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CLASS ACTION LITIGATION

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REPORT

The wave of class actions relating to the meltdown in the financial sector ''is just starting to gather steam, write attorneys Ugo Colella and Michael T. Korns. The authors advise defense attorneys to ''take charge of the class certification process'' through ''a seemingly underutilized and unknown preemptive procedural device: the motion to deny class certification.''

Managing the Credit Crisis in Court: Defense Control of the Class Certification Process

UGO COLELLA AND MICHAEL T. KORNS

The wave of class actions relating to the meltdown in the financial sector is just starting to gather steam. One need only pick up a newspaper or turn on any cable news channel to understand that the current level of frustration, anger and plain old disbelief among institutional and individual investors is widespread and deep. Therefore, it comes as no surprise that, on an almost daily basis, class action lawsuits alleging fraud and deceit, violations of the securities laws, and other misconduct are trickling in to state and federal courthouses across the country.

It's not that these class actions are a new breed or that the lawyers filing them are otherwise asserting never-before-seen legal theories. To the contrary, they are standard fare in the class action world. What has changed, however, is the public perception of these lawsuits and the sheer number of them likely to fill courts' dockets in the coming weeks, months and years. Prior to the recent turmoil in the financial markets, class actions in the financial services sector were seen, for the most part, as products of greedy plaintiffs' lawyers seeking to make a quick buck. Not so anymore. Defense counsel should assume that class action lawsuits arising from the current credit crisis will enjoy a warmer reception in the courts than in days past.

The cost of defending (and potentially settling) this new round of class litigation could be staggering. Indeed, some have estimated that the costs to defendants and those who insure them could easily run into the *billions* of dollars. Although the current focus is on the cost to taxpayers of the $700 billion government bailout, consumers and taxpayers are likely to get whacked a second time if the rising tide of credit crisis class actions ends up crippling class defendants and the insurers that are contractually obligated to defend and indemnify those defendants.

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A Preemptive Motion to Deny Class Certification

In this toxic environment, class defendants can and should take charge of the class certification process to dispose of non-meritorious class actions quickly and at a reduced cost. In particular, class action defendants should use a seemingly underutilized and unknown preemptive procedural device: the motion to deny class certification. Although there are very few published decisions that discuss the propriety of a defense motion to preclude class treatment, federal courts plainly encourage, and in some cases expect, a class defendant to take the offensive and to affirmatively seek to derail a class action where time is of the essence.

A preemptive defense motion to preclude class certification early in credit crisis-related litigation fits squarely within CAFA's overarching purpose.

Over the years, Congress has taken steps to make class certifications more difficult to achieve, the most significant of which is the Class Action Fairness Act of 2005 (CAFA). CAFA was hailed as a pro-business measure because it pulled the more pricey and consequential class actions into federal court, where the ability of plaintiffs to certify a class was perceived to be much more difficult than in state court. A preemptive defense motion to preclude class certification early in credit crisis-related litigation fits squarely within CAFA's overarching purpose.

Federal jurisdiction is not a silver bullet that makes class actions magically disappear. Instead, as in state court, class action defendants in federal court still face a potentially damaging and expensive lawsuit that they must defend. Yet federal jurisdiction has many advantages absent in the typical state court, not the least of which is the speed with which class actions are decided. Federal judges have broad discretion to fashion the timing and procedures that will govern the class certification process, including the methods and scope of class-related discovery. Equally, Rule 23 of the Federal Rules of Civil Procedure counsels speed and provides flexibility in the class certification decision because it requires that the decision be made ''[a]t an early practicable time'' after a class action is commenced.

Because Rule 23 does not specify *who* can raise the class certification issue in the early stages of litigation, a class defendant has the right to go on the offensive and seek to preclude class certification before a class representative moves to obtain certification. This is not a difficult task for a class defendant. Class action complaints are required to at least make a prima facie case for Rule 23 treatment. Accordingly, from the face of a complaint, a class defendant typically will have a fairly clear picture of the type of class action proposed by a class representative (i.e., nationwide vs. statewide, global class vs. subclass, and so on). The class complaint in most cases thus provides a class defendant all that it needs to prepare an effective defense to certification.

The motion to deny class treatment may be a particularly important tactical device in the current and extremely volatile credit crisis climate. On the one hand, class defendants can ill afford the negative publicity of a multimillion- or billion-dollar class action lawsuit alleging fraud and other bad acts. On the other hand, class plaintiffs know this and are likely to set their media machines in motion to portray their target defendant(s) as part of the corruption in the financial markets that has gripped the imagination of the American public. That type of negative publicity can result in overwhelming (and often inadvisable) pressures to settle the litigation early, especially where a publicly traded company is the target defendant.

Rather than follow the traditional path of waiting for class plaintiffs to move for certification . . . a preemptive defense motion to prevent class certification has several advantages.

Rather than follow the traditional path of waiting for class plaintiffs to move for certification—a process that may, and often does, take several weeks or months—a preemptive defense motion to prevent class certification has several advantages. Among those advantages are altering negative public perceptions and disposing of non-meritorious class actions on a timetable and under circumstances over which class defendants can exercise at least a modicum of control.

