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**THE ANATOMY OF A FRANCHISE CLASS ACTION**

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## **INTRODUCTION**

Few topics generate the intense debate and strong feelings among lawyers and business persons alike produced by class actions. Proponents argue that the class vehicle ensures the vindication of rights that might otherwise go unasserted, and enables the judicial system to dispose of a multiplicity of similar claims or disputes efficiently and economically. Opponents insist that the class action mechanism encourages the filing of frivolous litigation, forces defendants to settle unmeritorious claims rather than risk a class wide adverse result, and is rife with conflicts. Few fair minded persons would dispute that there is some merit in each of these views.

Each of these arguments seems especially true when the class action vehicle is applied to the franchise relationship. Franchisees and their lawyers argue that certain types of franchise disputes are particularly susceptible of class treatment owing to the uniformity and consistency inherent in the multiple bilateral contractual relationships that make up a franchise system, especially in terms of disclosure, contracts, and business practices. They contend that a single franchisee is often without the resources to prosecute alone claims that many other franchisees may share, and that only the class action vehicle enables the prosecution of such claims. Franchisors point out that franchise disputes rarely involve the "small-sum" claims that proponents insist might be lost unless brought on a class-wide basis, that fee-shifting provisions ensure that meritorious claims can be brought regardless of the magnitude of the claim, and that a putative class action enables even a single disgruntled franchisee to intrude upon the franchisor's bilateral commercial relationships with its other franchisees and to force the franchisor to devote time, effort and resources – that might otherwise be spent supporting its franchisees – to defending against a claim whose potential impact bears no relationship to its merit.

What franchisors, franchisees and their respective counsel must surely agree on is that class actions are not going away soon, that the uniformity inherent in franchising makes certain types of disputes particularly susceptible of a finding of commonality, and that it is therefore important to understand how class actions work, what they might accomplish or can wreak, when and how a franchisee might successfully pursue class treatment, and what franchisors might do when faced with an effort to certify a franchisee class. In this paper, we attempt to address these important issues by, among other things, providing some historical context, addressing the substantive requirements of the state and federal rules governing class certification and the implications of class certification, examining the enforceability of class action waivers, and considering class action settlement issues.

### **I. HISTORY AND BACKGROUND OF CLASS ACTIONS<sup>1</sup>**

#### **A. The History of Class Actions**

Federal Rule of Civil Procedure 23, governing court class actions in federal courts, "stems from equity practice."<sup>2</sup> The English common law "Necessary Parties Rule," a doctrine eventually incorporated into the United States legal system, "mandated the joinder of all

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<sup>1</sup> The authors wish to express their deep gratitude to Amy Haywood of Cheng Cohen LLC and Robert Boulter of Lagarias & Boulter, LLP for their contributions to the research, drafting and editing of this paper.

<sup>2</sup> *Amchem Prods., Inc. v. Windsor*, 521 U.S. 591, 613 (1997).

interested persons in one suit, so as to avoid multiplicative litigation.”<sup>3</sup> Modern class actions developed as a way to avoid the rigid requirements of the Necessary Parties Rule in equity.<sup>4</sup> Because the Necessary Parties Rule’s mandatory joinder of parties “however numerous they may be” sometimes unfairly denied recovery to the parties before the court, equity created exceptions.<sup>5</sup> One early recitation of those exceptions included situations “where the parties are very numerous, and the court perceives that it will be almost impossible to bring them all before the court; or where the question is one of general interest, and a few may sue for the benefit of the whole; or where the parties form a part of a voluntary association for public or private persons, and may be fairly supposed to represent the rights and interests of the whole.”<sup>6</sup>

The emergence of class litigation in the United States was eventually codified in Equity Rule 38, which applied: “[w]hen the question is one of common or general interest to many persons constituting a class so numerous as to make it impracticable to bring them all before the court.”<sup>7</sup> The first version of Federal Rule of Civil Procedure 23 “was a substantial restatement of former Equity Rule 38 (Representatives of Class)” as that rule was being applied.<sup>8</sup> The new rule applied to all actions, whether legal or equitable.<sup>9</sup> While equity “had allowed class-like suits in the past, the Federal Rules now allowed for the first time, class suits for damages in the United States.”<sup>10</sup>

In 1966, Federal Rule 23 was amended and paved the way for the modern class- action suit.<sup>11</sup> Of all the 1966 class action amendments, Rule 23(b)(3) was considered “‘the most adventuresome’ innovation.”<sup>12</sup> It allowed for class actions for damages that could secure binding judgments on all class members except those who affirmatively opt-out.<sup>13</sup> Rule 23(b)(3) provided class action treatment where a suit may not fit into categories 23(b)(1) or (2), but is “nevertheless [] convenient and desirable depending upon the particular facts.”<sup>14</sup> In such cases,

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<sup>3</sup> *Bonanno v. The Quiznos Franchising Company LLC*, No. 06-cv-02358, 2009 U.S. Dist. LEXIS 37702, at \*31 (D. Colo. 2009).

<sup>4</sup> *Ortiz v. Fibreboard Corp.*, 527 U.S. 815, 832 (1999).

<sup>5</sup> *Id.* (quoting *West v. Randall*, 29 F. Cas. 718, 722 (1820)).

<sup>6</sup> *Id.*

<sup>7</sup> *Lowry v. Int’l Brotherhood of Boilermakers, Iron Shipbuilders and Helpers of Am.*, 259 F.2d 568, 571, 575 (5th Cir. 1958) (quoting former Equity Rule 38).

<sup>8</sup> Fed. R. Civ. P. 23, Notes of Advisory Comm.

<sup>9</sup> *Id.*

<sup>10</sup> *Bonanno*, 2009 U.S. Dist. LEXIS 37702, at \*33.

<sup>11</sup> *Ortiz v. Fibreboard Corp.*, 527 U.S. 815, 833 (“[M]odern class action practice emerged in the 1966 revision of Rule 23.”).

<sup>12</sup> *Amchem Prods., Inc. v. Windsor*, 521 U.S. 591, 614 (quoting Kaplan, A Prefatory Note, 10 B. C. Ind. & Com. L. Rev. 497, 497 (1969)).

<sup>13</sup> *Id.*

<sup>14</sup> Fed. R. Civ. P. 23, Notes of Advisory Comm., 1966 Amendments, Note to Subdivision (b)(3).

according to the Advisory Committee, a class action achieves “economies of time, effort, and expense, and promote[s] uniformity of decision as to persons similarly situated, without sacrificing procedural fairness or bringing about other undesirable results.”<sup>15</sup>

Rule 23(b)(3) has provided the basis for most franchising class actions. Class certification under Rule 23(b)(3) is permitted where, in addition to meeting the requirements of Rule 23(a), a court finds that (1) common questions predominate over individual issues and (2) class resolution is superior to other available methods for fairly and efficiently adjudicating the controversy.<sup>16</sup> In describing how these predominance and superiority requirements would apply, the Advisory Committee suggested that, for example, “a fraud perpetrated on numerous persons by the use of similar misrepresentations may be an appealing situation for a class action,” despite a need for a separate damages determination.<sup>17</sup> Yet a fraud action would not be suitable for class treatment “if there was material variation in the representations made or in the kinds or degrees of reliance by the persons to whom they were addressed.”<sup>18</sup>

While Rule 23 does not exclude certification of classes where the individual recoveries may be high, it was largely created to allow “vindication of the rights of groups of people who individually would be without effective strength to bring their opponents into court at all.”<sup>19</sup> Despite the benefits at the core of the class action which allows groups of people to bring claims that they may otherwise not have been able to bring as individuals,<sup>20</sup> Rule 23 is a procedural device.<sup>21</sup> As the Supreme Court has recognized, “no reading of [Rule 23] can ignore the Act’s mandate that rules of procedure shall not abridge, enlarge, or modify any substantive right.”<sup>22</sup>

## II. INITIAL FRANCHISEE PLAINTIFF CONSIDERATIONS

As with most representation, counsel’s initial tasks should include a determination of client issues and objectives. Sometimes multiple franchisees or a franchisee association may approach counsel seeking common relief. But individual franchisees may also sometimes present system wide problems and claims, or, conversely may present only claims involving unique individual issues.

The potential for class treatment inserts a number of additional factors into the mix. Counsel must consider a host of issues related to both the availability of the class device and the advantages and disadvantages to class litigation. Are the claims subject to the federal Class Action Fairness Act (“CAFA”) or may they proceed under state law? Is a mass action or

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<sup>15</sup> *Id.*

<sup>16</sup> Fed. R. Civ. P. 23.

<sup>17</sup> Fed. R. Civ. P. 23, Notes of Advisory Comm., 1966 Amendments, Note to Subdivision (b)(3).

<sup>18</sup> *Id.*

<sup>19</sup> *Amchem Prods., Inc., v. Windsor*, 521 U.S. 591, 617 (internal quotation omitted).

<sup>20</sup> *Id.* (quoting *Mace v. Van Ru Credit Corp.*, 109 F.3d 338, 344 (7th Cir. 1997)).

<sup>21</sup> See Rules Enabling Act, 28 U.S.C. § 2072(b).

<sup>22</sup> See *Ortiz*, 527 U.S. at 845 (quoting *Amchem Prods., Inc.*, 521 U.S. at 613, & Rules Enabling Act, 28 U.S.C. § 2072(b)).

joinder of a number of plaintiffs more advantageous from a strategic point of view? Do the proposed claims meet the Rule 23 criteria for class certification? Does the proposed class representative have standing to pursue class claims? Who will be the best class representative(s) and what are the available choices of forum and applicable substantive law? How many class representatives are needed? Are there subclassing issues? How large is the class? Are class interests likely to diverge resulting in antagonism between the class members? What are the incentives or barriers to class resolution and/or class settlement? Who are the appropriate defendants, and are they substantial enough to pay the requested damages? What is the fee structure and who will pay for costs? Is there a contractual or statutory basis for recovery of attorney's fees? If so, are the class representatives aware of their potential exposure in the case of defeat?

#### **A. The Claims Presented**

The type of claim presented by a franchisee client will obviously play a role in the ability to maintain a class action. While antitrust and contract claims may be identical across the system, misrepresentation claims may differ from state to state, especially when different salespersons and sales literature were involved in different areas. Similarly, misuse of advertising funds may affect all franchisees, while representations of profit and loss in the sale of an existing unit may be unique to a single plaintiff.

#### **B. The Size of the Franchise System**

The size of a franchise system, as well as the location of the franchisees, may limit the ability to maintain a class action. Franchise systems with fewer than fifty franchisees are usually unlikely candidates for class action treatment. While no strict number is set for minimum class size, most commentators suggest forty class members as a minimum. Similarly, widely dispersed franchisees may have difficulties in presenting class claims for state statutory violations, the elements of which may differ from state to state.

#### **C. Commonality of Claims Regarding the Offer and Sale of Franchises**

Fraud in the inducement claims may be difficult to sustain as class actions, if each plaintiff received different representations from different salespeople, and justified reliance will vary based on experience. But common documents, sales practices, or concealed information may support a class action fraud claim.<sup>23</sup>

#### **D. Commonality of Claims Regarding Relationship Issues**

Common claims are often presented by franchise relationship disputes. Given the nature of a franchise, namely a trademark license wedded to uniformity, via a common marketing plan, certain claims are often uniform systemwide:

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<sup>23</sup> *George Lussier Enterprises, Inc. v. Subaru of New England, Inc.*, 2001 WL 920060 at \*15 (D.N.H. 2001); see also *DT Woodard, Inc., v. Mail Boxes Etc., Inc.*, 2007 WL 3018861 (Cal. App. 2007).

- antitrust and pricing claims<sup>24</sup>
- national advertising claims<sup>25</sup>
- breach of contract claims<sup>26</sup>
- fraud and breach of franchise statutes<sup>27</sup>

#### **E. Commonality of Claims Regarding Termination**

Many, if not most, termination claims turn on a franchisee's individual circumstances. However, some cases, such as those involving termination of all dealers nationwide or other systemwide changes, may satisfy the required commonality.<sup>28</sup>

#### **F. Corroborating Evidence, Interviews Of Similarly Situated Franchisees**

Pre-filing investigation is important in all cases, and in class actions should be conducted regarding class certification issues in addition to the merits. This will generally involve interviewing other franchisees to determine the commonality and typicality of the claim presented by the potential named plaintiff and other issues.

#### **G. Explanation of the Differences Between Individual Claims and Class Claims**

A new client considering becoming a class representative should be counseled on a named plaintiff's different rights and duties with respect to individual and class claims. There is no prohibition on class representatives pursuing individual claims in addition to class claims. However, a class representative owes duties to the class and cannot unilaterally control, settle or dismiss class claims.

In selecting class representatives, counsel must analyze typicality and adequacy of representatives discussed below in Sections IV F-G. Not only should the class representative have claims typical of the proposed class(es) but also staying power since dismissal of a sole class representative prior to certification requires dismissal of the complaint.<sup>29</sup> The number of

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<sup>24</sup> *Bogosian v. Gulf Oil Corp.*, 561 F.2d 454 (3rd Cir. 1977); *George Lussier Enterprises, Inc. v. Subaru of New England*, 2001 WL 920060 (D.N.H. 2001); *Little Caesar Enterprises, Inc. v. Smith*, 172 F.R.D. 236 (E.D. Mich. 1997).

<sup>25</sup> See *Broussard v. Meineke Discount Muffler Shops, Inc.*, 155 F.3d 331 (4th Cir. 1998). The Fourth Circuit reversed the class certification. See fn. 53, *infra* and accompanying text.

