.

7. COLORADO SUPREME COURT REJECTS “FRAUD ON THE MARKET” THEORY IN CONSUMER CLASS ACTION AGAINST AUTO INSURER

SUMMARY

The Colorado Supreme Court has rejected application of the “fraud on the market” theory of reliance and causation to consumer insurance class actions. *Farmers Ins. Exch. v. Benzing*, 206 P.3d 812 (Colo. 2009).

The plaintiff alleged that Farmers had sold underinsured/uninsured (“UM/UIM”) insurance in violation of state deceptive trade practices law by failing to disclose that, under Colorado law, the coverage followed the insured, rather than the vehicle, thereby forcing insureds unnecessarily to purchase UM/UIM coverage on additional vehicles.

The Court concluded that the “fraud on the market theory,” borrowed from the securities law context, was inappropriate in this consumer class action context, where there was no efficient market and where the information allegedly concealed (a prior UM/UIM decision by the Colorado Supreme Court) was a matter of public record.

The Proceedings Below

The plaintiff alleged that the defendant insurance carriers violated the Colorado Consumer Protection Act (CCPA) when they failed to disclose to insurance purchasers the Colorado Supreme Court’s decision in *DeHerrera v. Sentry Insurance Co.*, 30 P.3d 167 (Colo. 2001), which held that once insureds purchase the first unit of UM/UIM coverage, they need not purchase additional UM/UIM coverage on a second vehicle in order to protect themselves and resident family members. 206 P.3d at 814.

The trial court originally assigned to the case certified the class, accepting as true the plaintiff’s allegation that he and the class of insureds purchased UM/UIM coverage on additional vehicles that provided no meaningful benefits. But after the case was transferred to another judge and the parties engaged in discovery, the second judge ruled that the UM/UIM coverage on additional vehicles did in fact provide a benefit: UM/UIM protection for guests and nonresident family members traveling in those vehicles. The trial court concluded that “mini-trials” would be necessary to determine if the alleged failure to disclose *DeHerrera* caused injury to any of the insureds, and therefore decertified the class. *Id.*

The appellate court reversed, relying primarily on the plaintiff’s argument that CCPA’s causation element can be established through the “fraud on the market theory.” The appellate court concluded that this theory eliminated the need to prove individual causation. *Id.*

The Colorado Supreme Court’s Decision

The Colorado Supreme Court reversed, concluding that, under the circumstances of the case, application of the “fraud on the market” theory would be inappropriate.

The Court noted the central issue here: whether the plaintiff could satisfy the “predominance” requirement by “advanc[ing] a theory by which to prove or disprove an element on a simultaneous, class-wide basis, since such proof obviates the need to examine each class member’s individual position.” *Id.* at 820 (internal quotations omitted). The issue most relevant to the predominance requirement here was “whether

the plaintiff has a method to establish, on a class-wide basis, that the defendants caused injury to insureds by failing to disclose” the implications of *DeHerrera* to them. *Id.*

The Court then turned to the device urged by the plaintiff to prove causation (reliance) on a classwide basis: the “fraud on the market” theory. The Court explained that the fraud-on-the-market theory is a judicially created presumption of reliance, typically employed in securities class actions, to establish reliance under Rule 10b-5. *Id.* at 821. Instead of alleging reliance on misrepresentations regarding the securities, plaintiffs in securities cases allege reliance on the market price of the securities—in other words, on the integrity of the securities markets in accurately reflecting the worth of the securities. *Id.*

The Court concluded that, in this case, the fraud-on-the-market theory was inapplicable. The plaintiff class here “did not allege reliance on both the market price of the policies and the integrity of the market.” *Id.* at 814. Instead, the class alleged reliance upon the defendant’s material omissions in face-to-face transactions.

Further, the Court held that the insurance market at issue was not “well-developed, impersonal, and efficient” to justify application of the presumption:

The market for commercial UM/UIM insurance is not simply a “thinly traded” one. Commercial insurance is not traded. There is no “market,” within the meaning of the fraud on the market theory, for commercial insurance at all. This is fatal to plaintiff class’s ability to rely on the fraud on the market theory to prove reliance because there is no mechanism by which all available public information is promptly impounded into the price of commercial automobile insurance.

