PANEL DISCUSSION: CLASS ACTIONS – WINNING UP FRONT BY PREVENTING CERTIFICATION

Moderator:
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Class Action Defense: Winning Early

Moderator

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This panel will explore effective strategies for defeating class actions through early aggressive actions.

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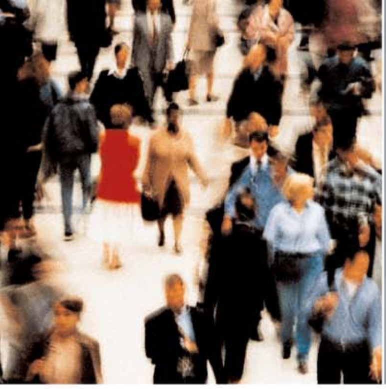

Class Action Alert

Recent developments in class action law

A publication of Nixon Peabody LLP

JANUARY 2008

In re Fosamax litigation: MDL court rejects certification of medical monitoring class

On January 3, 2008, the Hon. John F. Keenan welcomed in the new year with a memorandum and order denying class certification of three putative medical monitoring classes in the Fosamax product liability multi-district litigation, *In re Fosamax Products Liability Litigation,* MDL No. 1789, 1:06-md-1789-JFK, pending in the United States District Court for the Southern District of New York. Memorandum Opinion and Order, Docket No. 222. The decision falls in line with a series of cases over the last several years, in which courts have consistently rejected medical monitoring classes in pharmaceutical and medical device products-based litigation because of the need for individualized proof.

In 1995, the Food and Drug Administration approved Fosamax, a prescription medication manufactured by Merck & Co., Inc., for the treatment of osteoporosis, which afflicts more than 10 million Americans over the age of 50 (80 percent of whom are women). Osteoporosis is characterized by reduced bone density and quality, which results in diminished bone strength and increased susceptibility to fractures. The disorder is caused by an imbalance between the resorption of old bone cells and the generation of new bone cells. Fosamax addresses this imbalance by inhibiting the resorption of aging bone cells and reducing the rate of bone cell turnover.

The active ingredient of Fosamax is alendronate, a compound that consists of bisphosphonate and a nitrogen-containing amino group. The plaintiffs allege that bisphosphonate causes a painful, degenerative bone condition known as osteonecrosis of the jaw (ONJ), which is difficult to treat and can result in infection. Merck is currently defending more than 360 product liability actions in the MDL alone.

The plaintiffs sought the certification of three state-wide medical monitoring classes under the laws of Pennsylvania, Florida, and Louisiana that were defined to include citizens of those states who had ingested Fosamax during the class period, but had not been diagnosed with ONJ. The plaintiffs sought the creation of a monitoring program funded by Merck, under which each putative class member would receive bi-annual dental examinations that included comprehensive testing and the creation of a consultation report to be provided to the individuals' treating physicians. Noting the rejection of medical monitoring classes in the Vioxx, Prempro, Baycol, Paxil, Rezulin, and Propulsid cases,[1] among others, Judge Keenan reached the same result here.

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[1] *In re Vioxx Prods. Liab. Litig.*, 239 F.R.D. 405 (E.D. La. 2006); *In re Prempro Prods. Liab. Litig.*, 230 F.R.D. 555 (E.D. Ark. 2005); *In re Baycol Prods. Litig.*, 218 F.R.D. 197 (D. Minn. 2003); *In re Paxil*, 212 F.R.D. 539 (C.D. Ca. 2003); *In re Rezulin Prods. Liab. Litig.*, 210 F.R.D. 61 (S.D.N.Y. 2002); *In re Propulsid Prods. Liab. Litig.*, 208 F.R.D. 133 (E.D. La. 2002).

At the outset, Judge Keenan concluded that class certification was not appropriate based on the over-breadth of the class definition alone. He noted, in particular, that the class definition embraced any individual who had ever ingested Fosamax, while the plaintiffs' expert conceded that only those who were currently taking the medication were at a heightened risk for developing ONJ. Furthermore, the definition "did not set any dosage limitations on class membership," did not "attempt to screen individuals with unique risk factors for ONJ," and "fail[ed] to specify the duration of the proposed dental monitoring program." Judge Keenan was also unmoved by the plaintiffs' assurances that the class definition could be subsequently refined. He explained, "This wait-and-see approach is untenable because, until a class of persons alleged to be entitled to relief is defined, the Court cannot conduct the numerosity, commonality, typicality[,] and adequacy analyses that must precede certification."

More importantly, Judge Keenan concluded that, even if the plaintiffs' class definition had been more diligently tailored, certification was untenable because the plaintiffs could not demonstrate the elements' typicality, adequacy, predominance, or superiority.

The court observed, as in other medical monitoring cases, that the elements of typicality and predominance could not be met because "almost every element of a medical monitoring claim will require highly individualized proof of each class member's medical condition in the circumstances of their use of Fosamax." Among other things, the plaintiffs could not "advance a single collective theory of negligence that applies to all class members" because what Merck knew or should have known about the risks associated with Fosamax varied over time. In addition, Judge Keenan found no support for the contention that "a pharmaceutical drug that currently enjoys FDA-approval can be proven to be inherently dangerous to all persons who have taken it." To the contrary, the heightened risk of ONJ due to Fosamax use was highly dependent on dosage, duration of use, past medical history, and exposure to other ONJ risk factors. Therefore, proof of causation presented "an insurmountable obstacle."

In addition, Judge Keenan found that the need for individualized proof also undercut the class representatives' ability to represent the class because "the inherent differences" in their claims – for example, due to exposure to different risk factors for ONJ – make it "possible that class representatives would rely on arguments that are adverse to the interests of other class members."

Finally, Judge Keenan was not persuaded that the class action device was the superior vehicle to pursue medical monitoring claims, because "there is an insufficient basis to believe that all class members would prefer the proposed monitoring program to one designed with their own particular circumstances in mind." He was not swayed by the notion that medical monitoring claims provide insufficient incentives for plaintiffs to initiate individual actions, explaining:

> Hundreds of other Fosamax users have already filed suit against Merck seeking similar relief under many legal theories, and more lawsuits are filed each week. If these cases yield positive results for plaintiffs, more Fosamax users can be expected to come forward and prosecute their individual claims.

Lastly, the Court noted that the efficiencies of consolidation had already been achieved by instituting an MDL:

> Plaintiffs have not convinced the Court that the significant manageability difficulties posed by the class actions would be offset by any gain in efficiency. Most of the efficiency gains that class-treatment could bring in a case such as this have been captured already by the consolidation of all Fosamax cases in this Court for pre-trial proceedings.

Conclusion

At the heart of Judge Keenan's decision lies the prescient observation that the Supreme Court articulated more than a decade ago: "The class action device is not very useful in mass tort cases which tend to present significant questions, not only of damages but of liability and defenses of liability affecting individuals in different ways." *Amchem Prods., Inc. v. Windsor*, 521 U.S. 591, 625 (1997)) (internal punctuation omitted). In light of Judge Keenan's holding, and the wealth of case law rejecting medical monitoring classes that preceded it, one wonders how many more attempts the plaintiffs' bar will make at certifying such cases, particularly those involving pharmaceutical and medical device products that are pending in federal court. To the extent the plaintiffs persist, Judge Keenan's decision provides yet another road map for defending against these claims.