<sup>26</sup> *Bird Hotel Corp. v. Super 8 Motels, Inc.*, 246 F.R.D. 603 (D.S.D. 2007); *Westgate Ford Truck Sales, Inc. v. Ford Motor Co.*, 2007 WL 2269471 (Ohio App. 2007); see also *Allapattah Services, Incorporated v Exxon Corporation* 333 F.3d 1248 (11th Cir. 2003).

<sup>27</sup> *Bird Hotel Corp. v. Super 8 Motels, Inc.*, 246 F.R.D. 603 (D.S.D. 2007); *DT Woodard, Inc. v. Mail Boxes Etc.*, 2007 WL 301886 (Cal.App. 2007).

<sup>28</sup> *Bayshore Ford Truck Sales, Inc. v. Ford Motor Co.* 2006 WL 3371690, (D.N.J.,2006).

<sup>29</sup> *Quadrel v. GNC Franchising, L.L.C.*, 2007 WL 4241839 (W.D. Pa. 2007) (citing *Lusardi v. Xerox Corp.*, 975 F.2d 964, 974 (3rd Cir. 1992)).

class representatives may be of consequence, while one may be sufficient, additional representatives may be needed for each subclass.<sup>30</sup>

#### **H. The Cost of Notice**

Under Rule 23(d)(1)(B)(i), a federal court may require notice to the putative class members at any time, including notice of the pendency of the action, the relief sought, and other matters. Under federal law, a plaintiff may be ordered to provide notice to the class.<sup>31</sup> But in franchise cases, where the class is likely finite and addresses of class members may be obtained from the franchisor, notice by publication will generally not be ordered. Nonetheless, potential class representatives should be informed of the possible expense of notifying the class and of how that expense will be handled (e.g., whether counsel will advance the costs). Class representatives should also be advised of the possibility of being assessed attorney's fees, either statutorily or by contract, and that settlement of class claims must receive court approval.

### **III. THE CLASS ACTION COMPLAINT**

Class action complaints require allegations of sufficient facts to support class action status under Rule 23 rather than simply a reference to Rule 23.<sup>32</sup> These include identification of the plaintiffs, defendants, representative capacity sought, class definition and numerosity, common issues of law and fact, typicality, class damages and other requested relief. Ultimately, the district court must carefully analyze the evidence, the pleadings, and the arguments presented in the class certification motion to exercise its discretion under Rule 23 to grant or deny class certification.<sup>33</sup> But the complaint serves as the starting point to establish the basis for class certification and the contours of the class seeking certification.

### **IV. CLASS CERTIFICATION ISSUES AND FRANCHISE CASES**

#### **A. Timing**

Under Rule 23(c)(1)(A), the court is to determine class certification at the "earliest practicable time."<sup>34</sup> Most federal courts will set a schedule for the certification motion soon after the filing of the action. The schedule may provide for class action discovery, briefing and ruling before proceeding on the merits.<sup>35</sup>

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<sup>30</sup> *Quadrel v. GNC Franchising, L.L.C.*, 2007 WL 4241839 (W.D. Pa. 2007)

<sup>31</sup> *Eisen v. Carlisle and Jacquelin*, 417 U.S. 156 (1974).

<sup>32</sup> E.g., *Gillibeau v. City of Richmond*, 417 F.2d 426, 432 (9th Cir. 1969); *Johnson v. Bond*, 94 F.R.D. 125 (N.D. Ill. 1982) (class certification denied as complaint failed to allege common issues regarding employment discrimination).

<sup>33</sup> *General Telephone Co. of Southwest v. Falcon*, 457 U.S. 147 (1982).

<sup>34</sup> Rule 23(c) was amended in 2003 to allow more discretion to the district court to schedule the motion.

<sup>35</sup> Discovery on class certification issues may be ordered. See *Washington v. Brown & Williamson Tobacco Corp.*, 959 F.2d 1566, 1570-71 (11th Cir. 1992).

## **B. Local Rules**

Many federal courts have local rules regarding class action procedures. For example, Northern District of California local rule 23 has provisions regarding electronic posting of documents in class actions.<sup>36</sup> Central District of California local rule 23 specifies pleading requirements and requires the proponents of a class to file a motion for certification within ninety days of filing the complaint unless otherwise ordered by the court.<sup>37</sup>

## **C. Rule 23(a) Requirements**

Rule 23(a) sets forth the following requirements for all class certifications:

Prerequisites. One or more members of a class may sue or be sued as representative parties on behalf of all members only if:

- (1) the class is so numerous that joinder of all members is impracticable;
- (2) there are questions of law or fact common to the class;
- (3) the claims or defenses of the representative parties are typical of claims or defenses of the class; and
- (4) the representative parties will fairly and adequately protect the interests of the class.

### **1. Numerosity And Impracticability Of Joinder**

Under the numerosity requirement, the class must be so numerous that joining all class members would be difficult or inconvenient. When a class is one hundred or more, this alone may be sufficient to find joinder impracticable.<sup>38</sup> More difficult questions emerge with smaller classes, including whether the amount at issue, the geographic location of class members, and other issues factors joinder impracticable. In addition, class actions under the federal Class Action Fairness Act (“CAFA”) require 100 or more class members.<sup>39</sup>

In *Liberty Lincoln-Mercury, Inc. v. Ford Marketing Corp.*,<sup>40</sup> an asserted Robinson-Patman Act and New Jersey Franchise Practices Act class action failed to meet the numerosity requirement. The putative class or subclasses consisted of 38 Lincoln-Mercury dealerships or

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<sup>36</sup> N.D. Cal. Local Rule 23.

<sup>37</sup> C.D. Cal. Local Rule 23.

<sup>38</sup> *E.g., Safrun v. United Steelworkers of America, AFL-C10*, 132 F.R.D. 397, 401 (W.D. Pa. 1989) (300 former steel workers); *Anderson v. Douglas & Lomason Co.*, 122 F.R.D. 502 (N.D. Miss. 1988) (class of between 55 to over 100); *Little Caesar Enterprises, Inc. v. Smith*, 172 F.R.D. 236, 242 (E.D. Mich. 1997) (244 and 214 franchisees); *see also, Quadrel v. GNC Franchising, LLC*, 2007 WL 4241839 (W.D. Pa. 2007) (potential class of 1,800 with court noting more than 40 potential class members is generally adequate).

<sup>39</sup> 28 U.S.C. § 1332 (d)(5)(B).

<sup>40</sup> *Liberty Lincoln Mercury, Inc. v. Ford Marketing Corp.*, 149 F.R.D. 65 (D.N.J. 1993).

123 Ford and Lincoln Mercury dealerships. But only two of the dealerships had challenged Ford's practices. In addition, all of the dealerships were located in New Jersey. Given all the circumstances, the district court found joinder was not impracticable and denied class action status.

## 2. Commonality Of Claims

Rule 23(a)(2) requires that there be an issue common to the class.<sup>41</sup> But the commonality requirement is generally not difficult to meet, requiring only that one substantial issue affects all of the class.<sup>42</sup> While class certification is procedural, in analyzing commonality a district court will review substantive elements of the cause of action and the likelihood of common versus individual proof.<sup>43</sup>

Courts have recognized that suits alleging breaches of standard form contracts can be amenable to class treatment, and classes alleging breach of such contracts will often be certified.<sup>44</sup> However, class treatment may not be appropriate where large groups of franchisees allege breach of franchise agreements the terms of which have varied from franchisee to franchisee or year to year.<sup>45</sup> Even where franchise agreements contain similar language and franchisees allege a common violation, class certification can be denied where proof of whether the franchisor violated the agreements depends on a franchisee's individual circumstances.<sup>46</sup> Generally, groups of franchisees that allege fraud and misrepresentation are not suitable for class certification where proof of liability turns on the franchisor's representations to each individual franchisee and that franchisee's reliance on those misrepresentations.<sup>47</sup> However,

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<sup>41</sup> *Shankroff v. Advert, Inc.*, 112 F.R.D. 190 (S.D.N.Y. 1986) (common issue in securities fraud action was that promotional materials and advise failed to disclose adverse financial information); *Little Caesar Enterprises, Inc. v. Smith*, 172 F.R.D. 236 (E.D. Mich. 1997).

<sup>42</sup> *Mullen v. Treasure Chest Casino, LLC*, 186 F.3d 620, 625 (5th Cir. 1999).

<sup>43</sup> *Little Caesar Enterprises, Inc. v. Smith*, 172 F.R.D. 236, 241 (E.D. Mich. 1997).

<sup>44</sup> *Dupler v. Costo Wholesale Corp.*, 249 F.R.D. 29, 44-45 (S.D.N.Y. 2008) (quoting *Steinberg v. Nationwide Ins. Co.*, 224 F.R.D. 67, 74 (E.D.N.Y. 2004) ("Claims arising from interpretations of a form contract appear to present the classic case for treatment as a class, and breach of contract cases are routinely certified as such.")).

<sup>45</sup> *Broussard v. Meineke Discount Muffler Shops, Inc.*, 155 F.3d 331, 338 (4th Cir. 1998).

<sup>46</sup> *Danvers Motor Co., Inc v. Ford Motor Co.*, 543 F.3d 141, 143-44 (3d Cir. 2008) (holding that class certification was not appropriate where franchisees alleged that franchisor's program in connection with the franchise agreement violated state and federal law because treatment of each franchisee under the program required individual proof). *Sparano v. Southland Corp.*, No. 94 C 2098, 1996 U.S. Dist. LEXIS 17485, \*8-9 (N.D. Ill. Nov. 21, 1996) (holding that while there may be common questions regarding franchisor's decision to cut capital expenditures and cease advertising, a determination of breach would require the court to "separately consider the conditions at each class member's franchise").

<sup>47</sup> *Broussard v. Meineke Discount Muffler Shops, Inc.*, 155 F.3d 331, 338 (4th Cir. 1998); see also *Sprague v. Gen. Motors Corp.*, 133 F.3d 388, 399 (6th Cir. 1998) (denying class certification in part where each claim depended on that person's interaction with the company despite the fact that class members may have signed the same forms, received the same documents and attended the same meetings).

individual reliance issues alone do not always preclude class treatment of common law fraud claims.<sup>48</sup>

In *Good v. Ameriprise Financial, Inc.*,<sup>49</sup> franchisees and employees sought to certify claims against Ameriprise regarding its payment of commissions. The evidence, however, established that Ameriprise had changed the contracts is used repeatedly over the years. In addition, Ameriprise reserved the right to change terms via bulletins and other writings. Thus, commissions had been set by differing bulletins and varied from plaintiff to plaintiff. As a result, the district court declined certification, finding there was no common issue to advance in the litigation. But the district court also noted that even with different contracts, if the contract claims contain a common issue, or where subclasses are feasible, certification might be appropriate.

In *Bird Hotel Corp. v. Super 8 Motels, Inc.*,<sup>50</sup> class claims involving uniform breach of contract issues were readily certified. In *George Lussier Enterprises, Inc. v. Subaru of New England, Inc.*,<sup>51</sup> one of the claims reviewed for commonality included RICO wire and mail fraud allegations. The franchisor contested the commonality of these fraud claims with respect to all of the franchisees, but the district court found commonality due to the defendant's transmission of common documents to all dealers:

The overwhelming majority of plaintiffs' allegations focus on documents sent by defendants to all dealers concerning company policies applicable to all dealers. In essence, plaintiffs allege "that defendants engaged in common course of misrepresentations designed to affect all plaintiffs in a like fashion." *Iron Workers Local Union No. 17 Ins. Fund v. Phillip Morris Inc.*, 182 F.R.D. 523, 540 (N.D. Ohio 1998). Therefore, plaintiffs' claims focus on defendants' class-wide conduct, not on defendants' individual interactions with dealers. See *id.* at 541.

Thus, plaintiffs' claims are readily distinguishable from those cases where individual issues of reliance were found to predominate over issues common to the class because the plaintiffs alleged that they relied on unique, oral misrepresentations made in the context of individual transactions.<sup>52</sup>

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<sup>48</sup> *Sparano*, 1996 U.S. Dist. LEXIS 17485, at \*10 (certifying franchisee class with regard to fraud claims because "issue of individual reliance may be reserved for determination of damages").

<sup>49</sup> *Good v. Ameriprise Financial, Inc.*, 248 F.R.D. 560 (D. Minn. 2008).

<sup>50</sup> *Bird Hotel Corp. v. Super 8 Motels*, 246 F.R.D. 603 (D.S.D. 2007); see also, *Westgate Ford Truck Sales, Inc. v. Ford Motor Co.*, 2007 WL 2269471 (Ohio App. 2007).

<sup>51</sup> *George Lussier Enterprises, Inc. v. Subaru of New England, Inc.*, 2001 WL 920060 (D.N.H. 2001).

<sup>52</sup> *Id.* at 15; see also, *DT Woodard, Inc. v. Mail Boxes Etc.*, 2007 WL 301886 (Cal. App. 2007).

