Schiff Hardin LLP Class Action Alert

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SEVENTH CIRCUIT DECERTIFIES "ECONOMIC INJURY" CLASS ACTION, CAUTIONS AGAINST "DOWNSIDES" OF CLASS ACTIONS GENERALLY

On October 28, 2008, the Seventh Circuit decertified a 29-jurisdiction class alleging that Sears Roebuck's use of the words "stainless steel" on certain of its dryers and in point-of-sale advertising constituted consumer fraud. *Thorogood v. Sears, Roebuck & Co.*, No. 08-1590, ___ F.3d ___, 2008 WL 4709500 (7th Cir. Oct. 28, 2008). Along the way, the Court, in an opinion authored by Judge Posner, made a series of pronouncements about the "downsides" of class actions and urged "caution in class certification generally." The opinion, therefore, should prove useful in defending not only against so-called "economic injury" cases, but all varieties of class actions.

Rulings on Plaintiff's Class Claims

Plaintiff, a citizen of Tennessee, filed a class action against Sears in the Northern District of Illinois, contending that Sears' use of the words "stainless steel" meant that the inside drum of the dryer was made of 100% stainless steel, when in fact part of the drum was made of ceramic-coated "mild" (i.e., not 100% stainless) steel. Plaintiff alleged that the non-stainless portion of the drum rusted and stained his clothes, and that he would not have paid the "premium" for stainless steel dryers had he known that the dryer was not 100% stainless steel.

Plaintiff brought claims on behalf of himself and a putative class of perhaps 500,000 purchasers in 28 states and the District of Columbia. Plaintiff contended that Sears' alleged misrepresentations violated the Tennessee Consumer Protection Act, as well as similar consumer protection statutes of the other states.

The district court certified the class, rejecting Sears' argument that Plaintiff could not represent a class because the Tennessee Act did not permit class actions. *Id.* at *3. The district court also found that a class

was proper because "Sears marketed its dryers on a class wide basis," and, therefore, "reliance can be presumed." *Id.* at *5 (internal quotations omitted).

The Seventh Circuit reversed, holding not only that common questions did not predominate over the issues particular to each purchase and purchaser of a dryer, but that there were "*no* common issues of law or fact, so there would be no economies from class action treatment." *Id.* at *4 (emphasis in original). The Court concluded that Plaintiff's concerns about alleged rust stains caused by the dryer drums, and his claimed reaction to Sears' alleged misrepresentations, were "idiosyncratic." *Id.* The Court held that class certification was improper because "[t]he evaluation of the class members' claims will require individual hearings":

> Each class member who wants to pursue relief against Sears will have to testify to what he understands to be the meaning of a label or advertisement that identifies a clothes dryer as containing a stainless steel drum. . . . . Advertisements for clothes dryers advertise a host of features that might matter to consumers, such as price, size, electrical usage, appearance, speed, and controls, but not, as far as anyone in this litigation has suggested except the plaintiff, avoidance of clothing stains due to rust.

Id. at *5.[1]

The Court also rejected the district court's conclusion that reliance could be presumed:

> Reliance on what? On stainless steel preventing rust stains on clothes? Since rust stains on clothes do not appear to be one of the hazards of clothes dryers, and since Sears did not advertise its stainless steel dryers as preventing such stains, the proposition that the other half million buyers, apart from Thorogood, shared his understanding of Sears's representations and paid a premium to avoid rust stains is, to put it mildly, implausible, and so would require individual hearings to verify.

Id.

Finally, the Court concluded that variations in class members' alleged damages likewise militated against class certification. *Id.* While acknowledging that "[a]ggregate proof of monetary relief may . . . be based on sampling techniques or other reasonable estimates," *id.* (internal quotations omitted), in this case, "the amount of damages will vary from consumer to consumer," given the "absence of any reason to believe that there is a single understanding of the significance of labeling or advertising clothes dryers as containing a 'stainless steel drum.' " *Id.*

The "Downsides" of Class Actions Generally

Before addressing the merits of Plaintiff's case, however, the Court set forth a series of reasons why courts should exercise "caution" before certifying any class, or approving a class action settlement:

[1] In an aside that has generated quite a bit of attention in the legal press and blogosphere, the all-male panel took issue with statements made by Plaintiff's attorney during oral argument regarding the alleged laundering expertise of men versus women: "At argument the plaintiff's lawyer, skeptical that men ever operate clothes dryers — oddly, since his client does — asked us to ask our wives whether they are concerned about rust stains in their dryers. None is." 2008 WL 4709500, at *4.