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Proposed legal changes in Europe would advance collective consumer litigation for antitrust violations

By Benjamin R. Dwyer and Vivian Quinn

The European Commission has determined that its antitrust law is "underdeveloped" because lawsuits by private entities alleging breach of that law are "rare." To remedy this, on April 3, 2008, the Commission issued a White Paper calling for specific changes to the laws of the European Union's twenty-seven member states that would encourage and increase such litigation. Most notably, the Commission proposes new laws to facilitate collective actions on behalf of consumers. Companies that do business in Europe, particularly those that sell consumer goods, must be aware of the proposals and their likely effects.

Background

European Union (EU) antitrust law—*competition* law as it is called in Europe—is embodied in Articles 81 and 82 of the EC Treaty. Article 81 prohibits anticompetitive agreements between two or more companies. Article 82 prohibits companies with dominant market positions from abusing their position. This substantive law, discussed in greater detail below, is uniform and binding on all companies that do business in one or more of the EU member states.

The European Commission and designated agencies in each of the EU's national governments (National Competition Authorities, or NCA's) possess investigative and enforcement powers under the competition law.[1] These include the power to issue injunctions against anticompetitive practices and/or fine offenders. Although individuals and private entities may also bring actions for infringement of competition law, the vast majority of enforcement action taken to date has been by the Commission and, to a lesser extent, the NCAs. The Commission believes that public enforcement alone is insufficient and that increased private enforcement of competition law would complement the role of the public authorities.

The Commission is particularly concerned about the inability of smaller claimants—e.g., consumers—to bring claims against violators of the competition law.

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[1] The term National *Competition Authority* is actually a generic term for the 27 designated agencies—one in each member state—with jurisdiction over competition law in the respective states. For example, the UK's NCA is the Office of Fair Trading. In Germany it is the *Bundeskartellamt*; in France it is the *Conseil de la Concurrence*.

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It notes that antitrust litigation by individuals is cost-prohibitive and, to the extent that so few such claims are brought, does not deter anticompetitive conduct. It also notes that many victims are indirect purchasers—that is, consumers or other end-users who are several steps removed from a competition law infringer. As discussed in more detail below, the Commission proposes two methods for promoting aggregation of individual claims.

Private actions under the competition law must be brought in the national courts of the member states. Accordingly, the procedural and evidentiary rules applicable to such actions are as varied as the member states themselves. Many are deemed by the Commission as "obstacles," which discourage private parties from bringing claims under the competition law. The Commission believes that increased private actions will complement the work of governmental competition authorities, deter anticompetitive practices, reward victims of these practices, and foster competition within Europe's Internal Market to the benefit of European consumers and businesses.

Article 81

Article 81 prohibits agreements or other concerted business practices between companies (in EU parlance, "undertakings") which *may* affect trade between member states and which are intended to, or effectively restrict, competition. Examples of such restrictions listed in Article 81 include fixing selling or purchasing prices; applying unequal terms to equivalent transactions; limiting production, markets, technical development or investment; sharing markets or supply; and conditioning contracts on acceptance of unrelated obligations. Examples of enforcement under Article 81 include the punishment of an EU manufacturer of consumer electronics for granting an exclusive dealership to its French distributor which resulted in significant price increases there. Producers of aniline dyes who raised prices nearly simultaneously and took other actions evidencing market coordination among them were punished even in the absence of an explicit agreement.

Article 82

Article 82 prohibits companies that have a "dominant" market position from abusing that position by, *inter alia*, imposing unfair prices or engaging in other unfair trading practices. A company has a dominant market position when it is able to behave, to an appreciable extent, independently of its competitors, customers and consumers, thus enabling it to hinder the maintenance of effective competition. A dominant position is presumed when market share is 50% or more; a market share as low as 40% can qualify as dominant in certain circumstances. An abuse or exploitation of the dominant position occurs when a company engages in conduct that would not be possible in a competitive market. Examples listed in Article 82 include imposing unfair prices; limiting production, markets or technical development to the detriment of consumers; and imposing other unfair trading conditions. Examples of companies punished under Article 82 include a multinational non-EU producer of vitamins fined by the Commission for abusing its dominant position by using preferential supply contracts and loyalty rebates to reinforce its dominant position. An EU-based pharmaceutical company was fined for delaying market access for the generic version of its top-selling prescription medication before the patent expired on the latter.

In the foregoing examples of action taken under Articles 81 and 82, the Commission was principally responsible for the investigation and punishment. The main thrust of the White Paper is to bring private entities, particularly consumers, into the process and to provide collective redress for them.

For example, to date, there have been relatively few cases brought under Article 82 for unfair pricing, but this may change with the adoption of the White Paper's proposals.

The Proposals

In order to expand enforcement of competition law through increased private litigation, the Commission's April 3, 2008 White Paper proposed changes to the laws of member states applicable to private actions for damages[2] under the competition law, including the following:[3]

Collective actions. The Commission determined that smaller players— *e.g.*, consumers—hurt by anticompetitive practices are often discouraged by the cost of litigation from pursuing claims for their losses. Aggregation of claims, however, would reverse the cost-benefit ratio of litigation. It recommends two means for aggregating consumer claims: (1) designating qualified entities such as consumer advocacy organizations to bring *representative actions* on behalf of others and (2) allowing *opt-in* collective actions, whereby affected individuals may choose to join a class of litigants.

Cost allocation. It is commonly recognized that Europe's "loser pays" principles of cost allocation is a major reason for the lack of litigation relative to the U.S. The Commission recommends that member states consider adjusting cost allocation rules—for example, by affording national courts discretion to derogating the loser pays rule in certain circumstances and early in the litigation.

Relaxed burden of proof. Presently in some member states, a finding of a breach of Article 81 or 82 confers liability on the infringer; in others, that is not enough and the claimant must also prove negligence or intent. The Commission recommends that in the latter group, the fault requirement be eliminated. Defendants in these countries would be entitled, however, to offer a defense of excusable error, though the proof requirement for that defense would be high.[4]

Binding governmental findings. In some member states, a finding of an NCA that a company has breached competition law is binding proof in parallel private actions. In others, such findings are not binding in civil courts and private claimants must prove the breach independently. The Commission recommends that the latter group adopt rules requiring their respective courts effectively to adopt the finding of any member state's NCA in parallel private actions.

Greater access to evidence. The Commission determined that "information asymmetry"—*i.e.*, that the evidence of anticompetitive practices is nearly exclusively in the hands of the alleged offender—prevents private claimants from accessing the evidence necessary to prove their claims. It

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[2] Other remedies available to private claimants include injunction and nullity, but the White Paper's proposals do not directly address these.