Id. at 822.

Finally, the Court concluded that the plaintiff’s theory actually hinged on the *inefficiency* of the market for UM/UIM insurance. If that market were truly efficient, the Court reasoned, the “price of the policies” would immediately reflect “all available public information.” *Id.* at 825. But at the time the insureds purchased or renewed their UM/UIM policies, the Court’s decision in *DeHerrera* was a matter of public record. “Thus, the market price would have incorporated our decision, and would have dropped to reflect its holding.” *Id.* at 823.

8. MISSOURI APPELLATE COURT REINSTATES JURY VERDICT AGAINST INSURER IN NON-OEM PARTS/"OMITTED REPAIRS" CLASS ACTION

SUMMARY

The Missouri Appellate Court reinstated a \$17 million jury verdict against American Family Mutual Insurance Co. in a class action challenging the insurer's designation of non-OEM crash parts, and alleged omission of required repairs, in auto repair estimates. *Smith v. American Family Mut. Ins. Co.*, ___ S.W.3d ___, 2009 WL 1181490 (Mo. Ct. App. May 5, 2009).

Purporting to distinguish the Illinois Supreme Court's non-OEM parts ruling in *Avery v. State Farm Mutual Automobile Insurance Co.*, 835 N.E.2d 801 (Ill. 2005), *cert. denied*, 547 U.S. 1003 (2006), the Missouri Appellate Court concluded that the pre-loss condition of the OEM part being replaced was "immaterial to the analysis": "the sole inquiry as to pre-loss condition is whether the part to be replaced was in fact an OEM part or an aftermarket part." The Court also held that, under the plaintiffs' theory of the case, the contract "breach" took place at the time American Family *specified* the use of non-OEM repair parts in its estimate; the fact that a non-OEM part was not *actually installed* on the car was irrelevant. The Court held that the plaintiffs had presented sufficient evidence of the alleged "universal inferiority" of non-OEM crash parts to sustain the jury's class verdict.

The Court applied this same reasoning to the plaintiffs' claim for "omitted repairs"; whether the repairs were actually done was "not relevant" to the question whether American Family had breached its contract by failing to include sufficient time and materials to pay for all necessary repairs to return the car to pre-loss condition.

The Proceedings Below

The plaintiffs brought a putative nationwide class action in Missouri state court challenging American Family's use of a computer program that designated "non-OEM" (i.e., non-Original Equipment Manufacturer, or "aftermarket") crash parts in the repair of automobiles older than the last three model years, and also identified the types of repairs required for the vehicle.

The plaintiffs claimed that American Family breached its contracts with policyholders to restore the damaged vehicles to their pre-loss condition by basing claims payments on "(1) the systematic specification of 'inferior' non-OEM crash parts for repairs and (2) the systematic omission of specific 'necessary' repairs from estimates." 2009 WL 1181490, at *1.

The trial court initially certified a nationwide class, but the Missouri Supreme Court upheld certification of only a Missouri class of plaintiffs. *See State ex rel. American Family Mut. Ins. Co. v. Clark*, 106 S.W.3d 483, 485 (Mo. 2003).

The case proceeded to a jury trial in February 2007. After a three-week trial, the jury returned a verdict for the plaintiffs on both claims for breach of contract: On Count I (regarding non-OEM parts), the jury awarded damages in the amount of \$13,118,325; on Count II (omitted repairs), the jury awarded damages in the amount of \$4,274,112. *Id.* at *2.

American Family moved for judgment notwithstanding the verdict or, in the alternative, for a new trial. The trial court granted the motion for JNOV as to both counts and conditionally denied the motion for a new trial.

In granting JNOV as to Count I, the trial court found that the plaintiffs failed to prove, on a classwide basis, that American Family had breached its duty to pay: “To show class-wide breach and damages, Plaintiffs were . . . required to compare the aftermarket parts to the pre-loss condition of parts the aftermarket parts were replacing on the class vehicle.” The plaintiffs’ evidence “failed to show that any aftermarket part was inferior to any part it actually replaced on any class vehicle or was inferior to any part on any class vehicle for which an aftermarket part was specified as part of the repair estimate.” *Id.* at *3.