- The "Much Greater Conflict of Interest" Between Class Counsel and Class Members:

> There is first of all a much greater conflict of interest between the members of the class and the class lawyers than there is between an individual client and his lawyer. The class members are interested in relief for the class *but the lawyers are interested in their fees*, and the class members' stakes in the litigation are too small to motivate them to supervise the lawyers in an effort to make sure that the lawyers will act in their best interests.

Id. at *1 (emphasis added).

- The Possibility of "Collusion" in Class Action Settlements:

> The defendants in class actions are interested in minimizing the sum of the damages they pay the class and the fees they pay the class counsel, and so they are willing to trade small damages for high attorneys' fees, especially since, as Judge Friendly put it, a juicy bird in the hand is worth more than the vision of a much larger one in the bush, attainable only after years of effort not currently compensated and possibly a mirage. The result of these incentives is to forge a community of interest between class counsel, who control the plaintiff's side of the case, and the defendants. . . . The judge who presides over the class action and must approve any settlement is charged with responsibility for preventing the class lawyers from selling out the class, but it is *a responsibility difficult to discharge when the judge confronts a phalanx of colluding counsel*.

Id. at *2 (internal quotations and citations omitted; emphasis added).

- The "Enhanced Risk of Costly Error":

> A further problem with the class action is the enhanced risk of costly error. When enormous consequences turn on the correct resolution of a complex factual question, the risk of error in having it decided once and for all by one trier of fact rather than letting a consensus emerge from several trials may be undue. Suppose a company is sued in a number of different cases for selling a defective product. It wins some of the cases and loses some, so that the aggregate outcome is a fair reflection of the uncertainty of the plaintiffs' claims. But when the central issue in a case is given class treatment and so resolved by a single trier of fact, a trial becomes a roll of the dice; a single throw will determine the outcome of a large number of separate claims — there is no averaging of divergent responses from a number of triers of fact having different abilities, priors, and biases.

Id. at *2 (internal quotations and citations omitted).

- The "Tendency" of Federal Diversity Class Actions "to Undermine Federalism":

> [A]nother downside to the class action . . is the tendency, when the claims in a federal class action are based on state law, to undermine federalism. Our plaintiff wants to litigate

> in a single federal district court half a million claims wrested from the control of the courts of the 29 jurisdictions in which those claims arose and the laws of which govern the claimants' entitlement to and scope of relief. The instructions to the jury on the law it is to apply will be an amalgam of the consumer protection laws of the 29 jurisdictions, and procedural rules by which particular jurisdictions expand or contract relief will be ignored.

Id. at *2 (internal quotations and citations omitted).

The Court did not accept Sears' argument that "the Tennessee rule [prohibiting class actions under the Tennessee Act] precludes the maintenance of the present case as a class action," because the Tennessee rule is "procedural." *Id.* at *3. Nevertheless, the Court observed that Sears "was on to something":

> Even though the plaintiff bases his claim, and that of any other Tennesseans who happen to be members of the class, on Tennessee law, he and they are seeking a breadth of relief that Tennessee does not offer them in its courts. Maybe that is a defect of Tennessee law. *But the purpose of the diversity jurisdiction is to protect out-of-state residents against state judicial bias in favor of residents; it is not to expand the relief obtainable under state law*.

Id. (emphasis added).

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SIXTH CIRCUIT ALLOWS INJURED EMPLOYEES' RICO CLAIMS TO PROCEED AGAINST EMPLOYER AND CLAIMS ADMINISTRATOR REGARDING WORKERS COMP BENEFITS

On October 23, 2008, the Sixth Circuit ruled that injured employees could pursue RICO claims against their employer, a claims administrator, and the employer's physician/medical expert for allegedly selecting unqualified doctors to provide fraudulent medical opinions to support the denial of workers compensation benefits. *Brown v. Cassens Transp. Co.*, No. 05-2089, ___ F.3d ___, 2008 WL 4658643 (6th Cir. Oct. 23, 2008). In so doing, the Sixth Circuit rejected the defendants' arguments that the Michigan workers compensation regulatory scheme, via the McCarran-Ferguson Act, "reverse preempted" the RICO claims, and it engaged in a lengthy discussion of the nature of "insurance" and of workers compensation regulatory schemes. As a result, this case could be of importance in the dozens of class action lawsuits filed in recent years against workers compensation carriers for alleged underpayment of claimant medical bills.