[3] The full text of the White Paper may be accessed at http://ec.europa.eu/comm/competition/antitrust/actionsdamages/files_white_paper/whitepaper_en.pdf.

[4] Countries affected would include Spain, Portugal, Denmark, Finland, Sweden, Poland, and Greece.

recommends increasing the power of national courts to direct defendants to make disclosures of documents and other evidence.

Flexible accrual/start of limitations periods. To ensure that hidden anticompetitive practices do not deprive potential private claimants of their actions, the Commission recommends that member states amend their laws to begin the running of applicable limitations periods upon the reasonable discovery by a potential claimant of an infringement, or the issuance of infringement decisions by investigative authorities.[5]

Damages calculation. The Commission proposes that damages fully compensate alleged victims for actual losses, including lost profits.

The Commission explicitly attempts to avoid the excesses of the U.S. class action system.[6] Thus, for example, claimants must opt-in, as opposed to opt-out as in the U.S. Claimants seeking court intervention for directed disclosure would have to meet certain thresholds of initial fact pleading and proof. Perhaps most notably, the Commission's proposals would limit damages to compensatory damages—it does not propose double or treble damages or other punitive measures.

Nevertheless, the proposals, if enacted, would require companies doing business in Europe to be aware of the ramifications. For example, the potential consequences of an investigation by the Commission or an NCA would extend beyond the potential for, *e.g.*, a fine or injunction. A company may find that pertinent documents would also have to be provided to a consumers' organization or law firm and/or that the governmental entity's finding is automatically binding in civil courts.

The White Paper represents the final position of the Commission. The next step is a public comment period, followed by drafting of implementing legislation.

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[5] There is wide variety in limitations laws among the member states; limitations periods may range from one to 30 years.

[6] Notably, the Commission, and in particular its chief competition law commissioner, Neelie Kroes, have repeatedly assured the public that the proposals are designed to balance the need for effective redress for smaller, less sophisticated victims of anticompetitive practices without importing the excesses of U.S.-style class actions.

We welcome your questions and comments. If you need assistance on any matter, please call or e-mail Christopher M. Mason (cmason@nixonpeabody.com 212-940-3017) or Paul J. Hall (phall@nixonpeabody.com 415-984-8266) as the coordinating heads of our class action defense practice across our substantive litigation teams, or contact any of our partners listed below:

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Class Action Alert

Recent developments in class action law

A publication of Nixon Peabody LLP

MAY 5, 2008

Second Circuit creates doubt about arbitration clauses and class action waivers in credit card contracts

By Christopher M. Mason and Leah R. Threatte

At the end of April, the United States Court of Appeals for the Second Circuit released an opinion in *Ross v. Bank of America,* No. 06-4755-cv, 2008 U.S. App. LEXIS 8927 (2d Cir. April 25, 2008), casting doubt on the use of arbitration clauses with class action waivers in the credit card industry. The plaintiffs in *Ross* are holders of credit cards issued by various defendant banks. The trial court, in a decision by a well-respected District Court judge, had held that those plaintiffs failed to show the necessary "injury in fact" for Article III standing in their allegations that "mandatory arbitration clauses found in credit card contracts issued by Defendants-Appellees . . . are the product of illegal collusion among credit providers . . . ." *Id.,* 2008 U.S. App. LEXIS 8927, at *3. The Second Circuit reversed, holding that such allegations would suffice to show an injury in fact for purposes of standing. *Id.; accord id.,* 2008 U.S. App. LEXIS 8927, at *12-18.

In their pleadings, plaintiffs had alleged that the defendant banks were engaged in a conspiracy (through an "Arbitration Coalition") to force cardholders to accept mandatory arbitration clauses waiving class actions. *Id.,* 2008 U.S. App. LEXIS 8927, at *4. This allegedly created "a 'non-price trade advantage over cardholders' and the removal of any economic incentive for the banks to comply with antitrust and other laws," and "an increase in dispute-related costs to individual cardholders . . . [together with] the removal of all non-arbitration credit cards from the market, thereby depriving the cardholders of meaningful choice in the area of credit card services, and [creating] a diminution in the overall quality of credit services offered to consumers." *Id.,* 2008 U.S. App. LEXIS 8927, at *5-6. In turn, this purportedly amounted to violations of Section 1 of the Sherman Act, 15 U.S.C.A. § 1 (West 2008), as a conspiracy to restrain trade and as an illegal group boycott by the defendants.

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Three of the defendants had cardholder agreements with pre-dispute arbitration provisions that allowed their cardholders to opt out of arbitration. The other defendants had cardholder agreements that contained pre-dispute arbitration clauses with class action waivers that did not allow any opt out. *See Ross,* 2008 U.S. App. LEXIS 8927, at *3-4. All defendants, however, attacked the plaintiffs' claims on grounds that, because none of the plaintiffs had "yet initiated a dispute that was forced, against their wishes, into arbitration, they have yet to be injured, and therefore present no live case or controversy." *Id.,* 2008 U.S. App. LEXIS 8927, at *7.

The trial court agreed with this analysis and held that the alleged injuries could not satisfy the Constitutional requirement for an injury in fact sufficient to support standing by the plaintiffs. *Id.,* 2008 U.S. App. LEXIS 8927, at *8. (The trial court did not reach the further issue of antitrust injury. *See id.,* 2008 U.S. App. LEXIS 8927, at *9 n.1). Instead, the trial court held that the plaintiffs' "injuries" were "entirely speculative", depending as they did on the assumptions that "someday (1) Defendants may engage in misconduct; (2) the parties will be unable to resolve their differences; (3) Plaintiffs may commence a lawsuit; (4) the dispute will remain unresolved; and (5) Defendants will seek to invoke arbitration provisions." *In re Currency Conversion Fee Antitrust Litig.,* No. 05 Civ. 7116, 2006 U.S. Dist. LEXIS 66986, at *14-15 (S.D.N.Y. Sept. 20, 2006), *rev'd sub nom. Ross v. Bank of America,* No. 06-4755-cv, 2008 U.S. App. LEXIS 8927 (2d Cir. April 25, 2008).

In reversing the trial court's holding, the Second Circuit criticized it for "overlook[ing] the cardholders' antitrust arguments, instead viewing their claims, at the banks' urging, merely as challenges to the arbitration provisions in their credit agreements." *Id.,* 2008 U.S. App. LEXIS 8927, at *12. Without (so it claimed) intimating "whether the cardholders' alleged injuries would survive an antitrust standing analysis", the Second Circuit instead announced that the plaintiffs' allegations demonstrated at least two injuries in fact sufficient to confer standing. (Based on those injuries, it also rejected arguments that the plaintiffs' claims were not yet ripe. *See id.,* 2008 U.S. App. LEXIS 8927, at *20-21.)

