Legal Backgrounder

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STATE CLASS ACTION REFORM: LESSONS FROM TEXAS

by

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With Congress' passage of the Class Action Fairness Act (CAFA), one question that frequently arises is: will class action litigation now shift to federal courts? That may be what Congress generally intended, but because of the way the law is written, one shouldn't expect state class actions to vanish entirely. To reduce removal or enhance remand prospects, plaintiffs' counsel may design one-state actions. If this is the case, lawyers will need to focus on state class action decisions, and reformers on state reforms.

Texas, through court decisions, legislation, and rule amendment, has transformed class action litigation, and will be a benchmark for state reform efforts. The Texas decisions, statutory law, and rule changes address every major aspect of class action litigation: jurisdiction and venue; the certification decision; interlocutory appeal and stay of discovery; settlement; opt-out; class counsel; fees; and supersedeas.

CAFA. CAFA amended 28 U.S.C. § 1332 to give federal courts jurisdiction over any proposed class action in which the amount in controversy exceeds $5 million and at least one class member is a citizen of a state different than that of at least one defendant.

CAFA, however, requires the federal court to decline jurisdiction if 2/3 or more of the class members and the principal defendants are citizens of the forum state. CAFA also requires the federal court to decline if 2/3 or more of the class and at least one defendant against whom significant relief is sought and whose conduct is a significant basis for the claims are citizens of the forum state, the principal injuries were incurred there, and no similar action has been filed in the previous three years. Finally, CAFA authorizes the federal court to decline jurisdiction in cases in

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which more than 1/3 but less than 2/3 of the class members are citizens of the state of filing, after weighing the role of forum state law, and the nexus between the forum state, the alleged harm, the class, and the defendants.

Thus, plaintiffs' counsel, in drafting a proposed class action, can try to discourage removal and improve the odds of remand by narrowing the proposed class, defendants, injury, and law to one state.

CAFA also enhances plaintiffs' counsel's incentives to avoid federal court. In particular, it adds a new 28 U.S.C. § 1712, under which fees in federal court class action coupon settlements will be lower and the settlements closely scrutinized.

The Texas Supreme Court Cases. As far back as 1996, the Texas Supreme Court identified class actions as "extraordinary proceedings with extraordinary potential for abuse." *General Motors Corp. v. Bloyed*, 916 S.W.2d 949, 953 (Tex. 1996). Major decisions since 2000 address important class action issues.

The first and most important decision, *Southwest Refining Company v. Bernal*, 22 S.W.3d 425 (Tex. 2000), was written by Justice Alberto Gonzales, currently Attorney General of the United States.

Bernal rejected the approach "certify now and worry later" that so often creates enormous leverage. *Id.* at 435. Instead, "rigorous analysis" is required "to determine whether all prerequisites to certification have been met." *Id.* For this purpose, the trial court must go beyond the pleadings, and determine "how the claims can and will likely be tried" — referred to as the "trial plan" requirement. *Id.*

Bernal then turned to the certification requirement — predominance of common issues over individual issues — which was most relevant to that case, as it involved a refinery explosion with 900 potential personal injury class members each uniquely affected. The test is "whether common or individual issues will be the object of most of the efforts of the litigants and the court." *Id.* at 434.

The Court specifically rejected the "rough-cut justice" recommendation of Samuel Issacharoff (now lead reporter for the American Law Institute's Principles of Aggregate Litigation Project) and the plaintiffs' argument, based on Issacharoff's recommendation that claims may be "simply too small to justify the cost of individual litigation." *Id.* at 438. The Court held such arguments do not excuse compliance with class certification requirements, nor lower any plaintiff's burden of proof on causation and damages, nor override each defendant's right to contest every element of every claim. *Id.* at 438-39.

In *M.D. Anderson Cancer Center v. Novak*, 52 S.W.3d 704 (Tex. 2001) the Texas Supreme Court dismissed a class action for lack of subject matter jurisdiction based on the named plaintiff's failure to rely on the allegedly false fundraising letter sent out by the defendant. The Court held that dismissal of the class action was required, whether or not some other proposed class representative who did have standing might exist.

Henry Schein, Inc. v. Stromboe, 102 S.W.3d 675 (Tex. 2002), reversed certification of a nationwide class of dentist office management software purchasers. Certification did not meet

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Bernal's rigorous analysis and trial plan requirements in three significant, precedent-setting ways.

First, the Court noted that reliance was an element in five of the plaintiffs' causes of action and held that the plaintiffs' burden to prove reliance was "in no way altered by the assertion of claims on behalf of a class," and the "[i]nescapably individual differences" in reliance involved "cannot be concealed in a throng." *Id.* at 693. A Texas intermediate appellate court has since held that under *Schein*, certification of a lawsuit involving reliance is a "near-impossibility." *Fidelity and Guar. Life Ins. Co. v. Pińa*, ___ S.W.3d ___, 2005 WL 977596, *7 (Tex. App. – Corpus Christi, 2005, no pet. h.).

Second, *Schein* found the lower courts' choice-of-law analysis insufficient. The Court held that the plaintiffs had wholly failed to demonstrate that Texas law should apply to a sufficient number of claims in the proposed nationwide class action so that "common legal issues" would predominate and the "manageability" criterion would be satisfied. *Id*. at 697.