Plaintiffs were current and former employees of Cassens who submitted workers compensation claims and contended that their self-insured employer and other parties engaged in a pattern of racketeering activity to deny Plaintiffs their workers compensation benefits, including through the retention of unqualified doctors to provide fraudulent medical opinions. *Id.* at *1.

The district court dismissed the RICO claims on the ground that the Michigan Workers Disability Compensation Act (WDCA) "reverse preempted" the claims pursuant to the McCarran-Ferguson Act, 15 U.S.C. § 1012, and for failure to plead the claims with the requisite particularity. The Sixth Circuit initially affirmed on the ground that Plaintiffs had failed to plead reliance on the defendants' alleged misrepresentations. The Supreme Court, however, vacated the judgment and remanded for further

consideration in light of *Bridge v. Phoenix Bond Indemnity Co.*, 128 S. Ct. 2131 (2008), which held that a civil RICO plaintiff does not need to show that it detrimentally relied on the defendant's alleged misrepresentations.

On reconsideration, the Sixth Circuit held that the employees adequately had pleaded the elements of a RICO claim, 2008 WL 4658643, at *2-5, but dismissed their claims under Michigan law for intentional infliction of emotional distress on the grounds that the defendants' alleged conduct was not "so outrageous in character . . . as to go beyond all possible bounds of decency," *id.* at *13 (internal quotations omitted).

The Court also concluded that the WDCA did not "reverse preempt" the RICO claims pursuant to the McCarran-Ferguson Act, which provides: "No Act of Congress shall be construed to invalidate, impair, or supersede any law enacted by any State for the purpose of regulating the business of insurance, . . . unless such Act *specifically relates to the business of insurance*." 15 U.S.C. § 1012. (emphasis added).

Among other things, the Court held that (1) workers compensation benefits "are not insurance"; (2) the WDCA "was not enacted for the purpose of regulating the business of insurance"; and (3) RICO "would not invalidate, impair, or supersede the WDCA."

The McCarran-Ferguson Test

The Court first cited Supreme Court precedent on the contours of McCarran-Ferguson:

- "[S]tatutes aimed at protecting or regulating this relationship [between insurer and insured], directly or indirectly, are laws regulating the business of insurance . . . ."

- The focus of McCarran-Ferguson "is upon the relationship between the insurance company and its policyholders: The relationship between insurer and insured, the type of policy which could be issued, its reliability, interpretation, and enforcement-these were the core of the 'business of insurance.' "

- In determining whether particular practices constitute "the business of insurance," courts must consider three factors: "first, whether the practice has the effect of transferring or spreading a policyholder's risk; second, whether the practice is an integral part of the policy relationship between the insurer and the insured; and third, whether the practice is limited to entities within the insurance industry."

2008 WL 4658643, at *7 (internal quotations and citations omitted).

Workers Compensation Benefits Are Not "Insurance"

The Court next concluded that workers compensation benefits are not "insurance" and, therefore, that the McCarran-Ferguson Act did not apply to "reverse preempt" Plaintiffs' RICO claims.

The Court rejected the argument that workers compensation benefits "can be seen as a form of insurance to provide compensation for workplace injuries, . . . creating an insurance-like relationship in which the employer is the 'insurer' and the employee is the 'insured.' " *Id.* Citing *Black's Law Dictionary*, the Court defined insurance as "[a] contract by which one party (the insurer) undertakes to indemnify another party (the insured) against risk of loss, damage, or liability arising from the occurrence of some specified contingency." *Id.* at *8.

The Court concluded that there was no such "contract" between the employee and the employer in the workers compensation scheme:

> The WDCA is a public regulation of the employment relationship that is a substitute for the tort system rather than any contractual relationship between employees and employers. In the context of true contractual accident-insurance relationships, the insurer owes no preexisting duty to the insured to compensate the insured for any injury that the insured may sustain. Rather, as with other contractual relationships, the insured provides consideration in exchange for the insurer's obligation to pay benefits upon the event of an accident. By contrast, in the worker's compensation context, the employer owed the employee a preexisting duty under common-law tort to compensate the employee for workplace injuries due to the fault of the employer. . . . [T]he employer is not akin to an insurer because it had a preexisting duty under common law to compensate for workplace injuries, and worker's compensation merely creates a legislative remedy regarding the tort-liability relationship between employees and their employers, not an insurance contract. There is therefore no insurer and no insured.