In granting JNOV as to Count II, the trial court concluded that “[p]roof of damages from omitted repair procedures requires a showing that the omitted repair procedures were actually not done and that, as a result, the repair to all the class vehicles was not done completely satisfactory. Plaintiffs presented no evidence that the repairs were not actually done, only that some of the estimates did not contain an amount specifically designated for one or more of these repair procedures.” *Id.* at *7.

The Missouri Appellate Court’s Decision

The Missouri Appellate Court reversed.

- **The Non-OEM Parts Claim**

The Court first disagreed with the trial court’s conclusion that, to show classwide breach and damages, the plaintiffs were required to compare the non-OEM parts to the parts they were replacing, and to demonstrate that the non-OEM part was inferior to the part it *actually* replaced.

The Court concluded that the condition of the OEM part being replaced was “immaterial” to the analysis: “the sole inquiry as to pre-loss condition is whether the part to be replaced was in fact an OEM part or an aftermarket part.” *Id.* at *4. The Court concluded that the jury’s verdict was supported by plaintiffs’ evidence of the alleged “universal inferiority” of non-OEM parts.

Court also disagreed with the trial court’s conclusion (relying on *Avery*) that, to prove actual damages, the plaintiffs had to prove that the non-OEM part that was inferior to the existing part in its pre-loss condition “was *actually used* to repair the vehicle’s damage.” *See id.* at *5 (emphasis added). The Court ruled that, under the plaintiffs’ theory of “breach,” the breach did *not* occur when the non-OEM part was actually *installed* on the car, but rather when American Family “cut a check to its policyholders based on an estimate *specifying* aftermarket parts.” *Id.* at *6 (emphasis added). The Court contended that *Avery* was distinguishable because *Avery* allegedly did not involve this theory of breach. *See id.* at *5-6.

In fact, the Illinois Supreme Court in *Avery* addressed *precisely* this same theory of “specification” damages—in other words, that the breach occurred upon *specification* of non-OEM parts in the repair estimate. The Court in *Avery* squarely rejected this theory of breach as having “no basis in law”:

We agree . . . that plaintiffs’ theory of specification damages makes no sense. In our view, plaintiffs’ notion of specification damages contravenes the basic theory of damages for breach

of contract, under which the claimant must establish an actual loss or measurable damages resulting from the breach in order to recover.

835 N.E.2d at 832.

- **The “Omitted Repairs” Claim**

The Court reversed the trial court’s ruling on “omitted repairs” for much the same reason as the non-OEM parts claim: that the plaintiffs had alleged a theory of contract breach at the time of the repair estimate, not at the time of the actual repair:

That these repairs were not specified on the estimate meant that the estimate did not include the labor and materials necessary to perform the repairs. Thus, American Family did not pay sufficient funds to return the car to pre-loss condition. Whether the repairs were actually done is not relevant to whether American Family breached their contract with the insureds by failing to include sufficient time and materials to pay for all necessary repairs to return the car to pre-loss condition.

2009 WL 1181490, at *7.

9. OREGON APPELLATE COURT UPHOLDS JURY'S COMPENSATORY DAMAGES AWARD,
VACATES PUNITIVE AWARD, AGAINST INSURERS IN "PIP" CLASS ACTION
CHALLENGING COMPUTERIZED MEDICAL FEE REVIEWS

SUMMARY

In a class action challenging auto insurers' use of computerized medical fee reviews in Personal Injury Protection ("PIP") claims, the Oregon Appellate Court upheld an award against the insurers of nearly \$900,000 in compensatory damages and prejudgment interest, but vacated the jury's \$8 million punitive damages award as unconstitutionally excessive. *Strawn v. Farmers Ins. Co.*, No. 990809080; A131605, ___ P.3d ___, 2009 WL 1409471 (Or. Ct. App. May 20, 2009).

The class alleged that the defendants failed to pay insureds' "reasonable medical expenses" for PIP claims through the use of "cost-containment" software that evaluated medical providers' bills in relation to other providers' charges for the same procedure in a given region.