In *Broussard v. Meineke Discount Muffler Shops*,<sup>53</sup> the Fourth Circuit reversed the district court's class certification order and overturned a \$390 million jury award to a class of Meineke franchisees. The district court had certified a "non-opt out class of all persons or entities throughout the United States that were Meineke franchisees operating at any time during or after May of 1986" which claimed that Meineke's handling of advertising breached the franchise agreement it had with every franchisee.<sup>54</sup> On plaintiffs' breach of contract claims, the court found a lack of commonality, noting that the terms of the franchise agreements used by Meineke had changed from year to year and contained "materially different contract language" regarding the claimed breach.<sup>55</sup> The franchisees could not be permitted to maintain a "collective breach of contract action on the basis of multiple different contracts."<sup>56</sup> Regarding the plaintiffs' tort claims, the court focused on audiotapes of franchisee purchases that contained differing representations regarding the custody of advertising funds. In addition to the varying oral representations, the court found justified reliance was likely to be a factual issue as to each plaintiff.<sup>57</sup> Fatal to certification of the class with regard to their fraud claims was that the franchisees "built their breach of fiduciary duty, fraud and misrepresentation claims on the shifting evidentiary sands of individualized representations to franchisees."<sup>58</sup> However, the Fourth Circuit recognized that class actions may be appropriate where standardized documents and pitches are used to close a sale.<sup>59</sup>

### **3. Typicality Of Claims**

The requirement of typicality is also usually not burdensome, requiring only a similarity of legal theories and remedies sought.<sup>60</sup> In *Allen v. Holiday Universal*,<sup>61</sup> for example, challenges to class certification, including a challenge for lack of typicality, were rejected. The action involved members of Holiday Universal Health clubs, some of whom had allegedly ratified illegal health club contracts. The district court found that the asserted ratification by some class members did not bar a finding of typicality because ratification was irrelevant to the common issue of liability under Pennsylvania law.

In *Westgate Ford Truck Sales, Inc. v. Ford Motor Co.*,<sup>62</sup> the Ohio Court of Appeals found typicality over an objection that the class representative had contradicted the allegations of the

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<sup>53</sup> *Broussard v. Meineke Discount Muffler Shops*, 155 F.3d 331 (4th Cir. 1998).

<sup>54</sup> *Id.* at 334-336.

<sup>55</sup> *Id.* at 340.

<sup>56</sup> *Id.* at 340.

<sup>57</sup> *Id.* at 341.

<sup>58</sup> *Id.* at 340-41.

<sup>59</sup> *Id.*

<sup>60</sup> *Little Caesar Enterprises, Inc. v. Smith*, 172 F.R.D. 236 (E.D. Mich. 1997).

<sup>61</sup> *Allen v. Holiday Universal*, 249 F.R.D. 166 (E.D. Pa. 2008).

<sup>62</sup> *Westgate Ford Truck Sales, Inc. v. Ford Motor Co.*, 2007 WL 2269471 (Ohio App. 2007).

complaint at a deposition. But the class representative had testified consistently as well, and the other statements were obvious misstatements.<sup>63</sup>

#### **4. Adequacy Of Representation**

Rule 23(a)(4) requires that class actions be maintained only by “representative parties [who] will fairly and adequately protect the interest of the class.” The adequacy requirement involves an examination of both the class representatives and the class counsel.

##### **a) Adequacy of the class representative**

Class representation is not appropriate when the class representative has conflicts or disparate interests with other members of the proposed class. Fed. R. Civ. P. 23(a)(4). While courts often reference “common interests”, the standard for disqualification is when the class representative has material conflicts involving issues common to the class.<sup>64</sup>

In franchising, although there is scant case law on this issue, this may occur if a class that includes both area franchisees or subfranchisors and franchisees is seeking relief against the franchisor. In claims of fraud and statutory violations, the area franchisee or subfranchisor may have participated in the misrepresentations.

There may also be a conflict of interest between current franchisees and former franchisees who sue defendant franchisors.<sup>65</sup> As “basic due process requires that named plaintiffs possess undivided loyalties to absent class members,”<sup>66</sup> courts may find that former franchisees are inadequate representatives of current franchisees.<sup>67</sup>

In *George Lussier Enterprises, Inc. v. Subaru of New England, Inc.*,<sup>68</sup> a class action alleging antitrust, RICO and Automobile Dealer Day In Court claims was filed on behalf of both current and former franchisees. The defendants challenged the adequacy of representation arguing that former franchisees would seek only damages while current franchisees might prefer injunctive relief. The district court declined to find inadequate representation, noting that the named representatives included current and former franchisees that should be able to decide the remedy among themselves.

In *McNerney v. Carvel*, a Connecticut superior court held that because the named plaintiffs were former franchisees of Carvel who sought to represent current Carvel franchisees,

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<sup>63</sup> *Id.* at \*8.

<sup>64</sup> *Spann v. AOL Time Warner, Inc.*, 219 F.R.D. 307 (S.D.N.Y. 2003) (class certification denied in ERISA action as conflict existed between plaintiffs which had and had not executed releases).

<sup>65</sup> *Iandolo v. Benetton Servs.*, No. 86 C 10157, 1988 U.S. Dist. LEXIS 9637, (N.D. Ill. 1988) (holding that former Benetton franchisee would not provide adequate representation for current franchisees).

<sup>66</sup> *Broussard v. Meineke Discount Muffler Shops, Inc.*, 155 F.3d 331, 338 (4th Cir. 1998).

<sup>67</sup> *McNerney v. Carvel*, No. CV0059244, 2001 Conn. Super. LEXIS 619, at \*17 (Conn. Super. February 23, 2001) (collecting cases); see also *In re: Ford Motor Co.*, 471 F.3d 1233, 1240 (11th Cir. 2006).

<sup>68</sup> *George Lussier Enterprises, Inc. v. Subaru of New England, Inc.*, 2001 WL 920060 (D.N.H. 2001).

the interests of the class were not aligned.<sup>69</sup> The former franchisee members of the class had “no interest in the continued success of Carvel,” while current franchisees had “a significant interest in Carvel’s continued success and an interest in maintaining positive future business relations with the defendants.”<sup>70</sup> The court recognized that “[t]his disparity of goals between these groups could seriously impact this litigation at various stages.”<sup>71</sup>

In *Broussard v. Meineke Discount Muffler Shops, Inc.*,<sup>72</sup> the Fourth Circuit found inadequacy of class representation due to conflicts of interest. The single putative class consisted of “all persons or entities throughout the United States that were Meineke franchisees operating at any time during or after May of 1986.”<sup>73</sup> But the all inclusive class awarded relief for various alleged ad fund abuses included three distinct groups: (1) former franchisees; (2) current franchises who had not signed an Enhanced Dealer Program (“EDP”) franchise agreement modification which provided for lower royalties and other benefits but included a release of Meineke; and (3) current franchisees who had signed an EDP modification.<sup>74</sup> The court found that because some of these franchisees only would benefit from a damages award, while others, who had signed an EDP agreement with a release, would not benefit from a damages award at all, the “remedial interests of those within the single class are not aligned.”<sup>75</sup> Due to the conflict, the single class was not proper.

### **b) Adequacy of class counsel**

The second inquiry for adequacy of representation under Rule 23(a)(4) concerns the qualifications of counsel for the class. The district court may examine the reputation, experience and resources of class counsel and their law firms.<sup>76</sup>

### **D. Rule 23(b) Categories**

In addition, to meeting the requirements of Rule 23(a), each class must fall within one of three categories identified in Rule 23(b).

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<sup>69</sup> *Id.* at 16.

<sup>70</sup> *Id.*

<sup>71</sup> *Id.*

<sup>72</sup> *Broussard v. Meineke Discount Muffler Shops, Inc.*, 155 F.3d 331 (4th Cir. 1998).

<sup>73</sup> *Id.*, at 335.

<sup>74</sup> *Id.*, at 338.

<sup>75</sup> *Id.* at 338 (quoting *AmChen Prods. Inc. v. Windsor*, 52 U.S. 591 (1997)).

<sup>76</sup> *In re General Motors Interchange Litigation*, 894 F.2d 1106 (7th Cir. 1979); *George Lussier Enterprises, Inc. v. Subaru of New England, Inc.*, 2001 WL 920060, at \*4 (D.N.H. 2001).

### **1. Rule 23(b)(1)**

A class action is proper under Rule 23(b)(1) when there is significant risk of inconsistent or varying adjudications or the adjudication of individual class members may adjudicate claims of absent class members or impair their claims.<sup>77</sup>

### **2. Rule 23(b)(2)**

Under Rule 23(b)(2), the plaintiffs must establish that the defendant acted or refused to act in a manner applying to the class so that injunctive or declaratory relief applies to the class.<sup>78</sup>

### **3. Rule 23(b)(3)**

The final category defined in Rule 23(b)(3) requires that common questions of law or fact predominate over individual issues so that a class action is superior to other means of adjudication.

In *George Lussier Enterprises, Inc. v. Subaru of New England, Inc.*,<sup>79</sup> a Rule 23(b)(3) class was certified involving antitrust, RICO and Automobile Dealer Day In Court claims. The district court began by noting that a class action was preferable to avoid repetitive individual actions. As to common issues predominating, the district court examined whether issues of generalized proof predominated over issues requiring individual proof. On tie-in sales, common proof rested on uniform contract requirements, and on RICO claims, common sales documents existed.

In *DT Woodard, Inc. v. Mail Boxes Etc.*,<sup>80</sup> a California Court of Appeal reversed the denial of class certification of California Franchise Investment Law and fraud claims. The Court of Appeal reversed, finding that the trial court had abused its discretion in not finding that common issues of fact existed regarding the misrepresentations and reliance. The Court of Appeal also noted that individualized proof of causation and damages did not bar class certification.<sup>81</sup>

In *Danvers Motor Co., Inc. v. Ford Motor Co.*,<sup>82</sup> certification of a car dealer class for alleged Robinson-Patman Act, Automobile Dealer Day In Court Act and state franchise law violations was reversed. The Court of Appeal found that many of the allegations centered on Ford's Blue Opal Program ("BOP") involving dealer performance and customer satisfaction. But

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<sup>77</sup> Fed. R. Civ. P. 23(b)(1); *Amchen Products v. Windsor*, 521 U.S. 591, 614 (1997).

<sup>78</sup> *George Lussier Enterprises, Inc. v. Subaru of New England*, 2001 WL 920060 (D.N.H. 2001) (district court declined a Rule 23(b)(2) class, finding that the action primarily sought damages rather than injunctive relief, but found a Rule 23(b)(3) class).

<sup>79</sup> *Id.*

<sup>80</sup> *DT Woodard, Inc. v. Mail Boxes Etc.*, 2007 WL 301886 (Cal. App. 2007).

<sup>81</sup> *Id.* at 11.

<sup>82</sup> *Danver Motor Co., Inc. v. Ford Motor Co.*, 543 F.3d 141 (3<sup>rd</sup> Cir. 2008).

the BOP issues were often individualized as to whether a dealer was certified, expenses incurred for certification, reimbursements received under BOP and other issues. The Third Circuit accordingly found that these individual issues did not sufficiently predominate to fulfill the Rule 23(b)(3) standard so that “the class is sufficiently cohesive to warrant adjudication by representation.”<sup>83</sup>

*Westgate Ford Truck Sales, Inc. v. Ford Motor Co.*,<sup>84</sup> affirmed a class certification of truck dealer breach of contract claims under Ohio Civ. R. 23(b)(3). The Ohio Court of Appeals cited Moore’s Federal Practice on the predominance issue:

Moore’s Federal Practice at 23-45 sets forth a number of standards that the courts have used to determine predominance: the substantive elements of class members’ claims require the same proof for each class member; the proposed class is bound together by a mutual interest in resolving common questions more than it is divided by individual interests; the resolution of an issue common to the class would significantly advance the litigation; one or more common issues constitute significant parts of each class member’s individual cases; the common questions are central to all of the members’ claims; and the same theory of liability is asserted by or against all class members, and all defendants raise the same basic defenses.<sup>85</sup>

The Ohio Court of Appeals confirmed predominance, finding that all class members were bound by the same contract provision hence the claims would involve common proof and legal analysis.

In *Quadral v. GNC Franchising, LLC*,<sup>86</sup> the district court certified one of two classes of GNC franchisees contending that GNC had violated the terms of a prior class action settlement. In addition to finding several common alleged violations of the settlement agreement, the court also addressed superiority of a class action under Rule 23(b)(3). The district court found class action superiority as no other actions were pending and there were no apparent insurmountable difficulties to a class action.

In *Allapattah Services, Inc. v. Exxon Corp.*,<sup>87</sup> Exxon gasoline dealers brought a class action alleging that Exxon breached its contract in the way it set wholesale gas prices to its dealers. The district court certified the breach of contract action for class treatment. Exxon challenged class certification on the grounds that unique factual and legal issues existed regarding the claims of each individual class member. The Eleventh Circuit affirmed the

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<sup>83</sup> *Id.* at 148.

<sup>84</sup> *Westgate Ford Truck Sales, Inc. v. Ford Motor Co.*, 2007 WL 2269471 (Ohio App. 2007).

<sup>85</sup> *Id.* at 11-12.

<sup>86</sup> *Quadrel v. G.N.C. Franchising, L.L.C.*, 2007 WL 4241839 (W.D. Pa. 2007).

<sup>87</sup> *Allapattah Services, Inc. v. Exxon Corp.* 333 F.3d 1248 (11th Cir. 2003); *see also Exxon Mobil Corp. v. Gill*, 221 S.W.3d 841, 845 -846 (Tex. Ct. App. 2007) (upholding a state-wide breach of contract certification based on violations of the UCC arising out of Exxon’s alleged failure to exercise good faith and honesty in the setting of open price terms).

certification order made under Rule 23(b)(3), finding “[w]hether [Exxon] breached that obligation was a question common to the class and the issue of liability was appropriately determined on a class-wide basis.”<sup>88</sup> The Eleventh Circuit specifically determined that the actual issue presented was whether the common issue of liability predominated over the affirmative defenses, which pertained primarily to the issue of damages rather than liability.<sup>89</sup> Other franchisee class actions, discussed below, have been certified for breach of contract, fraud and statutory violations. If common liability issues predominate, damages issues requiring individual proof should not bar a Rule 23(b)(3) class.<sup>90</sup>

### **E. A Note On ALI’s Principles The Law Of Aggregate Litigation**

On April 1, 2009, the American Law Institute published its Proposed Final Draft of the Principles of the Law of Aggregate Litigation, a project that has been ongoing for nearly five years. Although the Principles address all of the many forms of aggregate litigation, they focus for the most part on the most controversial one: the class action. The Principles are set forth in three sections, definitions and general principles, aggregate adjudication, and aggregate settlements.