Id.

Michigan's Workers Comp Scheme Was Not Enacted "for the Purpose of Regulating the Business of Insurance"

The Court next observed that merely because the WDCA addresses practices that are *related* to "the business of insurance" does not mean that it was "enacted . . . for the *purpose* of regulating the business of insurance." *Id.* at *9 (emphasis added). The Court concluded that the purpose of enacting the WDCA was to "provid[e] certain recovery to employees for workplace injuries while limiting employers' liability rather than the regulation of insurance." *Id.* The Court acknowledged that several provisions of the Act relate to "the business of" workers compensation insurance, including the terms of the insurance contract between the employer and the carrier. *Id.* at *10. But the Court noted that Cassens self-insures, and "self-insurance does not relate to the 'business of insurance' under the McCarran-Ferguson Act because there is no relationship between an insurer and an insured." *Id.*

RICO Would Not "Invalidate, Impair, or Supersede" Michigan's Workers Compensation Scheme

Finally, the Court concluded that preemption was not appropriate because RICO "would not invalidate, impair, or supersede" the WDCA. RICO "would not render [the WDCA] ineffective given that those subject to these laws can comply with both simultaneously." *Id.* at *11 (internal quotations omitted). Nor, the Court concluded, would RICO "impair" the WDCA, because it did not directly conflict with state regulation and would not frustrate Michigan's policy or administrative regime. *Id.* RICO's remedies for "racketeering" violations, the Court held, were "perfectly compatible" with the WDCA's prohibition of and sanctions for the improper denial of employee workers compensation benefits. *Id.* The fact that RICO's allowance for treble damages and attorneys' fees is different from the WDCA's statutory penalties was not problematic, because RICO proscribed the same conduct as state law, even if it provided materially different remedies. *Id.* at *11-12.

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ILLINOIS FEDERAL COURT DECERTIFIES INSURANCE AGENT WAGE AND HOUR CLASS ACTION

Addressing an issue that has plagued insurers and other companies across the country, a federal district court in the Northern District of Illinois decertified a class of California insurance agents alleging that Bankers Life had violated various California wage and hour statutes by misclassifying the agents as independent contractors, rather than employees. *Walker v. Bankers Life & Cas. Co.*, No. 06 C 6906, 2008 WL 2883614 (N.D. Ill. July 28, 2008).[2] After the Seventh Circuit denied Plaintiffs' Rule 23(f) Petition and the district court set an October 27 trial date, the parties settled the case.

The district court noted that its prior class certification order was entered "when the parties completed limited discovery." *Id.* at *9. The court agreed with Bankers Life that, with discovery, it had "become apparent that common questions will not predominate over individual ones and the class action device is not a superior method for adjudication." *Id.*

No Predominance of Common Issues

First, the court concluded that resolving the issue whether the agents were misclassified as contractors "would require an onerous inquiry into each agent's relationship with Bankers Life," including application of a multifactor test to determine whether Bankers Life had "the right to control the manner and means of accomplishing the result desired." *Id.* at *6, 10. The court held:

> The right to control test is not to be viewed in isolation, as there are several indicia of the relationship, which are not to be applied mechanically. . . . [Defendant's] evidence includes differences among agents with respect to work hours, training attendance and requirements, sales builder meeting attendance and requirements, phone clinics and appointments, lead generation, marketing procedures, use of scripts and standardized forms, performance reviews, work supplies, and company appointments. Additionally, . . . in each office, training varies, as do clinics, best practices, and employee monitoring.

Id. at *10.

The court rejected Plaintiffs' contention that evidence of *actual* control is irrelevant, and that only the *right* to control should be considered:

> Although courts use the "right to control" language as the proper standard, courts also look at actual control in analyzing whether an employment relationship exists under the multifactor test established by California law. . . . An analysis of the underlying relationship is essential, to analyze whether an employer-employee relationship exists. The actual exercise of control may be probative of the existence of an employment relationship.