The Appellate Court upheld both class certification and the classwide jury verdict on compensatory damages. The Court rejected the defendants' arguments that the class had failed to satisfy its burden of proving the reasonableness of each individual medical bill. Oregon law, the Court concluded, created a "presumption" of reasonableness of an insured's medical bills, and the "gravamen" of the plaintiff's claim was that the defendants' claim review *methodology* was improper. Thus, the class was not required to prove the reasonableness of the medical bills; rather, the *defendants* had the burden of proving that their claims adjusting *procedures* satisfied their statutory and common law obligations.

The Court, however, concluded that the punitive damages award was constitutionally excessive and that a maximum appropriate punitive/compensatory damages ratio was 4:1. The Court remanded with instructions to grant a new trial on punitive damages, unless the plaintiffs agree to a remittitur of four times the amount of compensatory damages and prejudgment interest.

The Proceedings Below

Under Oregon law, every private-passenger auto policy issued in Oregon must provide for PIP benefits, including all "reasonable and necessary" medical expenses incurred within one year after the date of the claimant's injury. 2009 WL 1409471, at *1.

The plaintiff alleged that, beginning in 1998, the defendants endeavored to reduce PIP payments to insureds through the use of computerized medical bill review programs. The carriers contracted with Medical Management Online (MMO), a bill review vendor, which in turn licensed a "cost containment software program" from Medata, a company that manages a database of approximately 100 million medical expenses. *Id.* at *2.

The software program allowed MMO's clients (mostly insurance carriers and state agencies) to "determine whether a bill from a medical provider was more expensive than a given percentage of the range of charges in other bills for the same [medical procedure] in the provider's designated geographic area." The class alleged that the defendants initially selected the "80th percentile" (later increased to the 90th and then

99th percentiles) to evaluate medical bills, and if the fees exceeded that selected percentile, the defendants would not pay in excess of that amount. *Id.* at *2-3.

The plaintiff filed a class action suit, bringing claims for breach of contract, breach of the implied duty of good faith and fair dealing, fraud, and declaratory relief. The trial court granted the plaintiff's motion for class certification.

The case went to trial in November 2003. The jury returned a verdict for the class of nearly \$1.5 million (approximately half of which was compensatory damages, and half prejudgment interest), as well as \$8 million in punitive damages. *Id.* at *3.

The trial court then conducted a post-verdict "claims administration process" to determine the amount of damages for each individual class member and to distribute the jury award to those class members who submitted claims. After evaluating the claims submitted, the trial court reduced the jury's compensatory and prejudgment interest award to \$898,323.80 (but refused to reduce the punitive award accordingly) and also awarded class counsel approximately \$2.8 million in attorneys' fees. *Id.*

The defendants appealed. Among other grounds, they argued that the case never should have been certified as a class action, because the class claims required individualized proof of the reasonableness of each class member's medical bills. The defendants also argued that the class never presented at trial proof of the reasonableness of each individual medical bill at issue. The defendants also contended that the punitive damages award was unconstitutionally excessive.

The Oregon Appellate Court's Decision

- **Class Certification and Classwide Proof at Trial**

The Appellate Court rejected the defendants' arguments that individualized issues of the reasonableness of the insureds' medical bills precluded class certification and required reversal of the jury verdict.

The Court stated that under the Oregon Supreme Court's decision in *Ivanov v. Farmers Insurance Co.*, 185 P.3d 417 (Or. 2008), the Oregon PIP statute created a "presumption" of reasonableness of medical bills.

Ivanov, the Court concluded, "defeats [the defendants'] contention that plaintiffs failed to offer sufficient proof of the reasonableness of their medical expenses." 2009 WL 1409471, at *6. The Court held that the "gravamen" of the class claims was that the defendants' *review methodology* was impermissible. *Id.* (emphasis added). Thus, the plaintiffs "were not required to offer any additional evidence that, at the time the bills were submitted, they were reasonable; the expenses were presumptively reasonable at that point. Instead, [the defendants] had the burden of establishing that the *procedures* [they] employed to deny plaintiffs' claims satisfied its statutory and common-law duties." *Id.* (emphasis added).