An earlier draft had proposed far-reaching changes to existing class action law and practice, most significantly the role of predominance and superiority in class certification analysis. Those proposed changes generated intense debate. The Proposed Final Draft reincorporates the concepts of predominance and superiority, but seeks to elaborate, “in more systematic fashion,” on current practices. In particular, the Principles attempt to address the tendency of those seeking certification “to frame legal and factual issues at high levels of generality so as to argue for their commonality,” and the tendency of those opposing class certification to “catalogue in microscopic detail each legal or factual variation suggesting the existence of individual questions.” The Principles do this by placing emphasis on the question of whether certification would “materially advance” the overall litigation and introducing the requirement that common questions of law or fact should be “core” issues in the overall litigation.

The Principles also address aggregate settlements, codifying existing law and practice but also proposing important changes. One issue that remains hotly debated concerning non-class aggregate settlements is whether an individual may reject a settlement. The Reporters’ Memorandum states that if the categorical view that no settlement can ever limit an individual’s right to reject is accepted, then “our proposal cannot work.” Disagreement remains as well with respect to the authority vested in lawyers in creating settlements and in structuring the distribution of benefits from the settlement.

The Final Draft was approved by ALI’s members in May 2009, but it will become final only after a special subcommittee reviews the draft to make sure that all changes that were to be made to the nearly 300 page document were in fact made. It is uncertain what impact if any

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<sup>88</sup> *Allapattah Services, Inc. v. Exxon Corp.*, 333 F.3d 1248 (11th Cir. 2003).

<sup>89</sup> *Id.* (relying on a host of cases holding that the presence of individualized damages issues does not prevent a finding that the common issues in the case predominate); see also e.g. *In re Visa Check/MasterMoney Antitrust Litig.*, 280 F.3d 124, 139 (2d Cir.2001); *Bertulli v. Indep. Ass’n of Cont’l Pilots*, 242 F.3d 290, 298 (5th Cir. 2001).

<sup>90</sup> *Little Caesar Enterprises, Inc. v. Smith*, 172 F.R.D. 236, 267 (E.D. Mich. 1997); see also, *DT Woodard, Inc. v. Mail Boxes Etc.*, 2007 WL 3018861 (Cal.App. 2007).

the Principles will have on the manner in which state and federal courts will address questions of certification and class settlements, however. Research reveals that to date only one court has even mentioned the project, and then only in passing in a footnote.

## V. DEFENDANT CLASSES

While the certification of a defendant class is far less common than the certification of a plaintiff class, Rule 23 clearly contemplates defendant classes.<sup>91</sup> Rule 23(a) states that “[o]ne or more members of a class may sue *or be sued* as representative parties.”<sup>92</sup> Rule 23 also speaks in terms of “claims *or defenses*”<sup>93</sup> and refers to “prosecuting separate actions by *or against* individual class members.”<sup>94</sup> Defendant classes are rarely certified, however.<sup>95</sup> When they are, it is most commonly in patent infringement cases, in suits against public officials challenging the validity of uniformly applied laws, and in securities litigation.<sup>96</sup>

Due process concerns are substantial with regard to defendant classes because the unnamed class members may be exposed to liability.<sup>97</sup> For this reason, courts will generally apply a higher level of scrutiny in determining whether to certify a defendant class “to assure fairness to absent class members based on long-standing due process protections.”<sup>98</sup> A court will carefully scrutinize the adequacy of representation for a defendant class, but it makes no difference to an adequacy of representation determination that the defendant class representatives are unwilling representatives.<sup>99</sup>

For the same reasons that a franchise system consisting of uniform bilateral relationships between a franchisor and its franchisees governed by similar if not identical contracts might be fertile ground for a franchisee to seek class certification in a dispute with predominating common questions of fact or of law, so too might a franchisor bring a defendant class action where it claims some right or entitlement as against each member of the putative defendant class of franchisees. Although research reveals no reported decisions involving the certification of a defendant class of franchisees, a class vehicle might merit consideration in situations presenting system-wide challenges, particularly those involving concerted action among franchisees, such as refusals to comply with system-standards, royalty strikes, and

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<sup>91</sup> See Fed. R. Civ. P. 23; see also *Thillens, Inc. v. Comm. Currency Exch.* 97 F.R.D. 668, 673 (N.D. Ill. 1983) (recognizing that Rule 23 “clearly contemplates both plaintiff *and* defendant class actions”) (emphasis in original).

<sup>92</sup> Fed. R. Civ. P. 23(a).

<sup>93</sup> *Id.* (emphasis added).

<sup>94</sup> *Id.* (emphasis added).

<sup>95</sup> *Thillens, Inc. v. Comm. Currency Exch.* 97 F.R.D. 668, 674 (N.D. Ill. 1983); *Bakalar v. Vara*, 237 F.R.D. 59, 63 (S.D.N.Y. 2006) (recognizing that defendant class actions are seldom certified) (collecting cases).

<sup>96</sup> *Thillens, Inc. v. Comm. Currency Exch.* 97 F.R.D. 668, 674 (N.D. Ill. 1983) (collecting cases).

<sup>97</sup> *Bakalar v. Vara*, 237 F.R.D. 59, 63 (S.D.N.Y. 2006).

<sup>98</sup> *Id.*

<sup>99</sup> *Major League Baseball Properties, Inc. v. Price*, 105 F. Supp. 2d 46, 55 (E.D.N.Y. 2000)

situations where system-wide declaratory relief might quell unrest or resolve looming disputes that impact all franchisees.

## **VI. OPT-IN AND OPT-OUT CLASSES EFFECT OF CLASS ACTION PROCEEDINGS ON UNNAMED CLASS MEMBERS**

Under Rule 23, if a class is certified, all class members will be provided notice and an opportunity to opt-out. If a class member does not opt-out, they will be bound by the result of the class action.

In contrast, some statutes require that plaintiffs opt-in to the action, such as wage claims under the Fair Labor Standards Act.<sup>100</sup> Under the applicable FLSA statute, “no employee shall be a party plaintiff to any such action unless he gives his consent in writing to become such a party and such consent is filed in the court in which such action is brought.”<sup>101</sup> Because such an opt-in requirement is inconsistent with a class action, opt-in actions are sometimes called collective actions rather than class actions.<sup>102</sup> As opt-in collective actions involve notice to potential plaintiffs of the pendency of the action, early court intervention is important.<sup>103</sup>

One of the primary reasons class actions generate such strong feelings on both sides is because of the potential impact class certification has not just on the defendant, but on unnamed class members who are not present or participating in the proceeding. The concept of virtual representation at the core of class actions means that persons who did not bring the action and who will not actively participate in it will be saddled with the outcome whether they like it or not, unless they affirmatively opt out. This imposes an affirmative burden on every class member to exercise diligence in understanding the claims at issue in the action and in deciding whether to opt out. Similarly, where the class action results in a settlement, it is incumbent on each class member to become knowledgeable about the terms of the settlement and what it means in terms of claims that will be released and the consideration being offered.

The usual principles of both res judicata (claim preclusion) and collateral estoppel (issue preclusion) apply in class actions.<sup>104</sup> In Rule 23 class actions, the members of a class which qualifies for certification are parties to the action and will be bound by the judgment (except for those members of the class who elect to opt out).<sup>105</sup> In *Cooper v. Federal Reserve Bank*,<sup>106</sup> the Supreme Court explained:

[U]nder elementary principles of prior adjudication a judgment in a properly entertained class action is binding on class members in

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<sup>100</sup> 29 U.S.C. § 216.

<sup>101</sup> 29 U.S.C. § 216(b).

<sup>102</sup> 7B Wright & Miller, Fed. Practice and Procedure § 1807, *Whalan v. W.R. Grace & Co.*, 56 F.3d 504 (3rd Cir. 1995).

<sup>103</sup> *Hoffman-La Roche, Inc. v. Sperling*, 493 U.S. 165 (1989).

<sup>104</sup> *Cooper v. Federal Reserve Bank*, 467 U.S. 867, 874; (1984).

<sup>105</sup> See *Hoffmann-La Roche, Inc. v. Sperling*, 493 U.S. 165, 177 (1989); see also FED. R. CIV. P. 23(c)(3).

<sup>106</sup> 467 U.S. at 874.

any subsequent litigation...A judgment in favor of the plaintiff class extinguishes their claim, which merges into the judgment granting relief. A judgment in favor of the defendant extinguishes the claim, barring a subsequent action on that claim. A judgment in favor of either side is conclusive in a subsequent action between them on any issue actually litigated and determined, if its determination was essential to that judgment.

Because of the potential res judicata effect of class actions, Rule 23(c)(3) states as follows:

(3) *Judgment.* Whether or not favorable to the class, the judgment in a class action must:

(A) for any class certified under Rule 23(b)(1) or (b)(2), include and describe those whom the court finds to be class members; and

(B) for any class certified under Rule 23(b)(3), include and specify or describe those to whom the Rule 23(c)(2) notice was directed, who have not requested exclusion, and whom the court finds to be class members.

Moreover, pursuant to Rule 23(d)(2), after certification of a class, notice to the class of the proceedings may be discretionary or mandatory. For example, in class actions certified under Rule 23(b)(3), “the court must direct to class members the best notice that is practicable under the circumstances, including individual notice to all members who can be identified through reasonable effort.”<sup>107</sup> “Appropriate notice” to the class “may” be directed by the court in class actions certified under Rule 23(b)(1) or (2).<sup>108</sup>

Class members who do not opt-out of the proceedings may be bound to any settlement or judgment entered therein. Consequently, Rule 23(e) mandates that “[t]he claims, issues, or defenses of a certified class may be settled, voluntarily dismissed, or compromised only with the court’s approval” which shall only be granted after notice to the class and a hearing on fairness of the proposed settlement, voluntary dismissal or compromise.<sup>109</sup>

Where there is inadequacy of representation, however, absent class members may collaterally attack the res judicata effect.<sup>110</sup> If a member of a class bound by a judgment in a

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<sup>107</sup> FED. R. CIV. P. 23(c)(2)(B).

<sup>108</sup> FED. R. CIV. P. 23(c)(2)(A).

<sup>109</sup> FED. R. CIV. P. 23(e).

<sup>110</sup> See e.g. *Williams v. General Electric Capital Auto Lease, Inc.*, 159 F.3d 266 (7th Cir. 1998) (enjoining further litigation of class action because the issues had already been resolved in a nationwide class action in another forum).

prior class action can establish that she was not adequately represented in that action, the class action judgment may not be binding as to her.<sup>111</sup>

In certain situations, unnamed class members may also be bound by a decision denying class certification. According to the Seventh Circuit's decision in *In re Bridgestone/Firestone*,<sup>112</sup> an order denying class certification may have a preclusive effect on unnamed class members who were adequately protected by the class representatives and class counsel in the action in which the class certification petition was denied.

In *Bridgestone/Firestone*, the court held that its previous order decertifying the class was entitled to preclusive effect under the doctrine of collateral estoppel. The court stated that although claim preclusion (*res judicata*) depends on a final judgment, issue preclusion (collateral estoppel) does not. For purposes of issue preclusion, “‘final judgment’ includes any prior adjudication of an issue in another action that is determined to be sufficiently firm to be accorded conclusive effect.”<sup>113</sup> The court found that the certification issue was addressed by the district and appellate courts, and certiorari was sought and denied.<sup>114</sup> Consequently, the court held that its determination that no nationwide class was tenable was “sufficiently firm” to have a preclusive effect on unnamed class members.<sup>115</sup> Moreover, the court also held that it had personal jurisdiction over the unnamed class members based on *RICO* and Seventh Circuit law which authorized nationwide service of process.<sup>116</sup>

In *Carnegie v. Household Int'l, Inc.*,<sup>117</sup> the same court explained that it did not rule in *Bridgestone/Firestone* that any ruling denying class certification is binding in future litigation. Rather, the court explained that its decision was “more nuanced” and that “the binding effect of such a ruling would depend on whether the class members who would be affected by it had been adequately protected by the class representatives and class counsel in the proceeding in which the ruling was made.”<sup>118</sup> In fact, in *Bridgestone/Firestone*, despite the injunction order that prevented all members of the putative national classes, and their lawyers, from attempting to have nationwide classes certified again with respect to the same claims, the court denied the defendants’ request to enjoin statewide class actions.<sup>119</sup> It did so based on the fact that it had not made a ruling on the propriety of a statewide class action and because each state may

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<sup>111</sup> *Hansberry v. Lee*, 311 U.S. 32 (1940).

<sup>112</sup> *In re Bridgestone/Firestone*, 333 F.3d 763 (7th Cir. 2003).

<sup>113</sup> *Id.* at 767 (quoting *Restatement (Second) of Judgments* § 13 (1980)).

<sup>114</sup> *Id.*

<sup>115</sup> *Id.*

<sup>116</sup> *Id.* at 768.