First, the Second Circuit accepted as sufficient the argument that, by limiting the choice of dispute resolution methods available to cardholders, defendants might allegedly increased the plaintiffs' potential monitoring costs by eliminating the option for them to rely on class action attorneys. *Id.,* 2008 U.S. App. LEXIS 8927, at *14-15. But under the theory that class action attorneys perform a monitoring function for "free" for consumers in exchange for the opportunity to bring class actions, class action attorneys would presumably not monitor banks that, in the absence of illegal collusion, chose to use arbitration clauses with class action waivers anyway. So this "cost" could increase only as to banks that, but for illegal collusion, would not have chosen such a pre-dispute arbitration clause. And the second supposedly sufficient allegation of injury in fact, that "[a] card that limits the holder to arbitration is less valuable (all other factors being equal) than a card that offers the holder a choice between court action or arbitration", *id.,* 2008 U.S. App. LEXIS 8927, at *15, would tend to indicate that all banks should rationally choose to use pre-dispute arbitration clauses with class action waivers without regard to any collusion between them on that subject anyway. If having an arbitration clause of the kind attacked by the plaintiffs would deter marginal litigation by requiring that a plaintiff (or a plaintiff's counsel) invest in the case (as the plaintiffs claimed in more derogatory terms, see id.), then a bank should, "all other factors being equal," choose to use such a clause.

Other federal courts have held that mandatory pre-dispute arbitration clauses containing class action waivers are not precluded by federal law in the consumer credit context. *See, e.g., Gay v. CreditInform,* 511 F.3d 369, 375 (3rd Cir. 2007) (upholding such a pre-dispute arbitration clause in the context of the federal Credit Repair Organizations Act, 15 U.S.C.A. §§ 1679, *et seq.* (West 2008)). In the antitrust context, some other federal courts have proven hostile to pre-dispute arbitration clauses containing class action waivers, however. *See Kristian v. Comcast Corp.*, 446 F.3d 25 (1st Cir. 2006) (severing provision of arbitration clause denying class arbitration because of supposed potential to prevent plaintiffs from vindicating their statutory rights under federal antitrust statutes).

Given this tension, the *Ross* decision bears watching on remand. As a practical matter, a number of industries other than the credit card industry have experienced widespread adoption of pre-dispute arbitration clauses with class action waivers by companies in those industries. The *Ross* decision may chill such adoption even if no collusion exists.

In addition, while the *Ross* opinion does not squarely say so, the Second Circuit appeared to accept as economically valid the allegation that "[t]he cost of litigating the antitrust issue when the particular dispute arises will almost certainly be disproportionate to the dispute. (A plaintiff will not spend a hundred thousand dollars in legal fees to litigate a five thousand dollar dispute.)." On remand, it may be interesting to note the extent to which the defendants attack this presumption. Arguments of cost of litigation would seem to make no sense—without more—when, by statute, a litigant is entitled to recovery of his, her, or its attorneys' fees and treble damages. *See, e.g.,* 15 U.S.C.A. § 15 (2008). The Second Circuits' acceptance of the plaintiffs' allegations on this point as sufficient to show injury also seems to depend on the plaintiffs themselves making the economic investment for litigation. This assumes that no plaintiffs' attorney would be willing to represent a plaintiff for the right to statutory fees, an assumption that—again, without more—seems to be unwarranted. *Cf., e.g., Matsushita Elec. Indus. Co. v. Zenith Radio Corp.,* 475 U.S. 574, 587 (1986) ("if the factual context renders" an antitrust claim "implausible—*if the claim is one that simply makes no economic sense"* then a plaintiff must offer "more persuasive evidence . . . than would otherwise be necessary" to avoid summary judgment).

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Class Action Alert

Recent developments in class action law

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JULY 2008

Good hygiene for special litigation committees

By Christopher M. Mason, Carolyn G. Nussbaum, and Steven M. Richard

Two recent opinions of the Delaware Chancery Court in *Sutherland v. Sutherland*, No. 2399-VCL, 2008 Del. Ch. LEXIS 49 (May 5, 2008), and 2008 Del. Ch. LEXIS 59 (May 29, 2008), emphasize some practical truths that all Delaware corporations (and corporations organized in most other states as well) should recognize when they use a special litigation committee in response to a shareholder demand or derivative suit.

The *Sutherland* case involved a family-owned timber company and its subsidiary. The plaintiff and another family member together owned 50 percent of the relevant common stock. They opposed family members who owned the other half of the common stock—but who also had absolute voting control through certain preferred stock.

Believing that the family members with voting control were, as officers and directors, improperly using corporate funds for their personal benefit, the plaintiff, in her role as a shareholder, sued derivatively for waste and breach of fiduciary duty. In response, the companies created a special litigation committee.

The special litigation committee consisted of a single outside director who was a partner in a reputable accounting firm. It had full authority to investigate and act for the companies with respect to the plaintiff's claims, retained independent legal counsel, undertook an investigation, and produced a report recommending the dismissal of the plaintiff's claim. When the companies moved to dismiss the plaintiff's claims based on the special litigation committee's recommendation, however, the Chancery Court denied their motion. *See Sutherland*, 2008 Del. Ch. LEXIS 49.

The general legal standard for judicial review of a motion to dismiss based on a special litigation committee's recommendations appears in the well-known opinion in *Zapata Corp. v. Maldonado*, 430 A.2d 779 (Del. 1981). As that case and its progeny hold, a Delaware corporation must show the court that a special litigation committee has acted in good faith, made a reasonable investigation, and maintained its independence before the committee's recommendation may be followed as a basis for dismissal.[1] The Chancery Court in *Sutherland,* however, did not find that the companies had made all three of these showings.

The reason for this clearly had something to do with the single-member nature of the special litigation committee in *Sutherland.* As students of shareholder derivative suit history will recall, one of the few cases in which a Delaware court has ever rejected the recommendation of a special litigation committee was *Lewis v. Fuqua*, 502 A.2d 962 (Del. Ch. 1985)—a case in which the "committee" also consisted of a single director. The first of the *Sutherland* opinions cited the *Lewis* decision for the proposition that single-member committees may be "closely scrutinized." 2008 Del. Ch. LEXIS 49, at *9 & n.20. The second *Sutherland* opinion, becoming much more emphatic about how much closer this scrutiny should be, quoted the *Lewis* decision for the proposition that, "in a case involving a one-person SLC [special litigation committee], the moving party must prove that the SLC was 'like Caesar's wife … above reproach.'" 2008 Del. Ch. LEXIS 59, at *4 & n.7.

The single-member committee in *Sutherland* could not meet the standards of "Caesar's wife." While the Chancery Court found the record sufficient to show that the committee was independent, 2008 Del. Ch. LEXIS 49, at *9-16, the companies did not adequately establish the committee's good faith or the reasonableness of its investigation, *see generally id.* at *17-26, even though the investigation "was, in many respects, exhaustive and time consuming," *id.* at *16-17. The Chancery Court therefore denied the motion to dismiss.