- **Punitive Damages**

The Court then reviewed the propriety of the punitive damages award, which was approximately nine times the amount of the post-verdict award for compensatory damages and prejudgment interest.

The Court's methodology consisted of three steps: (1) determining whether there was a factual predicate for the punitive award; (2) if so, determining whether the punitive award was constitutionally excessive under the "*Gore* factors" (the reprehensibility of the defendant's conduct, the disparity between the punitive award and the actual or potential harm suffered by the class, and the difference between the punitive award and comparable civil penalties); and (3) if the award is excessive, determining an appropriate punitive award. *Id.* at *13-14.

First, the Court concluded that there was a sufficient factual predicate for punitive damages: a reasonable jury "could have understood the facts and available inferences in this case to demonstrate that [the defendants] engaged in a willful pattern of deceit in wanton disregard of the injury that it would cause to . . . insureds and medical providers." *Id.* at *14.

Second, the Court determined that the \$8 million punitive award was constitutionally excessive. The Court agreed with the defendants that the appropriate punitive/compensatory damages ratio must be determined by the amount of the *post-verdict* award after the claims administration procedure (\$898,323.80)—not the initial jury verdict of \$1.5 million. *Id.* at *15.

Finally, the Court concluded that a punitive/compensatory ratio of 4:1 was appropriate because, among other things, due process generally prohibits punitive awards that significantly exceed four times the amount of compensatory damages, when the injuries are economic, and not physical. *Id.* at *14. The Court therefore vacated the punitive award and remanded for a new trial on punitive damages, unless the plaintiff agreed to a remittitur of punitive damages to four times the amount of compensatory and punitive damages.

10. ELEVENTH CIRCUIT REVERSES DENIAL OF CERTIFICATION OF EMPLOYEES' RICO CLASS ACTION, HOLDS THAT DISTRICT COURT FAILED TO CONDUCT "RIGOROUS ANALYSIS" OF CLASS CERTIFICATION REQUIREMENTS

SUMMARY

The Eleventh Circuit has reversed a district court's denial of class certification in a RICO employment class action. *Williams v. Mohawk Indus., Inc.*, No. 08-13446, ___ F.3d ___, 2009 WL 1476702 (11th Cir. May 28, 2009).

The Eleventh Circuit held that the district court abused its discretion and failed to conduct a "rigorous analysis" when it denied class certification sought by employees of Mohawk Industries. The employees complained that Mohawk had engaged in racketeering activity by hiring illegal aliens and depressing the employees' wages.

The Eleventh Circuit held that the district court erred when it ruled that the employees' complaint failed to present common issues of law or fact and that the claims of the proposed representatives were not typical of the claims of the absent class members. Those errors, the Eleventh Circuit concluded, also led the district court to misapply the standard for determining whether the employees may maintain a Rule 23(b)(3) class action for monetary relief as well as a Rule 23(b)(2) hybrid class for injunctive relief.

The Eleventh Circuit reversed and remanded the case to the district court to determine whether the class could be certified under both Rules 23(b)(2) and (b)(3).

Proceedings in the District Court

Originally filed in January 2004, this case had been to the Eleventh Circuit twice before. The putative class consisted of current and former employees of Mohawk who worked for hourly wages at various facilities in northern Georgia and who alleged that Mohawk had engaged in a pattern of racketeering activity prohibited by the Racketeer Influence and Corrupt Organizations Act, 18 U.S.C. § 1962(c), by hiring and harboring illegal aliens in violation of the Immigration and Nationality Act, 8 U.S.C. §§ 1324(a)(1)(A)(iii), (a)(1)(A)(iv), (a)(3)(A). 2009 WL 1476702, at *1.

The employees alleged that Mohawk formed an enterprise with various temporary employment agencies to hire illegal aliens and depress wages. The employees alleged that they were harmed by the racketeering activity of Mohawk because their wages were depressed. The employees also alleged that Mohawk violated a Georgia racketeering statute by committing various predicate acts of fraud and misuse of visas, 18 U.S.C. §§ 1546(a), (b), and that Mohawk was unjustly enriched by its criminal activities. 2009 WL 1476702, at *1.