<sup>117</sup> *Carnegie v. Household Int'l, Inc.*, 376 F.3d 656, 663 (7th Cir. 2004).

<sup>118</sup> *Id.*

<sup>119</sup> *In re Bridgestone/Firestone*, 333 F.3d 763, 766 (7th Cir. 2003).

apply its own choice-of-law rules and substantive law.<sup>120</sup> Accordingly, the ruling did not have a preclusive effect on cases seeking state-specific certification or certification of different claims.

Since these Seventh Circuit decisions, the United States Supreme Court has held, in *Taylor v. Sturgell*,<sup>121</sup> that “[a] party’s representation of a nonparty is ‘adequate’ for preclusion purposes only if, at a minimum: (1) the interests of the nonparty and her representative are aligned . . . and (2) either the party understood herself to be acting in a representative capacity or the original court took care to protect the interests of the nonparty.” The Court stated that the “[p]reclusion doctrine, it should be recalled, is intended to reduce the burden of litigation on courts and parties.”<sup>122</sup>

In *Shook v. Bd. Of County Comm’rs of El Paso*,<sup>123</sup> the Tenth Circuit addressed the issue of repeated attempts at class certification. In *Shook*, the court stated:

Neither does the inability of plaintiffs to have this particular class certified defeat their ability to have these issues reviewed either individually or even through the class action mechanism. . . . Different named plaintiffs are of course also free to pursue another class action, defining a class (or subclasses) for whom relief is deemed more manageable, within the bounds of the district court’s discretion. After all, to the extent that the denial of class certification can have preclusive effect on unnamed class members, see *In re Bridgestone/Firestone, Inc., Tires Prods. Liab. Litig.*, 333 F.3d 763 (7th Cir. 2003) (giving preclusive effect to the denial of class certification as against unnamed class members); *Bailey v. State Farm Fire and Cas. Co.*, 414 F.3d 1187, 1190 (10th Cir. 2005) (noting that “[m]any of the principles articulated in *Bridgestone/Firestone* are sound”), the failure to certify this specific class hardly has preclusive effect on different plaintiffs in a future suit seeking certification of a different class or seeking different relief. The only question we pass on today is the narrow question whether the relationship between the class proposed and the relief sought in this suit satisfies Rule 23(b)(2).<sup>124</sup>

Generally, once a Rule 23 class is certified, all members of the certified classes are bound by any settlement or judgment in those proceedings. However, many issues will impact whether an order denying class certification will have a preclusive effect in subsequent class action proceedings. The procedural posture (e.g., whether the certification order has been reviewed by an appellate court), the nature of the claims asserted, the nature of the class sought to be certified, whether the district court has personal jurisdiction over the unnamed class members and whether the unnamed class members were adequately represented by the named plaintiffs and their counsel will impact whether the denial of class certification will have a

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<sup>120</sup> *Id.*

<sup>121</sup> *Taylor v. Sturgell*, \_\_\_ U.S. \_\_\_, 128 S. Ct. 2161, 2176, 171 L. Ed. 2d 155 (2008) (internal citations omitted).

<sup>122</sup> *Id.* at 2177.

<sup>123</sup> *Shook v. Bd. Of County Comm’rs of El Paso*, 543 F.3d 597 (10th Cir. 2008).

<sup>124</sup> *Id.* at 610-11.

preclusive effect on subsequent efforts to certify a class. Ultimately, these issues will have to be analyzed on a case-by-case basis to determine the preclusive effect of an order denying class certification.

## **VII. FORUM ISSUES**

### **A. State Courts**

State courts may present advantages for franchisee class actions. The benefits of state court class actions may include easier class certification rules, less than unanimous jury trial requirements, and other perceived benefits. However, the removal provisions of CAFA, discussed below, may render such advantages moot.

Can a state class action cover plaintiffs from other states when the franchisor is also from another state? If not, then a state court class action may only be available in the home state of the franchisor. Several California state courts have denied putative national class actions because multiple state law issues were implicated.<sup>125</sup>

### **B. Federal Court And CAFA Removal**

The Class Action Fairness Act of 2005 (“CAFA”) generally provides for expanded federal diversity jurisdiction over class actions of a certain size. CAFA requires that the putative class have one hundred or more members in order to qualify for federal jurisdiction.<sup>126</sup> In franchising, with the number of franchisees likely to be obtainable from franchise disclosure documents or other sources, the number of putative class members would appear subject to easy determination. CAFA has a minimum aggregate jurisdictional amount at issue of \$5,000,000.<sup>127</sup> With a minimum of 100 class members, this reduces the diversity plaintiffs’ minimum from \$75,000 to \$50,000. CAFA also lessens the diversity jurisdiction requirements for federal jurisdiction to diversity between any putative class member and any defendant.

### **C. Removal Limitations Under CAFA**

Instead of the general thirty day removal requirement, a defendant may remove a class action subject to CAFA requirements at anytime. But there are three statutory provisions identifying circumstances under which a federal district court may or must decline jurisdiction. Under the “Local Controversy Exception,” the class action must be remanded when more than two thirds of the putative class members are from the forum state, at least one defendant against which significant relief is sought is from the forum state, and the principal injuries occurred in the state where the action was originally filed and when no other class action asserting similar factual allegations against any of the defendants has been filed in the last three years.<sup>128</sup> Under the “Home State Exception,” if the primary defendants and two thirds of the putative class members are citizens of the state where the action was filed, the district court

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<sup>125</sup> *Osborne v. Subaru of America, Inc.*, 198 Cal.App.3d 646, 243 Cal.Rptr. 815 (1988); *Baltimore Football Club v. Superior Court*, 171 Cal.App.3d 352, 215 Cal.Rptr. 323 (1985).

<sup>126</sup> 28 U.S.C. § 1332 (d)(5)(B).

<sup>127</sup> 28 U.S.C. § 1332 (d)(2).

<sup>128</sup> 28 U.S.C. § 1332 (d)(4)(A).

also must decline jurisdiction.<sup>129</sup> Another provision of CAFA authorizes the court to decline to exercise jurisdiction where between one third and two thirds of the putative class members and the primary defendants are citizens for the forum state.<sup>130</sup>

CAFA also has settlement provisions that are discussed below.

#### **D. Arbitration**

That class actions may be conducted in arbitration was recognized decades ago in *Keating v. Superior Court*<sup>131</sup>:

If the right to a classwide proceeding could be automatically eliminated in relationships governed by adhesion contracts through the inclusion of a provision for arbitration, the potential for undercutting these class action principles, and for chilling the effective protection of interests common to a group, would be substantial. Arbitration proceedings may well provide certain offsetting advantages through savings of time and expense; but, depending upon the nature of the issues and the evidence to be presented, it is at least doubtful that such advantages could compensate for the unfairness inherent in forcing hundreds or perhaps thousands, of individuals asserting claims involving common issues of fact and law to litigate them in separate proceedings against a party with vastly superior resources. Because the principles of res judicata and collateral estoppel do not apply in arbitration proceedings, any issue resolved against a party such as Southland in one arbitration proceeding would have to be decided anew in a subsequent arbitration, resulting in needless duplication and the potential for inconsistent awards. And while arbitration ideally takes place outside the judicial arena, it would be naïve to assume, in such a situation, that courts would not be called upon to determine issues ancillary to the arbitration proceedings. The effect would be to place upon the parties, and upon the courts, many of the burdens which the class action decide was designed to avoid.<sup>132</sup>

Recent issues regarding contractual waivers of class arbitration are discussed below in Section IX.

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<sup>129</sup> 28 U.S.C. § 1332 (d)(4)(B).

<sup>130</sup> 28 U.S.C. § 1332 (d)(3).

<sup>131</sup> *Keating v. Superior Court*, 31 Cal.3d 584, 609-610, 645 P.2d 1192, 183 Cal.Rptr. 360 (1982), rev on other grounds, *Southland Corp. v. Keating*, 465 U.S. 1 (1984).

<sup>132</sup> *Id.* at 609-610.

## VIII. MANDATORY DISCLOSURES, PRE-CERTIFICATION DISCOVERY AND CASE MANAGEMENT REPORTS IN FEDERAL COURT

Federal district courts generally take control of all aspects of cases, and class actions are usually no exception. Thus, counsel will need to make mandatory Rule 26 disclosures and case management reports. At the case management conference, counsel will be expected to propose class discovery, class certification motion dates, as well as to address other issues which often will be held in abeyance pending the class certification. Bifurcation of discovery between class certification discovery and subsequent discovery on the merits is often an important issue at the initial case management conference, especially in the current e-discovery era.

Federal Rule of Civil Procedure 23(c)(1) directs the courts to decide certification “at an early practicable time.” Therefore, Counsel representing franchisees should be prepared to set forth a cohesive certification discovery plan at the Rule 16 case management conference or sooner, if local rules have time limits on class certification motions. For example, the Central District of California requires, absent court approval, that class certification motions be brought within 90 days of the filing of the complaint. The plan should identify the depositions and other discovery necessary the relevance of the discovery sought to certification, and a proposed discovery schedule.

Precertification discovery is generally focused on the necessary elements of certification found in Rules 23 (a) and 23 (b). Under Rule 23 (a), the party seeking certification must show all of the following: an ascertainable class, numerosity, commonality, typicality of claims, and adequacy of representation. If the above requirements are met, the party seeking certification must still establish one of three alternative factors under Rule 23(b) discussed in Section IV.D. above. The party defending against certification will seek to negate any or all of these elements generally via internal evidence and through discovery directed at the representative plaintiffs.

Given these inquiries, there will be some unavoidable overlap between merits and certification issues. In *Coopers & Lybrand v. Livesay*,<sup>133</sup> the Supreme Court explained that “the class determination generally involves considerations that are ‘enmeshed in the factual and legal issues comprising the plaintiff’s cause of action.’” Sometimes this will lead to disputes that will require court resolution. Courts may give plaintiffs discovery but also may impose limits to ensure the discovery, is not overbroad and burdensome.<sup>134</sup> The same is true for defendants’ discovery, but the court will need to see justification for broad discovery regarding unnamed class members. Jurisdictional issues under CAFA may also be the subject of focused pre-certification discovery.<sup>135</sup>

Federal courts generally deny plaintiffs’ discovery of class member names out of concerns the discovery will be used to solicit clients unless legitimate reasons can be

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<sup>133</sup> *Coopers & Lybrand v. Livesay*, 437 U.S. 463, 469 & n.12 (1978) (citations omitted).

<sup>134</sup> See *Mantolite v. Bolger*, 767 F.2d 1416, 1424 (9th Cir. 1985).

<sup>135</sup> *Rippee v. Boston Market Corp.*, 408 F.Supp.2d 982, 985 (S.D. CA 2005).

articulated.<sup>136</sup> In *Oppenheimer Fund, Inc. v. Sanders*,<sup>137</sup> the Supreme Court held that the production of class members' names was not "within the scope of legitimate discovery."<sup>138</sup> The Court also acknowledged that it did "not hold that class members' names and addresses never can be obtained under the discovery rules," but those instances are limited to issues relevant to class certification such as numerosity or where contact with members of the class could yield information relevant to issues in the case.<sup>139</sup>

Some state courts may have more liberal rules permitting such discovery with certain limitations.<sup>140</sup> However, federal and state *bans* on communication with unnamed class members are carefully circumscribed and raise First Amendment concerns.<sup>141</sup> Rule 23(d) authorizes the court to regulate communications with potential class members, but this power is generally exercised only in clear cases warranting the prevention of dissemination of misinformation, unethical conduct, or taking advantage of the class. Communications with named representatives are the same as in other litigation.

## IX. CLASS ACTION WAIVERS

### A. Class Action Waivers Generally

The appropriate standard for finding a waiver of a right is bound up with the nature of the right at issue. Several courts, including the United States Supreme Court, have recognized that Rule 23 is a procedural rule, and any "right" to litigate as a class is procedural only.<sup>142</sup> While "the policy at the very core of the class action mechanism is to overcome the problem that small recoveries do not provide the incentive for any individual to bring a solo action prosecuting his

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<sup>136</sup> *Hatch v. Reliance Ins. Co.*, 758 F.2d 409, 416 (9th Cir. 1985).

<sup>137</sup> *Oppenheimer Fund, Inc. v. Sanders*, 437 U.S. 340 (1978).

<sup>138</sup> *Id.* at 354.

<sup>139</sup> *Id.* at 351 n. 13, 354 n. 20.

<sup>140</sup> See, e.g., *Pioneer Electronics (USA), Inc. v. Sup.Ct.*, 40 Cal.4th 360, 373, 53 Cal.Rptr.3d 513, 522 (2007) ("Contact information regarding the identity of potential class members is generally discoverable, so that the lead plaintiff may learn the names of other persons who might assist in prosecuting the case.") (internal citations omitted).

<sup>141</sup> See *Gulf Oil Co. v. Bernard*, 452 U.S. 89 (1981) ("[T]he mere possibility of abuses does not justify routine adoption of a communications ban that interferes with the formation of a class or the prosecution of a class in accordance with the Rules.").