Finally, *Schein* addressed the "superiority" requisite in a damages class action. Plaintiffs had limited their claims to $74,000 each to avoid federal diversity, "strongly suggesting that individual recoveries could exceed that figure," so individual litigation appeared feasible. *Id.* The Court rejected the argument that the only relevant superiority criterion was efficiency in the sense of one class trial, adopting the Seventh Circuit's view that individual lawsuits on different facts and under different states' laws could more efficiently provide accurate information on the amount such cases are worth. *Id.* at 700.

In *Compaq Computer Corp. v. Lapray*, 135 S.W.3d 657 (Tex. 2004), the trial court certified a nationwide class of purchasers of computers containing allegedly defective floppy disk controllers. The Court analyzed at length and held that, in certifying declaratory judgment under the Texas equivalent of federal rule 23(b)(2), the trial court "must consider, and due process may require, individual notice and opt-out rights," even though the rule's language does not say so. *Id.* at 667. The Court analyzed whether plaintiffs could "evade *Bernal* by seeking (b)(2) certification" and held "they may not." *Id.* at 670. Although that part of the rule does not use the terms "predominance" and "superiority, " the class cohesion concept requires a comparable, and similarly rigorous, analysis. *Id.* at 670-71. Finally, the Court held that trial courts, when ruling on class certification, "must conduct an extensive choice of law analysis before they can determine predominance, superiority, cohesiveness, and even manageability." *Id.* at 672.

In *State Farm Mutual Automobile Insurance Company v. Lopez*, 156 S.W.3d 550 (Tex. 2004), the Texas Supreme Court reversed certification of a Texas-only class of mutual insurance policyholders suing for dividends, holding that the rigorous analysis and trial plan requirements apply to all prerequisites, including irreconcilable class conflicts, not just predominance and superiority.

Of greater importance, the Court noted that State Farm had presented dispositive motions (standing and the internal affairs doctrine) on which the trial court simply had not ruled. The Court said "dispositive issues should be resolved by the trial court before certification is considered." *Id.* at 557. The Court cited a Seventh Circuit opinion by Judge Posner, *Cowen v. Bank United of Texas, FSB,* 70 F.3d 937 (7th Cir. 1995), approving a summary judgment which disposed of the putative class representatives' claims on the merits.

The 2003 Texas Statute. The Texas class action rule is modeled closely on the federal rule,

and most of the Texas Supreme Court decisions cite federal precedents. But in 2003, the Texas legislature passed litigation reforms, some addressed specifically to class actions, and others applicable to them, that depart from the federal model in important ways.

First, Texas had already provided a right of interlocutory appeal of class certification to its intermediate courts. In 2003, Texas changed the jurisdiction of the Texas Supreme Court to remove what some justices, before *Bernal*, had seen as major barriers to that Court's review of certification. *See* TEX. GOVT CODE § 22.225(d) and (e). Texas provided that interlocutory appeal stays everything, including discovery. *See* TEX. CIV. PRAC. & REM. CODE § 51.014. The combined effect of these two changes is to remove the leverage of class certification and discovery without full prior appellate review.

Second, Texas required that, before deciding on certification, the trial court must rule on pleas to the jurisdiction asserting that an administrative agency has exclusive or primary jurisdiction, so that that ruling may go up with the interlocutory appeal of certification. TEX. CIV. PRAC. & REM. CODE § 26.051.

Finally, Texas limited class counsel's fees in two ways. In a coupon settlement, counsel must be paid coupons and cash in the same portions as the class. In any fee award, counsel is limited to lodestar fees times a multiplier not to exceed four. TEX. CIV. PRAC. & REM. CODE § 26.003.

Other 2003 Texas statutory amendments, though not specific to class actions, are important to class actions. In particular, to supersede a final judgment, the defendant may now post the lesser of half its net worth or $25 million. This ends the *Pennzoil*-style "bet-the-company" risk of going to trial in a class action.

The New Texas Class Action Rule. In 2004, the Texas Supreme Court, after input from its Advisory Committee of judges, professors and lawyers, amended the Texas class action rule, TEX. CIV. PROC. RULE 42. Amended rule 42 implements the 2003 statutory changes, incorporates the trial plan and predominance and other key elements of *Bernal* and other case law, and adopts many of the recent changes to Federal Rule 23.

In particular, Texas Rule 42 (g) addresses the standards and process for appointment of class counsel, and Texas Rule 42 (h) requires a motion, notice, hearing, and findings on class counsel's fees. Rule 42(e) requires a second opportunity to opt-out at the settlement stage, and requires filing of a statement identifying any side agreements.

Relevance to Class Action Litigation and Reforms in Other States. State courts mainly cite federal class action precedents, and this is proper in that most state rules are based on Federal Rule 23. But state court civil litigation differs from federal court litigation in jurisdiction, procedure, and substantive law. Thus, the Texas class action cases may be of considerable persuasive value in other states. In states where legislative or state Supreme Court rule reform of class actions is a realistic possibility, Texas statute and rule changes should be considered.

The American Law Institute. With the passage of CAFA and the amendments to Federal Rule 23, the principal national forum for class action public policy has shifted from Congress and the Federal Rules Advisory Committee to the American Law Institute. As previously mentioned, ALI has launched a "Principles of Aggregate Litigation" project, whose scope includes all federal and state court class action litigation.

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