After two trips to the Eleventh Circuit, the case returned to the trial court, where the plaintiff employees moved to certify a class of "[a]ll persons legally authorized to be employed in the United States who are or have been employed in hourly positions by Mohawk Industries, Inc., its subsidiaries or affiliates in Georgia at any time from January 5, 1999 to the present, other than Excluded Employees." Plaintiffs proposed to exclude employees who had worked only at certain Mohawk facilities in Georgia.

The employees sought certification of one of their state statutory claims (seeking only injunctive relief under Rule 23(b)(2), and certification of all of their claims (seeking both monetary and injunctive relief under Rule 23(b)(3).

The district court denied class certification. The court held that the employees did not satisfy Rule 23(a)(2)'s commonality requirement because, contrary to the plaintiffs' arguments that Mohawk had engaged in a grand conspiracy to employ illegal workers, the evidence in the record indicated that Mohawk's operations, including its use of temporary employment agencies and wage-setting practices, were extremely decentralized. The district court also held that the plaintiffs failed to meet Rule 23(a)(3)'s requirement of typicality because one of the named plaintiffs never worked at a Mohawk facility that used temporary labor and because both named plaintiffs worked at only a handful of Mohawk's facilities. 2009 WL 1476702, at *2-3.

Further, the district court concluded that a Rule 23(b)(2) class for injunctive relief could not be certified because the employees' demand for monetary damages was not incidental to their demand for injunctive relief. The district court also declined to certify a "hybrid class" for both monetary and injunctive relief on the ground that having one jury "resolve all of the many individual and case-specific issues relating to Plaintiff's claims before the Court issued a ruling as to equitable remedies would be overly cumbersome, confusing, and highly inefficient." *Id.* at *3.

Likewise, the district court refused to certify a Rule 23(b)(3) class on the grounds that common issues did not predominate and the class action would not be superior to other available methods of relief. The district court again relied on the corporate structure of Mohawk when it determined that class litigation would present an "unmanageable number of individual legal and factual issues" because "the evidence in the record fails to support a determination that Defendant engaged in a relationship with the various temporary employment agencies at a corporate-wide level." *Id.* at *4.

The Eleventh Circuit's Decision

The Eleventh Circuit reversed.

First, the Eleventh Circuit reversed the district court on the requirement of commonality, emphasizing that "claims under RICO, in contrast with claims under Title VII, are often susceptible to common proof." *Id.* at *5. The Court held that the employees' complaint was not dependent on proof of individual acts of disparate treatment, as often is the case under Title VII, but instead was dependent on the common question of whether Mohawk conducted the affairs of an enterprise through a pattern of racketeering activity that depressed the wages of all employees. *Id.* at *6.

Next, the Eleventh Circuit reversed on the typicality requirement, holding that since the employees claimed that the hiring of illegal aliens by Mohawk depressed the wages of all legal hourly workers regardless of location, whether the two class representatives worked at a few locations was irrelevant. *Id.*

With respect to the Rule 23(b)(3) class, the Eleventh Circuit remanded to the district court to conduct a "pragmatic assessment" whether common issues predominated over individual issues and whether a class action was superior to individual actions. *Id.* at *7.

As for the proposed Rule 23(b)(2) class, the Eleventh Circuit held that district court's "flawed analysis of commonality . . . infected its consideration of a hybrid class action." *Id.* at *10. The Eleventh Circuit directed that, if the district court determines that common issues predominate and certifies a Rule 23(b)(3) class for damages, the district court must consider whether to certify a class under Rule 23(b)(2) with respect to the employees' claim for equitable relief under the Georgia statute.

The Eleventh Circuit noted that the district court had held that allowing many individual suits for liability and monetary relief followed by judicial resolution of classwide equitable relief would be "overly cumbersome, confusing, and highly inefficient." The Eleventh Circuit observed that "[t]his inefficiency dissolves if the district court determines common issues predominate and certifies a class under subsection (b)(3)." *Id.* at *10.