<sup>142</sup> See *Deposit Guar. Nat. Bank v. Roper*, 445 U.S. 326, 332 (1980) ("the right of a litigant to employ Rule 23 is a procedural right only, ancillary to the litigation of substantive claims"); *In re Am. Ex. Merchant's Litig.*, 554 F.3d 300, 312 (2d Cir. 2009) ("insofar as a plaintiff may be said to possess a 'right' to litigate an action in federal court as a class action under Rule 23" such right is procedural only); *Blaz v. Belfer*, 368 F.3d 501, 504 (5th Cir. 2004) (no substantive right to pursue a class action); *Johnson v. West Suburban Bank*, 225 F.3d 366, 371 (3d Cir. 2000) ("the 'right' to proceed as a class action, in so far as the TILA is concerned, is a procedural one").

or her rights,”<sup>143</sup> it is also true that “no reading of [Rule 23] can ignore the [Enabling] Act’s mandate that rules of procedure shall not abridge, enlarge, or modify any substantive right.”<sup>144</sup>

However, the California Supreme Court has stated that because class actions are “often inextricably-linked to the vindication of substantive rights,” placing “the ‘procedural’ label on such devices understates their importance.”<sup>145</sup> While class action waivers are not per se unconscionable under California law, they are generally found to be unconscionable and unenforceable when, “found in a consumer contract of adhesion” involving “small amounts of damages,” where “it is alleged that the party with the superior bargaining power has carried out a scheme to deliberately cheat large numbers of consumers out of individually small sums of money.”<sup>146</sup>

The New Jersey Supreme Court has also recognized that concerns with class action waivers arise where a small individual recovery makes it “difficult if not impossible” for plaintiffs to enforce their consumer rights without a class action.<sup>147</sup> Similar to California, New Jersey has held that class action waivers in contracts of adhesion that “predictably” involve small sum recovery and “functionally exculpate wrongful conduct” are unconscionable “whether in arbitration or in court litigation.”<sup>148</sup>

Perhaps because of this differing perspectives on the nature of the right involved courts have taken differing approaches in determining the validity of contractual agreements requiring parties to litigate or arbitrate their claims on an individual basis and prohibiting the use of class actions.

## **B. Waiver With Respect To Class Arbitration**

The issue has arisen most commonly in the arbitration context, where courts have been faced with arbitration agreements containing clauses that bar class treatment of the parties’ claims.<sup>149</sup> No court has held that contractual provisions prohibiting class arbitration of claims

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<sup>143</sup> *Amchem Prods., Inc. v. Windsor*, 521 U.S. 591, 617 (1997) (quoting *Mace v. Van Ru Credit Corp.*, 109 F.3d 338, 344 (7th Cir. 1997)).

<sup>144</sup> See *Ortiz v. Fibreboard Corp.*, 527 U.S. 815, 845 (1999) (quoting *Amchem Prods., Inc.*, 521 U.S. at 613, & Rules Enabling Act, 28 U.S.C. § 2072(b)).

<sup>145</sup> *Discover Bank v. Superior Court of Los Angeles*, 36 Cal. 4th 148, 161, 30 Cal. Rptr. 3d 76, 87 (2005); see also *Indep. Assn. of Mail Box Center Owners, Inc. v. Superior Court*, 133 Cal.App.4th 396, 34 Cal. Rptr. 3d 659 (2005).

<sup>146</sup> *Discover Bank v. Superior Court of Los Angeles*, 36 Cal. 4th 148, 162-63, 30 Cal. Rptr. 3d 76, 87 (2005).

<sup>147</sup> *Muhammed v. County Bank of Rehobeth Beach Del.*, 189 N.J. 1, 20 (2006).

<sup>148</sup> *Id.* at 22.

<sup>149</sup> See e.g. *In re Am. Express Merchs. Litig.*, 554 F.3d 300 (2d Cir. 2009); *Shroyer v. New Cingular Wireless Servs., Inc.*, 498 F.3d 976 (9th Cir. 2007); *Kristian v. Comcast Corp.*, 446 F.3d 25 (1st Cir. 2006); *Jenkins v. First Am. Cash Adv. of Ga.*, 400 F.3d 868 (11th Cir. 2005); *Iberia Credit Bureau, Inc. v. Cingular Wireless*, 379 F.3d 159 (5th Cir. 2004); *Livingston v. Assocs. Fin., Inc.*, 339 F.3d 553 (7th Cir. 2003); *Snowden v. CheckPoint Check Cashing*, 290 F.3d 631 (4th Cir. 2002); *Johnson v. West Suburban Bank*, 225 F.3d 366 (3d Cir. 2000).

are per se unenforceable. At least five federal circuits<sup>150</sup> and numerous other courts<sup>151</sup> have enforced arbitration clauses that prohibited class-wide treatment of claims. However, courts have found such contractual provisions unenforceable where enforcement “would effectively preclude any action seeking to vindicate the statutory rights” asserted by a plaintiff,<sup>152</sup> or where enforcement would be unconscionable under state law.<sup>153</sup>

In analyzing the issue of whether a prohibition on class treatment in an arbitration agreement is enforceable, courts have developed two distinct approaches.

## **1. Vindication of Statutory Rights Approach**

The first is a “vindication of statutory rights analysis, which has developed as part of the federal substantive law of arbitrability.”<sup>154</sup> In *Livingston v. Associates Finance*, the Seventh Circuit entertained a challenge to provisions in an arbitration agreement that prohibited the plaintiffs from either joining a class action or creating a class action.<sup>155</sup> The plaintiffs claimed that the class action ban was unenforceable because it precluded them from “effectively ‘vindicated their statutory cause of action in the arbitral forum.’”<sup>156</sup> In *Livingston*, the lower court denied the defendant’s motion to compel arbitration, but the Seventh Circuit reversed, holding that the Livingstons’ had failed to “show[] the likelihood of incurring [prohibitive] costs,”<sup>157</sup> through “individualized evidence that [they] likely will face prohibitive costs in the arbitration at issue and that [they are] financially incapable of meeting those costs.”<sup>158</sup>

Under the same “vindication of statutory rights” approach, however, the First and Second Circuits have refused to enforce arbitration provisions that contained prohibitions on class treatment where plaintiffs brought antitrust claims.<sup>159</sup> Importantly, these rulings seem limited to the antitrust context where costly expert reports are essential.

In *Kristian*, the First Circuit held that the plaintiffs, who brought antitrust claims, “provided uncontested and unopposed expert affidavits demonstrating that without some form of class

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<sup>150</sup> See *Jenkins*, 400 F.3d at 877-78; *Iberia Credit Bureau, Inc.*, 379 F.3d at 174-75; *Livingston.*, 339 F.3d at 559; *Snowden*, 290 F.3d at 638; *Johnson*, 225 F.3d at 378.

<sup>151</sup> See *Ornelas v. Sonic-Denver T, Inc.*, No. 06-cv-00253, 2007 U.S. Dist. LEXIS 6214, at \*14 (D. Colo. Jan. 29, 2007) (collecting cases).

<sup>152</sup> *In re Am. Express Merchs. Litig.*, 554 F.3d at 304; *Kristian*, 446 F.3d at 93.

<sup>153</sup> See e.g. *Shroyer*, 498 F.3d at 981 (finding class arbitration waiver unconscionable and unenforceable); *Muhammed v. County Bank of Rehobeth Beach, Del.*, 189 N.J. 1, 7 (2006) (same).

<sup>154</sup> *In re Am. Express Merchs. Litig.*, 554 F.3d at 320.

<sup>155</sup> *Livingston*, 339 F.3d 553.

<sup>156</sup> *Id.* at 556 (quoting *Green Tree Fin. Corp. v. Randolph*, 531 U.S. 76, 90 (2000)).

<sup>157</sup> *Id.* (quoting *Green Tree*, 531 U.S. at 92).

<sup>158</sup> *Id.* 557.

<sup>159</sup> *In re Am. Express Merchs. Litig.*, 554 F.3d 300 (2d Cir. 2009); *Kristian v. Comcast Corp.*, 446 F.3d 25 (1<sup>st</sup> Cir. 2006).

mechanism – be it class action or class arbitration – a consumer antitrust plaintiff will not sue at all.”<sup>160</sup> Thus, if the prohibition on the use of class mechanisms was enforced, “[p]laintiffs will be unable to vindicate their statutory rights.”<sup>161</sup>

In *In re Am. Express Merchants Litig.*, the Second Circuit similarly held that a provision preventing the plaintiffs from arbitrating their antitrust claims as a class was unenforceable because the plaintiffs “would incur prohibitive costs if compelled to arbitrate under the class action waiver.”<sup>162</sup> Because the plaintiffs had demonstrated that they would only be able to pursue their antitrust claims “through aggregation of individual claims,” enforcement of the provision would effectively grant the defendant “de facto immunity from antitrust liability by removing the plaintiffs’ only reasonably feasible means of recovery.”<sup>163</sup>

## **2. State Law Unconscionability Approach**

The second approach courts take where plaintiffs raise challenges to provisions in arbitration agreements precluding class treatment is to apply the framework of the Federal Arbitration Act (“FAA”) and proceed to an analysis of state contract law to determine the validity of such provisions.<sup>164</sup> Under the FAA, “an agreement in writing to submit to arbitration an existing controversy arising out of such a [transaction involving commerce] shall be valid, irrevocable, and enforceable, *save upon such grounds as exist at law or in equity for the revocation of any contract.*”<sup>165</sup> Thus, “generally applicable contract defenses, such as fraud, duress, or unconscionability, may be applied to invalidate arbitration agreements without contravening § 2.”<sup>166</sup> Courts then look to state law to determine if enforcement of an agreement to arbitrate which contains a prohibition on class treatment would be unconscionable.

For example, in *Jenkins*, the Eleventh Circuit determined that the FAA applied to the arbitration agreement in which the plaintiffs waived their ability to bring a suit as a class.<sup>167</sup> It then turned to Georgia law to determine whether the agreement was unconscionable.<sup>168</sup> In reversing the district court’s holding that the provision was unconscionable, the Eleventh Circuit rejected the district court’s determination that consumers would likely be unable to obtain legal representation without the class vehicle and observed that the Georgia RICO statute authorized

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<sup>160</sup> *Kristian*, 446 F.3d at 58.

<sup>161</sup> *Id.* at 61.

<sup>162</sup> *In re Am. Express Merchs. Litig.*, 554 F.3d at 315-316.

<sup>163</sup> *Id.* at 317, 320.

<sup>164</sup> See e.g. *G.R. Homa*, 558 F.3d 225; *Shroyer*, 498 F.3d 976; *Jenkins*, 400 F.3d 868; *Fensterstock v. Edu. Fin. Partners and Affiliated Computer Servs.*, 618 F.Supp.2d 276 (S.D.N.Y. 2009); *O’Shea v. Dir. Fin. Solutions, LLC*, No. 07-1881, 2007 U.S. Dist. LEXIS 90079 (E.D. Pa. December 5, 2007).

<sup>165</sup> 9 U.S.C § 2 (emphasis added).

<sup>166</sup> *Doctors Assocs. Inc. v. Casarotto*, 517 U.S. 681, 687 (1996).

<sup>167</sup> *Jenkins v. First Am. Cash Adv. of Ga.*, 400 F.3d 868, at 872, 875 (11th Cir. 2005).

<sup>168</sup> *Id.* at 875-876.

the recovery of attorneys' fees.<sup>169</sup> Joining other courts that have recognized that where there is an opportunity to recover attorney's fees, lawyers will generally be willing to represent plaintiffs even without the class mechanism, the Eleventh Circuit concluded that the arbitration provision was not unconscionable.<sup>170</sup>

The law of unconscionability varies by state. For example, the Third Circuit has held that an arbitration agreement containing a provision prohibiting class arbitration or consolidation was not unconscionable under Pennsylvania law.<sup>171</sup> The Ninth Circuit has held a similar provision unconscionable under California law.<sup>172</sup> Other courts have found provisions prohibiting class treatment of claims in arbitration to be enforceable under Colorado law,<sup>173</sup> Delaware law,<sup>174</sup> Florida law,<sup>175</sup> Louisiana law,<sup>176</sup> New York law,<sup>177</sup> and Pennsylvania law (where there was an ability to opt-out of the arbitration clause),<sup>178</sup> but unconscionable and unenforceable under Florida law,<sup>179</sup> New Jersey law,<sup>180</sup> California law,<sup>181</sup> and Washington law.<sup>182</sup>

### **C. Waiver With Respect to Class Litigation**

Two courts have addressed a contractual provision where the parties agreed to conduct any litigation on an individual, as opposed to class-wide, basis.<sup>183</sup> After undertaking an

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<sup>169</sup> *Id.* at 878.

<sup>170</sup> *Id.* at 878 (citing *Johnson*, 225 F.3d at 374, and *Snowden*, 290 F.3d at 368).

<sup>171</sup> *Gay v. Credtinform*, 511 F.3d 369 (3d Cir. 2007).

<sup>172</sup> *Shroyer v. New Cingular Wireless Servs.*, 498 F.3d at 976, 980 (9th Cir. 2007).

<sup>173</sup> *Ornelas*, 2007 U.S. Dist. LEXIS 6214, at \*21-22.

<sup>174</sup> *Fluke v. Cashcall, Inc.*, No. 08-5776, 2009 U.S. Dist. LEXIS 43231, at \*15-16 (E.D. Penn. May 21, 2009); *Pick v. Discover Fin. Servs. Inc.*, No. 00-935, 2001 U.S. Dist. LEXIS 15777, \*5 (D. Del. Sept. 28, 2001).

<sup>175</sup> *Cruz v. Curtis Smith*, No. 2:07-cv-714-FtM-29DNF, 2008 U.S. Dist. LEXIS 69938 (M.D. Fla. Sept. 15, 2008).

<sup>176</sup> *Iberia Credit Bureau Inc. v. Cingular Wireless LLC*, 379 F.3d 159, 174-75 (5th Cir. 2004).

<sup>177</sup> *Hayes v. County Bank*, 26 A.D.3d 465 (N.Y. App. Div. 2006).