The companies filed a motion to reargue this decision. As to the procedural issue of reargument, the Chancery Court held that the companies did not make the necessary showing that the denial of the motion to dismiss involved "a misunderstanding of a material fact or misapplication of the law…." 2008 Del. Ch. LEXIS 59, at *2. But the Chancery Court also took the opportunity to expand at length on *why* its earlier decision was correct (including emphasizing the higher, "Caesar's wife," standard for one-person special litigation committees. *Id.* at *4).[2]

The Chancery Court was especially critical of the special litigation committee's omission in its report of any reference to certain payments made for the benefit of one of the defendants—payments constituting the very sort of questionable transaction that had led the plaintiff to file her action. *Id.* at *5-6. The committee not only failed to mention these payments, but wrote its report in such a way to suggest that there were no such payments. *Id.* at *6. Only hotly contested discovery proceedings by the plaintiff to gain access to documents detailing the transactions overlooked by the committee uncovered those payments. *Id.* at *6-7. While the special litigation committee may have been right that strong statute-of-limitations defenses would have defeated any claims relating to those payments, the Chancery Court still held that "a good faith effort to deal with [the payments] necessarily required that the report *both* disclose the facts relating to the payments *and* present the analysis of [the defendants'] defense." *Id.* at *7 (emphasis added). Thus, while the committee in *Sutherland* was not required to conduct a forensic investigation, it was required to investigate not only the specific

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[1] A motion to dismiss based on a special litigation committee's recommendation is a "hybrid" motion that has elements both of a motion to dismiss and a motion for summary judgment. *See, e.g., Sutherland,* 2008 Del. Ch. LEXIS 49, at *7 & n. 6. As such, the moving party must show, not merely allege, these criteria.

[2] In contrast, Nixon Peabody has successfully defended a single-member special litigation committee's recommendation in *Hartman v. Thoman*, Index No. 2001/02645 (N.Y. Sup. Ct. Monroe Co. Jan. 21, 2002).

transactions pled in the plaintiff's complaint, but the *types* of claims and transactions that the complaint attacked. *See id.* at *8-9.

The Chancery Court also found that the special litigation committee's destruction of original interview notes, after using them to prepare what the court considered to be cursory and incomplete interview summaries, undermined the good faith and reasonableness of the committee's investigation in *Sutherland*: "[T]he touchstone of good faith in the context of a special litigation committee report is its demonstrated willingness to deal openly and honestly with *all* relevant and material information. Where, instead, the record shows that material information is consciously omitted …., the court must wonder what other information was omitted or what other information might have been uncovered by a more diligent inquiry." *Id.* at *7-8 (emphasis added).

The basic "function of judicial scrutiny of a special litigation committee's recommendation is to determine independently whether the action is likely to harm the corporation rather than help it." *Joy v. North*, 692 F.2d 880, 891 (2d Cir. 1982), *cert. denied*, 460 U.S. 1051 (1983). The Chancery Court's opinions in *Sutherland* are timely reminders of some basic elements of good "corporate hygiene" in preparing a special litigation committee to make this independent recommendation. Based upon our experience with such committees, we would recommend:

- Wherever feasible, create a special litigation committee of more than one director.
- Provide the committee with the funds and authority to retain its own independent counsel.
- Use minutes, rather than individual notes of committee members, to record committee meeting work.
- Produce a thorough committee report that addresses all material relevant evidence that came to the committee's attention, even if it was not specifically identified or referenced in the complaint.
- Keep all back-up materials and work product until after completion of the litigation.
- Address the factual strengths and weaknesses of all claims, even if the committee or counsel believes that the corporation has strong legal defenses to them.

We welcome your questions and comments. If you need assistance on any matter, please call or e-mail Christopher M. Mason (cmason@nixonpeabody.com 212-940-3017) or Paul J. Hall (phall@nixonpeabody.com 415-984-8266) as the coordinating heads of our class action defense practice across our substantive litigation teams, or contact any of our partners listed below.

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Class Action Alert

Recent developments in class action law

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JULY 2008

U.S. Supreme Court again reduces punitive damages in *Exxon*—What the decision suggests about future cases before this Court

By Raymond L. Mariani

The United States Supreme Court has again addressed the issue of punitive damages in a very recent decision, *Exxon Shipping Co. et al. v. Baker*, Slip Op. 07-219 (June 25, 2008). This decision concludes a 20-year saga over the appropriate measure of punitive damages for a massive oil spill that occurred off the coast of Alaska and caused economic losses to local residents and communities. The Court decided the case on narrow grounds of whether admiralty law permits punitive damages of the magnitude and the ratio to compensatory damages that was awarded by the jury, and modified several times by the trial judge and intermediate appellate court. However, the sweeping history and review of punitive damages jurisprudence, which was not essential to the decision, suggests that this Court has not written its last decision eroding punitive damages as a weapon of the plaintiff's tort bar in the United States.

The Court's decisions over the past few years that addressed whether punitive damages are excessive have relied upon the due process clause in the 14th amendment to the Constitution. That provision prohibits the imposition of grossly excessive or arbitrary punishments. The Court has criticized and reversed those punitive damages verdicts as inconsistent with these notions of fundamental fairness and justice, particularly where the awards do not bear a close ratio to the compensatory damages in the case.

Exxon presented several issues for review in this recent decision, two of which have potentially broader implications. Exxon asked the Court to reverse and strike the punitive damages award on the grounds that the federal statute governing plaintiff's damages claims implicitly prohibits punitive damages entirely, because it did not authorize that type of damages explicitly. The Court rejected this argument, holding that Congressional inaction does not necessarily prove legislative intent. It also noted the inconsistency of Exxon's position because the other damages awarded, *e.g.,* economic loss with no bodily injury or property damage, are likewise not explicitly authorized by statute, but were not appealed on that basis by Exxon. This suggests that the Court will not easily strike punitive awards on the basis of federal preemption or any weak statutory construction.

More importantly, the Court addressed whether the ratio of punitive damages to compensatory damages was consistent with the common law of admiralty. The Court reviewed the history of punitive damages, from its origins predating English common law to its treatment across a wide

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variety of jurisdictions. Punitive damages are grounded historically, in part, in compensation, but now are universally used to deter and punish. The majority ultimately concluded that the ratio of punitive awards to compensatory awards can be no greater than 1 to 1 in a maritime case. Accordingly, the case was remanded for entry of a verdict with a punitive damage award not to exceed the compensatory award.

The Court looked at three means of tempering the magnitude of punitive awards. It first concluded that verbal admonishments to the jury are insufficient. The wide variety of instructions used and the vagueness inherent in such non-quantitative criteria do not promote the systemic consistency that the Court seeks to promote in damages awards. The Court also reviewed the use of fixed-dollar amounts. Some states currently impose monetary caps on awards. The Court rejected this approach as impractical for judicial management. A fixed-dollar cap requires either an inflation adjustment, which the Court found too speculative to fix for the indefinite future, or for a court to adjust the dollar cap over time, which can only occur when a ripe case is presented for review.