Determining the "Appropriate" Case for a Preemptive Motion

Whether a preemptive motion to deny certification is appropriate depends on the answer to two questions: (1) Does the class defendant have a significant and realistic chance of obtaining an early dismissal of the complaint *on the merits* pursuant to Rule 12(b)(6) (failure to state a claim), Rule 12(c) (judgment on the pleadings), or Rule 54 (summary judgment) of the Federal Rules of Civil Procedure? (2) Under the facts and circumstances known to the class defendant, are there good grounds for defeating class treatment?

Dismissal on the Merits. The potential preclusive effect of a dismissal on the merits may make it prudent for a class defendant to exit a case through a dismissal motion rather than a denial of class certification. Indeed, federal courts may deem moot the class certification decision if the putative class plaintiffs do not have a viable claim under the federal or state substantive law that forms the basis of the class action. It therefore may be an inadvisable expenditure of a class defendant's resources—and a potentially significant delay in disposing of the action—to move to deny class certification when there is a significant chance that the complaint asserts a legally deficient claim in the first instance.

Grounds for Denying Class Certification. Whether a class defendant has a viable basis to defeat certification depends in large measure on the relevant and applicable case law discussing Rule 23's requirements. Counsel for the class defendant should determine whether the face of the class complaint flunks the class certification test embodied in Rule 23 or whether the allegations suffice but evidence in the possession of the class defendant will defeat class treatment.

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The Advantages of a Preemptive Motion to Deny Certification

If an early, dispositive motion on the merits of the class claims is unlikely to succeed but those claims are not likely to be suitable for class treatment, then a class defendant should answer the complaint and simultaneously move to deny class certification. Defense counsel should strive to accomplish these two steps within the time allowed for answering a complaint (*i.e.*, not later than 20 days after service of the class complaint). A preemptive defense motion to preclude class certification permits a class defendant to take control of the litigation right away, and that control brings with it several advantages.

Surprise. Perhaps the most important benefit to class defendants of quickly moving to deny certification is surprise to the plaintiffs. Although even the most seasoned plaintiffs' counsel will be prepared to move for class certification fairly soon after class litigation is initiated, very few will be prepared to seek certification at the time a class defendant answers a complaint. Class defendants normally are in the best position to (1) assess the viability of the claims made in the complaint, and (2) determine, with reference to applicable law, whether the claims are suitable for class treatment.

Of course, the element of surprise likely will be lost if a class defendant has not gathered evidence—documents and affidavits—sufficient to convince a court that class treatment is inappropriate. Indeed, a weak defense motion to deny certification can prove disastrous and virtually guarantee class certification because plaintiffs will be in an ideal position to rebut the defendant's weak showing by simply filling in the necessary evidentiary gaps.

By contrast, a preemptive defense motion with substantial teeth has the real potential to put class plaintiffs on the defensive. To properly rebut a class defendant's evidentiary showing, class plaintiffs may need discovery to better understand the prospects of class certification—for example, evidence that the particular claims are common or typical across a class, and the best evidence of commonality and typicality often is in the hands of the class defendant. Federal courts are fairly liberal about providing class plaintiffs the discovery they need to meet their burden of proving that class treatment is appropriate and consistent with Rule 23.

Controlling Class-Related Discovery. And that brings us to the next advantage of a preemptive defense motion to deny class certification: Controlling the timing, scope and methods of class-related discovery. By moving to deny class certification, a class defendant is in a good position to determine the course and scope of any discovery necessary to the certification determination.

To be sure, class plaintiffs bear the burden of proof and must themselves define the precise characteristics of the class that they seek to have certified. A class representative thus is thought to be in the best position to dictate the nature and scope of class-related discovery. Some courts have endorsed this view, but they have done so largely in cases where the class representative has moved to certify a class and has identified the evidence that she needs to meet Rule 23's requirements.

By defining (and hopefully narrowing) the scope of class-related discovery, a class defendant can simultaneously prevent intrusive, time-consuming and expensive discovery into the merits of the plaintiffs' underlying claims.

However, a class representative is likely to lose her ability to determine the direction of discovery if a class defendant goes on the offensive by moving to deny class certification. A carefully crafted motion to deny certification will contain the evidentiary support necessary to defeat the class treatment that a plaintiff seeks. In this way, a class defendant can limit discovery to the issues that it has raised to defeat class treatment and, in effect, force plaintiffs to litigate certification issues on terms and on issues dictated by the class defendant.

Preventing Merits-Related Discovery. Finally, by defining (and hopefully narrowing) the scope of class-related discovery, a class defendant can simultaneously prevent intrusive, time-consuming and expensive discovery into the merits of the plaintiffs' underlying claims. Indeed, many class actions *begin* with merits discovery because plaintiffs' counsel typically want a more complete understanding of the merits of the underlying claims early in the litigation. It is thus common for merits discovery to be followed by a motion for class certification. A preemptive motion to deny certification is likely to prevent merits discovery, at least in the majority of cases where the class certification issues are sufficiently distinct from the underlying merits of a claim.

A class defendant's initiation of the certification process has the potential to pay significant dividends in credit crisis-related class actions. Although a defense motion to prevent class certification is a little known or used tool, it can be a very powerful one when used properly. By wielding it at the inception of class litigation, defense counsel can put class plaintiffs on the defensive, define the issues that will ultimately determine the certification decision, and send an unmistakable signal to the court (and to the public) that there is no merit to the claims being made.

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