<sup>178</sup> *Fluke v. Cashcall, Inc.*, No. 08-5776, 2009 U.S. Dist. LEXIS 43231, at \*20 (E.D. Pa. May 21, 2009).

<sup>179</sup> *Powertel, Inc. v. Bexley*, 743 So. 2d 570 (Fla. Dist. Ct. App. 1999).

<sup>180</sup> *Muhammed*, 189 N.J. 1; see also *G.R. Homa*, 558 F.3d 225 (holding that class waiver is unconscionable if on remand it is determined that the consumer's claims are of "such a low value as to effectively preclude relief").

<sup>181</sup> *IJL Dominicana S.A. v. It's Just Lunch Int'l, LLC*, No. 08-5417-VAP, 2009 U.S. Dist. LEXIS 13689 (C.D. Cal. February 6, 2009); *Cohen v. Direct TV, Inc.*, 142 Cal. App. 4th 1442 (Cal. Ct. App. 2006); *Indep. Assn. of Mail Box Center Owners, Inc. v. Superior Court*, 133 Cal.App.4th 396 (2005). Peter Lagarias represented the plaintiffs in the *IJL Dominicana S.A.* and the *Independent Association of Mail Box Center Owners, Inc.* cases.

<sup>182</sup> *Luna v. Household Fin. Corp.*, 236 F.Supp. 2d 1166 (W.D. Wash. 2002)

<sup>183</sup> *Bonanno*, 2009 U.S. Dist. LEXIS 37702; *Martrano v. The Quiznos Franchising Co., LLC*, Bus. Fran. Guide (CCH) Para. 14,161 (W.D. Pa. 2009). Fredric A. Cohen was one of the lawyers who represented the defendants in the *Bonanno* and *Martrano* cases.

unconscionability analysis under Colorado law, the *Bonanno* court determined that the provision was not unconscionable and thus enforceable.<sup>184</sup> But in *Martrano*, the district court in Pennsylvania ruled that parties by private agreement may not displace federal procedural rules designed for the efficient functioning of the judiciary.<sup>185</sup> It is difficult to reconcile either the approaches these courts took to the identical question posed, or the conclusions they reached.

The *Bonanno* court's analysis began with the determination that the contractual provision requiring that disputes be brought on an individual and not a class basis amounted to a class action bar rather than a class action waiver. Because class certification is a procedural tool rather than a substantive right, there was nothing for the plaintiffs to waive. Therefore, the court concluded that, as the parties seeking to avoid enforcement of a contractual commitment, it was the plaintiffs' burden to show that the clause should not be enforced. Applying Colorado's law of unconscionability, the court concluded that the plaintiffs had failed to satisfy that burden. The court noted that, even had it treated the clause as a waiver and imposed on the defendant the burden of establishing the waiver's enforceability, the defendant had met that burden. Finally, the court questioned whether prudential considerations rendered the clause unenforceable, concluding that they did not.

*Martrano* broke with *Bonanno* from the outset, stating that whether private contractual arrangements bind or constrain a federal court's procedures is a question of federal law. Analogizing class actions to consolidations under Rule 42 and comparing the class action bar to a contractual forum selection clause, the court stated that, unlike the situation wherein a party seeks to enforce a forum selection clause, the parties' preferences are not among the factors relevant to the class certification decision under Rule 23. With respect to class certification and consolidation, the ultimate governing standard, the court concluded, is furtherance of efficient judicial administration, which the court stated leaves no room for enforceability of private agreements among litigants.

The *Martrano* court's approach raises several interesting questions, not the least of which is the analogy it drew between class certification and consolidation. One important difference between the two, which the court did not address, is the fact that they differ in terms of any imposition on a court's ability or discretion to manage its docket. "When actions involving a common question of law or fact are pending before the court," Federal Rule of Civil Procedure 42 empowers the court to order a joint hearing or trial of any or all the matters in issue in the action, to order all the actions consolidated, or to make such orders concerning proceedings therein as may tend to avoid unnecessary costs or delay. "Consolidation is within the discretion of the trial court."<sup>186</sup> The court may even invoke Rule 42 *sua sponte* rather than wait for a motion to consolidate made by a party.<sup>187</sup>

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<sup>184</sup> *Bonanno v. The Quiznos Franchising Co.*, 2009 U.S. Dist. Lexis 37702, at \*56-73 (Colo 2009).

<sup>185</sup> *Martrano v. The Quiznos Franchising Co., LLC*, Bus. Fran. Guide (CCH) Para. 14,161 (W.D. Pa. 2009).

<sup>186</sup> *Eric Quade v. Warden Kevin Milyard*, No. 07 CV 229 WYD MJW, 2008 U.S. Dist. LEXIS 102306 (D. Col. Dec. 18, 2008) (Daniel, J.).

<sup>187</sup> *Henderson v. United States*, 2008 U.S. Dist. LEXIS 29807, \*13 (W.D. Va. Apr. 11, 2008) ("The decision to consolidate is committed to Court's discretion and consolidation may be initiated *sua sponte*").

A district court does *not* have the same authority under Rule 23. A court may *not* certify a class *sua sponte* without making the findings required by Rule 23.<sup>188</sup> And while the merits of the court's Rule 23 determination are reviewed for an abuse of discretion, the standard the district court uses in making that determination is prescribed in Rule 23 and will be reviewed *de novo*.<sup>189</sup> In other words, a court has discretion to consolidate cases before it and may do so *sua sponte*, but it enjoys no similar power under Rule 23 with regard to class certification. Unlike consolidation, a court may only consider certification of a class when asked by a party to do so, and the question remains: on what basis may a court disregard the parties' private contract by which they agreed not to ask the court to certify a class?

Opponents of class actions (and proponents of private contracts) will argue that there is no reason why a party to a commercial contract might not waive its right to seek class treatment for a lawsuit it might file, and will point out that the numerous decisions on point in the arbitration context support that proposition. They will argue that, in litigation, the waiver of that right in no way encroaches upon a court's power under Rule 23 because that power is triggered solely upon the making of a motion for class certification and not independently of it. They will argue that concerns for the preservation of judicial resources and the efficient adjudication of disputes that animate Rule 42 are implicated by a multiplicity of real, actual lawsuits pending in the same court. Rule 42 empowers the court to address those concerns, even *sua sponte*, through consolidation. But are those concerns present in the context of a Rule 23 motion for class certification where there is no multiplicity of real, actual pending lawsuits, but rather only the class certification movant's insistence that other actions could exist? Should another action materialize, proponents of private contracts will argue, those concerns can be addressed under Rule 42, if in the same court, or through the Multi-District Litigation Panel or simple motion to transfer venue, if in other courts.

The different approaches taken by the *Bonanno* and *Martrano* courts to address this interesting question determined the result each reached, and the disagreement over approach is unlikely to be resolved anytime soon. The Tenth Circuit Court of Appeals denied plaintiffs' petition for leave to appeal from the *Bonanno* decision. The *Martrano* decision was rendered on a motion to dismiss, and therefore is not appealable. Further guidance on this important question will therefore have to await either a ruling on a class certification motion in *Martrano*, trial in *Bonanno*, or further analysis from another court.<sup>190</sup>

## **X. INTERLOCUTORY APPEAL OF ORDERS GRANTING OR DENYING CLASS-ACTION CERTIFICATION**

*Federal Rule of Civil Procedure* 23(f) now provides:

A court of appeals may permit an appeal from an order granting or denying class-action certification under this rule if a petition for permission to appeal is filed with the circuit clerk within 10 days after the order is entered. An appeal does not stay proceedings in

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<sup>188</sup> *Bonlender v. American Honda Motor Co., Inc.*, 2008 U.S. App. LEXIS 15598, \*2 (9th Cir. Jun. 6, 2008).

<sup>189</sup> *Vallario v. Vandehey*, 554 F.3d 1259, 1264 (10th Cir. 2009).

<sup>190</sup> Fredric A. Cohen represented the defendants in the *Bonanno* and *Martrano* cases. We anticipate lively discussion about these decisions at our session.

the district court unless the district judge or the court of appeals so orders.<sup>191</sup>

As the First Circuit stated, Rule 23(f) serves dual purposes. First, the rule provides a “mechanism through which appellate courts, in the interests of fairness, can restore equilibrium when a doubtful class certification ruling would virtually compel a party to abandon a potentially meritorious claim or defense before trial.”<sup>192</sup> Second, “the rule furnishes an avenue, if the need is sufficiently acute, whereby the court of appeals can take earlier-than-usual cognizance of important, unsettled legal questions, thus contributing to both the orderly progress of complex litigation and the orderly development of law.”<sup>193</sup>

It is difficult to imagine a situation in which counsel receiving an adverse class certification ruling would forego the opportunity to seek interlocutory review. It is important to note that Rule 23(f) permits a petition for interlocutory appeal from an order granting or denying class certification. Where it is not feasible to prosecute the action other than as a class action, putative class counsel will have no alternative but to seek review making death-knell arguments. Conversely, where a class is certified posing so great a threat to the defendant that it will be compelled to settle the case, an interlocutory appeal will be the defendant’s last opportunity to avoid that outcome. In considering whether to seek interlocutory review, it is important to remain mindful of the brief window within which the petition must be filed.

By its express terms, Rule 23(f) permits appeal only from orders granting or denying class certification and no others, such as rulings on motions to dismiss or for summary judgment.<sup>194</sup> Rule 23(f) does not set forth any standard that must be met for an appeal to be permitted. Rather, the Advisory Committee contemplated that “the courts of appeals will develop standards for granting review that reflect the changing areas of uncertainty in class litigation.”

Under Rule 23(f), the court of appeals’ discretion to permit or deny an appeal is “unfettered” and “akin to the discretion exercised by the Supreme Court in acting on a petition for certiorari.”<sup>195</sup> The courts of appeals may grant or deny permission to appeal a class certification order based on “any consideration” it “finds persuasive.”<sup>196</sup> Since enactment of Rule 23(f), most of the courts of appeals have published opinions setting forth the standards that they will use in deciding whether to grant interlocutory review under Rule 23(f). While some differences exist, the circuits generally agree that interlocutory review is appropriate in certain types of cases.

In *Blair v. Equifax Check Servs., Inc.*, the first appellate opinion addressing Rule 23(f), the Seventh Circuit held that interlocutory review is appropriate when the denial of class

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<sup>191</sup> FED. R. CIV. P. 23(f), Amendment of Rule 23, effective December 1, 2009 (West 2009).

<sup>192</sup> *Waste Mgmt. Holdings, Inc. v. Mowbray*, 208 F.3d 288, 293 (1st Cir. 2000).

<sup>193</sup> *Id.*

<sup>194</sup> *In re Lorazepam & Clorazepate Antitrust Litig.*, 289 F.3d 98, 106-07 (D.C. Cir. 2002) (issue of antitrust standing outside scope of a Rule 23(f) appeal).

<sup>195</sup> See FED. R. CIV. P. 23 Advisory Committee Notes to 1998 Amendments, *Subdivision (f)*.

<sup>196</sup> *Id.*

certification sounds the “death knell” for plaintiffs whose “claim is too small to justify the expense of litigation.”<sup>197</sup> Similarly, in a case where class certification is granted, interlocutory review is appropriate where a defendant’s potential liability may be so significant that settlement “becomes the only prudent course.”<sup>198</sup> These cases are known as “death knell” or “reverse death knell” cases, cases in which a class certification order is likely to force either a plaintiff or a defendant to resolve the case based on considerations independent of the merits.<sup>199</sup>

Interlocutory review is also proper where it involves a “fundamental issue” relating to class actions and will further the development of the law of class actions.<sup>200</sup> However, this category of cases is narrow based on the Advisory Committee’s note that “many suits with class-action allegations present familiar and almost routine issues that are no more worthy of immediate appeal than many other interlocutory rulings.”<sup>201</sup> Based on its concern that “a creative lawyer will always be able to argue that deciding her case would clarify some ‘fundamental issue,’” the First Circuit made a small emendation and held that granting review under Rule 23(f) in cases involving a fundamental issue is appropriate only if it is “important to the particular litigation as well as important in itself and likely to escape effective review if left hanging until the end of the case.”<sup>202</sup> Several circuits have adopted the First Circuit’s position on the fundamental-issues category.<sup>203</sup>

The circuits that have considered Rule 23(f) agree that “death knell” cases, “reverse death knell” cases and cases which may facilitate the development of the law of class actions warrant interlocutory review.<sup>204</sup> In addition, the Eleventh Circuit has held that Rule 23(f) review “may be warranted even if none of the other factors supports granting the Rule 23(f) petition.”<sup>205</sup>

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<sup>197</sup> *Blair v. Equifax Check Servs., Inc.*, 181 F.3d 832, 834 (7th Cir. 1999).

<sup>198</sup> *Carpenter v. Boeing Co.*, 456 F.3d 1183, 1189 (10th Cir. 2006); see also *Blair*, 181 F.3d at 834.

<sup>199</sup> See *Vallario v. Vandehey*, 554 F.3d 1259, 1263 (10th Cir. 2009); *Carpenter*, 456 F.3d at 1189; *Chamberlan v. Ford Motor Co.*, 402 F.3d 952, 959 (9th Cir. 2005); *In re Lorazepam*, 289 F.3d at 105; *Blair v. Equifax Check Servs., Inc.*, 181 F.3d at 834 (7th Cir. 1999); see also FED. R. CIV. P. 23 Advisory Committee Notes to 1998 Amendments, *Subdivision (f)*.