The third approach, of employing a ratio was cited as the best available, because it uses an inherent inflation adjustment, namely the gradual increase over time in compensatory awards. While this approach is arguably circular, the Court also cited its use of ratios to set the boundaries of punitive damages in the due process cases as a basis to do so again in *Exxon* for maritime cases. The Court surveyed ratios used by various states and other countries, and also cited articles that analyzed the mean and median ratios that are a product of statewide or nationwide awards. As support for its holding of a 1-to-1 ratio for maritime cases, the Court noted the maximum in many states of 2 to 1 or 3 to 1, as well as the historic median of 0.65 to 1 cited by one commentator.

What the *Exxon* decision may predict about restrictions imposed by the Court in future punitive damages cases, particularly non-maritime tort cases, can be discerned from a few different aspects of this decision and the prior landmark cases on the subject. First, the makeup of the panel in *Exxon* compared to prior decisions suggests a likelihood of further restrictions on punitive damages based on due-process considerations. The most recent punitive damages award cases before the Supreme Court have been: *Phillip Morris v. Williams*, 549 U.S. 336 (2007) (reversing award because it was based on harm to people other than the named plaintiffs in the case); *State Farm v. Campbell*, 538 U.S. 408 (2003) (holding that ratio of greater than 9 to 1 will rarely be justifiable under due-process clause); *Cooper Industries v. Leatherman Tool Group*, 532 U.S. 424 (2001) (the constitutionality of lower court decisions are reviewed *de novo*, not for abuse of discretion); and *BMW v. Gore*, 517 U.S. 559 (1996) (three factors to consider in reviewing awards are degree of reprehensibility of conduct, disparity between actual harm and punitive award, and comparison of award to similar cases).

The common members of the majority in those four prior decisions and in *Exxon* are Justices Souter and Kennedy. Chief Justice Roberts voted with the majority in the cases while he has been on the Court, namely *Exxon* and *Phillip Morris*. This creates three reliable votes for any further rollback on punitive damages. Justices Scalia and Thomas are both ardent opponents of punitive restrictions based on the due-process clause and joined the majority in *Exxon* only because it was a maritime case. Justice Ginsburg has opposed any restrictions and has never voted with the majority on the issue.

This leaves three generally supportive but less-predictable jurists on the issue as the swing voters: Justices Stevens, Breyer, and Alito. Stevens voted with the majority in *State Farm* and *Gore* and wrote the opinion in *Cooper*. He appears to have voted against the strict 1-to-1 ratio in *Exxon* solely because of a philosophical difference on maritime law. Breyer likewise voted with the majority in all four prior cases, but dissented in *Exxon* on the ratio issue because of the need for less rigidity in maritime cases. Alito recused himself in *Exxon* due to his ownership of stock in the company, but voted with

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the majority in *Phillip Morris* (albeit that was not a ratio case). This voting history indicates a likely five, or perhaps six, justices who would support further restrictions on punitive damages.

Further, certain comments in Exxon suggest that we should watch this space. The majority clearly favors a 1-to-1 ratio generally, not just for maritime cases. It ends the *Exxon* opinion by stating in the final footnote that a 1-to-1 ratio also might be the constitutional limit in the case had a due process analysis been warranted, because it would have aggregated the compensatory damages of all plaintiffs and then decided if the total was "substantial." The Court had already laid the groundwork for that 1-to-1 ratio in *State Farm*, holding that an inverse correlation generally should be applied as compensatory damages increase in magnitude.

The majority also notes the inherent authority of the judiciary to shape maritime law, including its remedies, because it is so much more a common law than legislative creation. Of course, many of these same comments could be directed to the common-law history of tort, particularly outside strict liability. While many states have codified certain causes of action for product and other tort liability, torts remain very much a creature of common law.

Lastly, the majority flatly stated that it will not hesitate to act if the Congress does not make the first move. It considers judicial inaction as a shirking of responsibility for crafting necessary common law remedies. The distance between these statements, and the fashioning of additional and perhaps more stringent punitive damage rules in non-maritime cases, is not so great that the current makeup of the Supreme Court cannot cover that ground.

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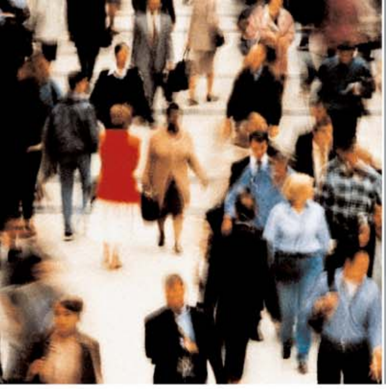

Class Action Alert

Recent developments in class action law

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Third Circuit provides support for class action waivers, rejects preemption of arbitration under Credit Repair Organizations Act

By Christopher M. Mason, Christopher D. Thomas, and Leah R. Threatte

Earlier this week, the United States Court of Appeals for the Third Circuit released an opinion deciding, in a case of initial impression nationwide, that the federal Credit Repair Organizations Act, 15 U.S.C. §§ 1679, *et seq.* (2000) (CROA), does not preclude arbitration of claims by a consumer against a company covered by the statute. *Gay v. CreditInform,* No. 06-4036, 2007 U.S. App. LEXIS 29302 (3rd Cir. Dec. 19, 2007). Perhaps even more importantly, the court also held that CROA does not preclude pre-dispute class waivers by consumers. *See id.,* 2007 U.S. App. LEXIS 29302, at *34. We represented the *amicus curiae,* the National Organization of Credit Correction Attorneys, favoring the result reached by the Third Circuit.

The plaintiff in the *Gay* case was an individual consumer who bought "credit repair services" from a company called Intersections, Inc. (Intersections). *Id.,* 2007 U.S. App. LEXIS 29302, at *1. Under the terms of a written agreement with the company, she paid it $4.99 per month for credit monitoring and improvement. *Id.,* 2007 U.S. App. LEXIS 29302, at *2. According to her, however, Intersections failed to make certain disclosures and demanded payment from her in advance for its services. *See id.,* 2007 U.S. App. LEXIS 29302, at *4. Believing that CROA required the disclosures not made by Intersections and that CROA forbade prepayment for credit monitoring and improvement services, the plaintiff commenced a putative class action against Intersections and a co-defendant later dismissed from the case.

In response to the lawsuit, Intersections both asserted that CROA did not apply to it, *see id.,* 2007 U.S. App. LEXIS 29302, at *2 n.2, and moved to stay and to compel the plaintiff to arbitrate her claim—on an individual basis—pursuant to an arbitration clause, *id.,* 2007 U.S. App. LEXIS 29302, at *5. The clause was a broad one. It provided that: "Any claim arising out of or relating to the Product shall be settled by binding arbitration in accordance with the commercial arbitration rules of the American Arbitration Association on an individual basis not consolidated with any other claim." *Id.* Based on this clause, the trial court granted the motion to stay and ordered the plaintiff to arbitrate on an individual basis.