Id. at *11. Moreover, Bankers Life's "right to control," the court concluded, "cannot be resolved solely by referring to the agent contract and uniform policy training manuals and publications." *Id.* Rather, "it would require scrutiny of each agents' experience with regard to training, monitoring, practices, and requirements on the job. Testimony regarding an agent's work hours, training attendance and requirements, sales builder meeting attendance and requirements, phone clinics and appointments, lead generation, marketing

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[2] Bankers Life is an Illinois insurance company authorized to do business in California.

procedures, use of scripts and standardized forms, performance reviews, work supplies, and company appointments would bear on the question of whether an employer-employee relationship exists." *Id.*

Class Action Not Superior

Second, the court concluded that a class action "is not superior to other available methods because of the number of individual issues to be litigated," and "[t]he difficulties likely to be encountered in managing the class action substantially outweigh any possible benefits derived from consolidating the plaintiffs' claims." *Id.* at *12. The court noted the "significant number of distinct factual issues with regard to each agent would be required." *Id.* The court concluded: "Ultimately, resolving the core issue of whether Bankers Life misclassifies its agents would result in mini-trials that would inhibit efficient resolution of this dispute. Accordingly, the class action device is not a superior method of adjudication." *Id.*

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ILLINOIS STATE COURTS REJECT CLASS ACTION CHALLENGES TO STATE FARM "STAFF COUNSEL"

Recognizing that a contrary ruling could precipitate a "dramatic fallout" for insurance carriers throughout Illinois, an Illinois Appellate Court and a number of Illinois trial courts rejected class action challenges to State Farm's use of "staff counsel" in representing policyholders and certain nonpolicyholders in lawsuits. *See, e.g.*, *Jacobs v. State Farm Mut. Auto. Ins. Co.*, No. 1-07-1057 (Ill. App. Ct. 1st Dist. Oct. 10, 2008) (unpublished Order); *Bowers v. State Farm Mut. Auto. Ins. Co.*, No. 06 L 09594 (Cir. Ct. Cook County, Ill., Oct. 31, 2008).

Plaintiff's counsel filed a number of class action suits against State Farm and other carriers (and threatened to file many others) alleging that the carriers' use of staff counsel constituted the unauthorized practice of law, because the attorneys were members of the carriers' legal departments and allegedly were subject to the control of corporate officials who were not attorneys licensed to practice in Illinois.

With respect to the representation of policyholders, the Illinois First District Appellate Court, in an unpublished Order, held that while Section 1 of the Illinois Corporation Practice of Law Prohibition Act, 705 ILCS 220/1 (CPLPA), prohibits carriers from "practicing law" in Illinois, Section 5 provides an exception to this rule, and allows insurance carriers to "employ an attorney in any litigation in which the corporation may be interested by reason of the issuance of any policy of insurance. Accordingly, it is lawful for insurance carriers . . . to employ attorneys or a law firm to defend their policyholders." *Jacobs*, No. 1-07-1057, slip op. at 7; *see id.* at 8 (also relying on *Kittay v. Allstate Ins. Co.*, 78 Ill. App. 3d 335, 397 N.E.2d 200 (1st Dist. 1979), as authority for allowing insurance carriers to employ attorneys to represent policyholders and fulfill contractual duty to defend). The Court also rejected Plaintiff's contention that the use of staff counsel operating under the name of "The Law Offices of Bruce Farrel Dorn & Associates" effectively created a "fictitious name" or was otherwise fraudulent or deceptive: "There is no suggestion . . . that the name under which the staff attorneys in question practice alters this analysis." *Id.* at 11.

With respect to the representation of nonpolicyholders, the trial court in *Jacobs* concluded that while it was unlawful for staff counsel to represent or hold themselves out as counsel for nonpolicyholders, Plaintiff's complaint was conclusory and did not satisfy Illinois fact-pleading requirements, failing to identify the individuals allegedly represented without a contractual relationship or the alleged misrepresentations made. The Appellate Court agreed that these allegations were insufficient to state a valid claim. *Id.* at 11-12.

Schiff Hardin Class Action Litigation Group

Schiff Hardin LLP has an active and experienced team of litigators who concentrate their practice in defending corporations against class actions and other complex civil litigation. Our attorneys have defended our corporate clients in class action cases in both state and federal courts throughout the United States.

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