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The plaintiff appealed. On appeal, she argued that CROA expressly forbids companies from obtaining waivers of rights provided to consumers by the statute. In particular, Subsection "f" of the statute states that:

> (a) …. Any waiver by any consumer of any protection provided by or any right of the consumer under this subchapter (1) shall be treated as void; and (2) may not be enforced by any Federal or State court or any other person. (b) …. Any attempt by any person to obtain a waiver from any consumer of any protection provided by or any right of the consumer under this subchapter shall be treated as a violation of this subchapter. (c) …. Any contract for services which does not comply with the applicable provisions of this subchapter (1) shall be treated as void; and (2) may not be enforced by any Federal or State court or any other person.

Among the rights protected by this provision, the plaintiff argued, is the right to a judicial forum and class procedures. *See* 15 U.S.C. § 1679g(a)(2), (b) (referring to "class action" in describing the damages that may be awarded by a "court" under CROA) (cited in *Gay,* 2007 U.S. App. LEXIS 29302, at *7-8). In the alternative, the plaintiff claimed that the arbitration clause in her contract with Intersections was unconscionable because of the purported class waiver. *See Gay,* 2007 U.S. App. LEXIS 29302, at *3, 37.

As we have noted in earlier *Class Action Alerts*, arguments such as this in the consumer context have been received favorably in some jurisdictions, with California courts being perhaps the leaders on the issue. *See*, *e.g., Discover Bank v. Superior Ct.,* 113 P.3d 1100 (2005) (class action waiver unenforceable in a contract of adhesion where predictably small amounts are at issue); *accord, e.g., Shroyer v. New Cingular Wireless Servs.,* No. 06-55964, 2007 U.S. App. LEXIS 19560 (9th Cir. 2007) (applying *Discover Bank* to invalidate arbitration provision in customer service agreement prohibiting class actions); *Gentry v. Superior Ct.,* 165 P.3d 556 (Cal. 2007) (applying *Discover Bank* to labor class actions).

The Third Circuit, however, extending and reaffirming its well-known decision in *Johnson v. West Suburban Bank*, 225 F.3d 366 (3d Cir. 2000) (refusing to find a substantive right to class actions under the Truth In Lending Act, 15 U.S.C. §§ 1601, *et seq.* (2005)), *cert. denied*, 531 U.S. 1145 (2001), rejected the plaintiff's version of this argument in the *Gay* case. Addressing both CROA and a similar Pennsylvania statute, the Pennsylvania Credit Services Act, 73 Pa. Cons. Stat. Ann. §§ 2181, *et seq.* (West 1993) (the CSA), which also mentions the right to sue in "court" (but does not mention class actions) and contains an anti-waiver provision (*see id.* § 2189(a)), the court held that, while those:

> statutes clearly contemplate consumers' actions being brought in a judicial forum and, in the case of the CROA, on a class action basis, and to that extent may be said to recognize a consumer's right to proceed in court, they neither contain provisions creating such rights nor indicate that Congress or the Pennsylvania Legislature, respectively, intended to exclude claims asserted under the CROA or the CSA from arbitration agreements.

Gay, 2007 U.S. App. LEXIS 29302, at *23.

The Third Circuit similarly rejected the plaintiff's argument that the arbitration provision in her contract with Intersections was unconscionable. Among other things, her pre-dispute agreement to arbitrate with Intersections could not, on its face, "constitute an unconscionable bargain" because she "retain[ed] the full range of rights created by the relevant statute," and those rights "remain available in individual arbitration proceedings." 2007 U.S. App. LEXIS 29302, at *52 (internal citation omitted); *accord, e.g., id.* 2007 U.S. App. LEXIS 29302, at *24. This indicated that no conflict exists between individual arbitration and the purposes of CROA and the CSA. *Id.,* 2007 U.S. App. LEXIS 29302, at *24. It also indicated that the inequality in bargaining power between the plaintiff and the defendants was not "so gross as to shock the conscience." *Id.,* 2007 U.S. App. LEXIS 29302, at *52 (internal citation omitted). Importantly, the court bolstered this conclusion elsewhere in its opinion in two ways: first, by observing that plaintiff had not "demonstrated that only Intersections supplies services of the kind for which [plaintiff] contracted with it," *id.*, 2007 U.S. App. LEXIS 29302, at *52 n.15, and, second, by pointing out that both CROA and the CSA give state and federal regulators rights to enforce those statutes, *id.*, 2007 U.S. App. LEXIS 29302, at *25. Such "provisions for administrative enforcement supply procedures for obtaining remedies reasonably substituting for those available in a class action." *Id.,* 2007 U.S. App. LEXIS 29302, at *26. Finally, given the explicit intent of Congress in the Federal Arbitration Act, 9 U.S.C. §§ 1-16 (2005), to favor arbitration, the Third Circuit expressly rejected two Pennsylvania Superior Court decisions, *Thibodeau v. Comcast Corp.*, 912 A.2d 874 (Pa. Super. Ct. 2006), and *Lytle v. CitiFinancial Servs., Inc.*, 810 A.2d 643 (Pa. Super. Ct. 2002), to the extent that they held that "a waiver of the right to bring judicial class actions in an arbitration agreement constitutes an unconscionable contract …. ." *Gay,* 2007 U.S. App. LEXIS 29302, at *62.

The Third Circuit's reasoning in *Gay* is better than the reasoning in most of the California cases on the subject, and better than the reasoning in federal cases such as *Kristian v. Comcast Corp.*, 446 F.3d 25 (1st Cir. 2006) (severing provision of arbitration clause denying class arbitration because of supposed potential to prevent plaintiffs from vindicating their statutory rights under federal antitrust statutes), which have found a fundamental, unwaivable substantive "right" to class treatment in statutes that, on their face, do not say that class procedures are substantive rights. In the somewhat splintered landscape of decisions on arbitration and class waivers, the *Gay* opinion stands as a good example of how the analysis should be done. *See also, e.g., Ranieri v. Bell Atl. Mobile,* 759 N.Y.S.2d 448 (N.Y. App. Div. 2003) (in arbitration clause of cellular service agreement, "given the strong public policy favoring arbitration …. and the absence of a commensurate policy favoring class actions, we are in accord with authorities holding that a contractual proscription against class actions …. is neither unconscionable nor violative of public policy").

We welcome your questions and comments. If you need assistance on any matter, please call or e-mail Christopher M. Mason (212-940-3017, cmason@nixonpeabody.com) or Paul J. Hall (415-984-8266, phall@nixonpeabody.com) as the coordinating heads of our Class Action Defense practice across our substantive litigation teams, or contact any of our partners listed below. Questions regarding the *amicus* brief in the *Gay* case may be directed to Chris Thomas (585-263-1087, cdthomas@nixonpeabody.com).

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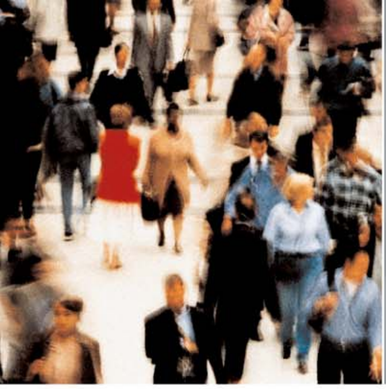

Class Action Alert

Recent developments in class action law

A publication of Nixon Peabody LLP

SEPTEMBER 2007

Vioxx reversal: Supreme Court of New Jersey overturns order certifying nationwide class in Cox-2 consumer fraud class action

On September 6, 2007, the Supreme Court of New Jersey overturned a class certification order of the New Jersey Superior Court in *International Union of Operating Engineers Local No. 68 Welfare Fund v. Merck & Co., Inc.*, Civil Action No. A-22, which had threatened to dramatically alter the landscape of products-based consumer fraud litigation, particularly in the drug and medical device arenas.

The plaintiffs, a putative class of third-party payors, asserted claims against Merck & Co., Inc. (Merck) under the New Jersey Consumer Fraud Act (CFA) in the wake of the Vioxx personal injury actions. They alleged that Merck engaged in a fraudulent and deceptive marketing campaign that misrepresented Vioxx's efficacy as compared with traditional pain medications, and actively concealed clinical data linking Vioxx with cardiovascular side effects. *Id.* at 7. The plaintiffs claimed that, as a result of this purported scheme, Vioxx was improperly accorded preferred status on formularies, causing third-party payors to overpay for the price of the medication. *Id.* at 13.

In July 2005, the Superior Court certified a nationwide class under the New Jersey CFA, thereby extending the reach of the statute well beyond New Jersey's borders. *Id.* at 4. The decision, which in the eyes of many observers effectively converted the New Jersey CFA into federal legislation, was affirmed by the New Jersey Appellate Division on March 31, 2006. *Id.* at 19.

On appeal to the Supreme Court of New Jersey, Merck contended that the certification as a nationwide class under the New Jersey CFA ran afoul of New Jersey's choice of law jurisprudence. *Id.* at 21. In addition, Merck argued that individual issues of fact and law predominated over the plaintiffs' claims and that a class action was not the superior vehicle to provide redress. *Id.* Although both Merck and the plaintiffs had identified the propriety of a nationwide class as the central issue of the appeal, the Supreme Court of New Jersey declined to address it. Instead, the Supreme Court of New Jersey reversed the Superior Court's decision, based on its analysis of the predominance and superiority elements. *Id.*

Predominance Analysis

As they had successfully argued below, the plaintiffs contended that the facts relating to Merck's marketing campaign and alleged concealment of information related to Vioxx's safety and efficacy were common to all class members. *Id.* at 25. Merck countered that, while each class member may have received the same information, they all reacted differently. *Id.* at 25-26. In particular, Merck asserted that some of the Prescription Benefit Managers (PBMs), which determined the status accorded to Vioxx in each of the third-party payors' formularies, assigned the medication a

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"preferred status" and placed it in a "low co-payment tier." *Id.* at 12. However, other PBMs responded to the information that Merck provided by giving Vioxx "non-preferred status" and placing it in a "high co-payment tier." *Id.*

The Supreme Court of New Jersey agreed with Merck. While noting that there was some factual commonality with regard to Merck's alleged conduct, the record conclusively demonstrated that the PBMs "made individualized decisions concerning the benefits that would be available for whom Vioxx was prescribed." *Id.* at 26. Therefore, "the commonality of [Merck's] behavior is but a small piece of the [plaintiff's] required proofs" and "the common fact questions surrounding what [Merck] knew and what it did would not predominate." *Id.* at 26-27.

In addition, the court squarely rejected the plaintiffs' argument that the issues of causation and damages could be established without offering individualized proof. Although, like many state consumer protection acts, the New Jersey CFA does not require a plaintiff to show reliance, a plaintiff must still demonstrate a "causal relationship" between the alleged misconduct and "an ascertainable loss." *Id.* at 24. To satisfy their burden on these elements, the plaintiffs employed a strategy that has become increasingly common in consumer fraud class actions. They relied on the testimony of an expert who opined that Merck's advertising program influenced the market and directly caused the price for Vioxx to artificially soar across the board. *Id.* at 27. The Supreme Court of New Jersey held that the plaintiffs were improperly eschewing their burden of proof by effectively advancing a "fraud on the market" theory, which the New Jersey courts have consistently limited to application in the securities fraud setting:

> To the extent that [a] plaintiff intends to rely on a single expert to establish a price effect in place of a demonstration of ascertainable loss or in place of a proof of a causal nexus between [a] defendant's acts and the claimed damages … [the] plaintiff's proof would fail. That proof theory would indeed be the equivalent of fraud on the market, a theory we have not extended to CFA claims.

Id. at 28. Therefore, the court concluded that the plaintiffs had not met their burden of establishing commonality of fact and law on these "critical" elements of their CFA claim. *Id.* at 29.

Superiority Analysis

The Supreme Court of New Jersey also found the superiority element to be lacking. The court noted the stark contrast between the third-party payors' claims and those of the plaintiffs in *Illiadis v. Wal-Mart Stores, Inc.*, 191 N.J. 88 (2007), a case in which it had recently affirmed certification. *Illiadis* involved a wage claim by a class of employees against Wal-Mart. There, in the court's view, the amount of relief available to any one class member was small and would not likely be pursued absent the use of the class device. As a result, the case presented "the quintessential example" of circumstance that would argue for certification. *Id.* at 31.

The court noted that the third-party payors stood on a "vast[ly] different" footing:

> Unlike individual wage earners, the [third-party payors] … allege that they have been damaged in large sums. Unlike those hourly wage earners, the [third-party payors] are well-organized institutional entities with considerable resources. Unlike in *Illiadis*, here we see no disparity in bargaining power and no likelihood that the claims are individually so small that they will not be pursued. In short, we find no ground on which to conclude that this proposed nationwide class meets the test for superiority that we have traditionally required.

Id. at 31-32. Thus, in terms of sophistication, financial wherewithal, and incentives, the third-party payors were more than capable of pursuing their claims against Merck without the aid of a class action.

Conclusion

While the intriguing, if not controversial, question of nationwide certification ultimately was not addressed, this decision will likely have a significant impact on consumer fraud class actions, even those that involve putative statewide classes. The plaintiffs' use of expert testimony to avoid individualized proof, one of the more popular tricks of the trade of the plaintiffs' bar, was debunked as an inappropriate application of the fraud on the market theory, outside the securities fraud arena. Equally significant is the role that superiority played in the Supreme Court of New Jersey's analysis. Superiority is an element that is often over-looked in attacking class certification. Here, however, the court appears to indicate that it would have reversed certification based on superiority alone. Due to the higher amount of recoverable damages in play for third-party payor classes relative to individual consumer classes, third-party payor classes are frequently the engine driving consumer fraud class actions in cases involving pharmaceutical and medical device products. If this decision gains traction in other jurisdictions, it could sound the death knell for third-party payor classes altogether and, thereby, lessen the financial attractiveness of consumer fraud actions to the plaintiffs' bar.

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