<sup>200</sup> *Blair*, 181 F.3d at 835; see also *Carnegie v. Household Int’l, Inc.*, 376 F.3d 656, 658 (7th Cir. 2004), (“the more important the resolution of the issue is either to the particular litigation or to the general development of class action law,” the greater the likelihood that appeal will be permitted).

<sup>201</sup> See *Vallario*, 554 F. 3d at 1263 (quoting FED. R. CIV. P. 23 Advisory Committee Notes to 1998 Amendments, *Subdivision (f)*).

<sup>202</sup> *Mowbray*, 208 F.3d at 294.

<sup>203</sup> See *Vallario*, 554 F.3d at 1263; *Chamberlan*, 402 F.3d at 959; *In re Lorazepam*, 289 F.3d at 105.

<sup>204</sup> See e.g. *Vallario*, 554 F.3d at 1263; *Chamberlan*, 402 F.3d at 957-59; *In re Delta Air Lines*, 310 F.3d 953, 960 (6th Cir. 2002); *In re Lorazepam*, 289 F.3d at 105; *Newton v. Merrill Lynch, Pierce, Fenner, & Smith*, 259 F.3d 154, 165 (3rd Cir. 2001); *In re: Sumitomo Copper Litig. v. Credit Lyonnais Rouse, Ltd.*, 262 F.3d 134, 139 (2d Cir. 2001); *Lienhart v. Dryvit Sys., Inc.*, 255 F.3d 138, 145-46 (4th Cir. 2001); *Prado-Steiman ex rel. Prado v. Bush*, 221 F.3d 1276, 1273 (11th Cir. 2000); *Mowbray*, 208 F.3d at 294; *Blair*, 181 F.3d at 834-35.

<sup>205</sup> *Prado-Steiman*, 221 F.3d at 1275.

Other circuits have since held that interlocutory review of a certification decision may be appropriate based on manifest error.<sup>206</sup> The Ninth Circuit held that interlocutory review is warranted when the district court's decision is "manifestly erroneous – even absent a showing of another factor."<sup>207</sup> The "error in the district court's decision must be significant; bare assertions of error will not suffice" and must be "easily ascertainable from the petition itself."<sup>208</sup> The Ninth Circuit has stated that "the kind of error most likely to warrant interlocutory review will be one of law, as opposed to an incorrect application of law to facts."<sup>209</sup>

Finally, a "sliding scale" standard has been used in some circuits. In those courts, "the stronger the showing of an abuse of discretion, the more this factor weighs in favor of interlocutory review."<sup>210</sup> Under the "sliding scale" approach, review is appropriate without regard to the other factors when the district court's decision is manifestly erroneous.<sup>211</sup> However, review may not be appropriate when it is less clear that the district court committed error. These courts also look to other issues such as the status of discovery, the procedural posture of the case, and the possibility of settlement or bankruptcy.<sup>212</sup> The Ninth Circuit has expressly declined to adopt the "sliding scale" approach.<sup>213</sup>

Interlocutory appeals are traditionally disfavored by courts of appeal.<sup>214</sup> Such appeals have been said to be "disruptive, time-consuming and expensive" for the parties and the courts.<sup>215</sup> Accordingly, several courts have stated that the grant of a petition for interlocutory review constitutes the "exception" rather than the "rule."<sup>216</sup> Parties are still generally required to raise all claims of error, in a single proceeding, after the district court renders a final judgment.<sup>217</sup> As the *Vallario* court explained, "this rule recognizes 'the limited capacity of appellate courts to consider interlocutory appeals, as well as the institutional advantage possessed by district courts in managing the course' of class litigation."<sup>218</sup> Consequently,

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<sup>206</sup> See e.g. *Vallario*, 554 F.3d at 1263-64; *In re Lorazepam*, 289 F.3d at 105; *Newton*, 259 F.3d at 164; *Lienhart*, 255 F.3d at 145.

<sup>207</sup> *Chamberlan*, 402 F.3d at 959.

<sup>208</sup> *Id.*

<sup>209</sup> *Id.*; see also *Vallario*, 554 F.3d at 1264.

<sup>210</sup> *Prado-Steiman*, 221 F.3d at 1275 n. 10.

<sup>211</sup> *Lienhart*, 255 F.3d at 146.

<sup>212</sup> *Prado-Steiman*, 221 F.3d at 1274-75; *Lienhart*, 255 F.3d at 144-46.

<sup>213</sup> *Chamberlan*, 402 F.3d at 960.

<sup>214</sup> See *Vallario*, 554 F.3d at 1262; *Carpenter*, 456 F.3d at 1189; *Chamberlan*, 402 F.3d at 959; *Mowbray*, 208 F.3d at 294; *In re Lorazepam*, 289 F.3d at 105.

<sup>215</sup> *Vallario*, 554 F.3d at 1262; *Mowbray*, 208 F.3d at 294; see also *In re Lorazepam*, 289 F.3d at 105.

<sup>216</sup> *Vallario*, 554 F.3d at 1262; *Chamberlan*, 402 F.3d at 959; *Prado-Steiman*, 221 F.3d at 1273; *Mowbray*, 208 F.3d at 294.

<sup>217</sup> *Vallario*, 554 F.3d at 1262; *Chamberlan*, 402 F.3d at 959; *In re Lorazepam*, 289 F.3d at 104-05.

<sup>218</sup> *Vallario*, 554 F.3d at 1262-63 (quoting *Lienhart*, 255 F.3d at 145).

parties seeking interlocutory review of an order granting or denying class certification must be familiar with the decisions of the particular circuit in which they are seeking relief and, in order to warrant review, the case must come within one or more of the categories recognized in that circuit.

## **XI. SETTLEMENT**

### **A. Issues For Consideration**

Those viewing class action settlements from a glass half-empty perspective often suggest that the settlement is a sellout of absentee class members or, conversely for defendants, that the settlement is the product of legalized blackmail by unworthy plaintiffs. But the glass half full practitioner might respond that a class settlement obtains relief otherwise unavailable for individual plaintiffs and provides a classwide bar of future claims for the settling defendant without the ongoing cost of litigation.

Whatever one's view, class action settlements must be presented and defended to the court with notice to all class members.<sup>219</sup> Class members may seek to intervene to challenge the settlement. In addition, CAFA class actions require that defendants notify state government officials of proposed settlements.<sup>220</sup>

Among the common issues involved in class action settlement are:

1. Monetary settlement: per capita, formula, total sum, recapture provisions.
2. Non-monetary aspects: will there be coupon or scrip relief, debt forgiveness, or other non-cash settlement consideration.
3. Releases: will there be limited versus general releases.
4. Injunctive relief: will there be injunctive relief or other ongoing performance obligations.
5. Attorney's fees: will attorney's fees be agreed to subject to court approval, will a range or cap be agreed to, or will the matter be left to the court given statutory provision for attorneys' fees.
6. Required opt-ins: will the defendants require a minimum number or percentage of class members to opt-in or not opt-out.

Settlement incentives to the named representatives raise special issues, discussed below in XI.D.

### **B. Motions For Approval And Notice Requirements**

When parties reach a class action settlement, one or both will file a motion for court approval. Approval of class action settlements involves a two step process: preliminary approval by the court and subsequent final approval or disapproval by the court following notice and an opportunity to be heard to all class members.<sup>221</sup> Given that many class members may

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<sup>219</sup> *Uhl v. Thoroughbred Technology and TeleCommunications, Inc.*, 309 F.3d 978 (7th Cir. 2002).

<sup>220</sup> 28 U.S.C. § 1715.

<sup>221</sup> See generally Manual for Complex Litigation (3d Ed.) Section 30.41.

not initially be aware of the action, let alone the proposed settlement, district courts often characterize their review of class action settlements as akin to a fiduciary duty.<sup>222</sup> When a challenge is made to a settlement, and the settlement does not address legal or damages issues adequately, the proposed settlement may be rejected.<sup>223</sup>

Notice of a class action settlement is required for due process because the settlement will bar, as *res judicata*, the future claims of all class members.<sup>224</sup> While Rule 23(e) provides for notice “in the manner the court directs,” due process requires that the notice be “reasonably calculated under all circumstances, to apprise interested parties of the pendency of the action and afford them an opportunity to present their objections.”<sup>225</sup> Counsel accordingly should request the district court to provide for adequate and neutral notice advising all class members about details of the action and settlement, how to obtain a copy of the settlement, and providing sufficient time to review the proposed settlement and to file claims, to opt-out, or to object.

In *Grunin v. International House of Pancakes*,<sup>226</sup> a notice of a class action settlement was challenged as neither designed to notify former franchisees nor to provide those notified with adequate time to object. The notice period provided only nineteen days, but this seemingly short period was found adequate because a franchisee association had endorsed the settlement and spent weeks lobbying for its approval, and franchisee class members had been involved in prior objections and had ongoing counsel representing them. The method of notification was by mail to the last known address of franchisees and former franchisees. The objecting franchisees who appeared, and thus had notice, asserted that publication notice should have been ordered and that one third of the class did not receive notice. This latter contention was rejected by the Eighth Circuit, which noted that mailed notice is preferred over newspaper publication, and that it would have been fruitless to publish a newspaper notice for the 90 to 100 class members for whom mail sent to their last known address mail was returned, since they were scattered throughout the nation.<sup>227</sup>

A district court is not to accept a settlement “that the proponents have not shown to be fair, reasonable, and adequate.”<sup>228</sup> The most important factor for approval of a class action settlement is the strength of the plaintiff class claims relative to the settlement consideration offered.<sup>229</sup> Other factors considered by courts for approval of a class action settlement include

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<sup>222</sup> *Grunin v. International House of Pancakes*, 513 F.2d 114, 123 (8th Cir. 1975).

<sup>223</sup> *Clark v. America Residential Services, LLC*, 175 Cal.App.4th 785, 96 Cal. Rptr. 3d 441 (2009) (citing *7-Eleven Owners for Fair Franchising v. The Southland Corp.*, 85 Cal.App.4th 1135 (2000)).

<sup>224</sup> *Eisen v. Carlisle & Jacquelin*, 417 U.S. 156, (1972).

<sup>225</sup> *Mullane v. Central Hanover Bank & Trust Co.*, 339 U.S. 306, (1950).

<sup>226</sup> *Grunin v. International House of Pancakes*, 513 F.2d 114 (8th Cir. 1975).

<sup>227</sup> *Id.* at 121-122..

<sup>228</sup> *Id.* at 123.

<sup>229</sup> *Id.* at 125.

the defendant's solvency and ability to pay, remaining litigation issues and their complexity, and opposition to the proposed settlement.<sup>230</sup>

Over a number of years, a class action settlement of antitrust claims was rejected, revised, and ultimately approved regarding the International House of Pancakes Franchise Litigation. The plaintiffs asserted that the franchisor, IHOP, had illegally tied to their franchise agreements requirements to buy or lease various equipment, food items and other goods and services from IHOP. The initial settlement proposal was rejected by the district court after many class member franchisees opposed the settlement as insufficient despite concern over the solvency of IHOP. The court of appeals affirmed the disapproval by the district court, noting that many of the class members had pointed out that the proposed settlement would continue many of the practices challenged as antitrust violations.<sup>231</sup> Two years later, a revised settlement was approved over the objections of some franchisees.<sup>232</sup>

In the second settlement proceeding, *Grunin v. International House of Pancakes*,<sup>233</sup> the settlement was approved despite objections of inadequate notice of the settlement and substantively that the settlement was not fair, reasonable and adequate. Regarding the continued assertion that the settlement perpetuated antitrust violations, the Eighth Circuit disagreed noting that certain leases were not required under the franchise agreement and the purchase of products was an integral part of the franchise. As to the adequacy of the settlement overall, the Eighth Circuit found the district court had considered the liability issues and damages in the multi-year cases in light of voluminous evidence. In addition, the parties challenging the settlement had not attacked any specific weaknesses in evidence presented to support the settlement.<sup>234</sup>

### C. Attorneys' Fees

Class action attorney's fees are considered and approved separately from the underlying settlement agreement, also generally in a two step process. Ultimately class members are to be provided notice and an opportunity to be heard regarding the provision of attorney's fees as well as the settlement itself.

The claims being settled and the settlement terms may affect the provision of attorney's fees. When a statutory claim which provides for attorney's fees is successfully settled, then the plaintiffs' counsel will generally be entitled to attorney's fees to be determined by the court.<sup>235</sup> In addition when a class action settlement creates a common fund for a class, plaintiff's counsel is generally entitled to attorney's fees to be determined by the court from the common fund.<sup>236</sup>

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<sup>230</sup> *Id.*

<sup>231</sup> *In re International House of Pancakes Franchise Litigation*, 487 F.2d 303 (8th Cir. 1973).

<sup>232</sup> *Grunin v. International House of Pancakes*, 513 F.2d 114 (8th Cir. 1975).

<sup>233</sup> *Id.*

<sup>234</sup> *Id.* at 125.

<sup>235</sup> *Boeing Co. v. Van Gemert*, 444 U.S. 472, 480-81, (1980); *Alyeska Pipeline Service Co. v. Wilderness Society*, 421 U.S. 240, 254-262 (1975).

<sup>236</sup> *Boeing Co. v. Van Gemert*, 444 U.S. 472, 480-81 (1980).

In the process of a class action settlement, attorney's fees terms may be discussed or agreed by the parties, subject to court approval. In some cases, an agreed sum may be reached; in other instances, an agreement may be reached that the defendants will not challenge an attorney's fee award up to a maximum amount.

The calculation of an award of attorney's fees to plaintiff's counsel starts with the number of hours expended on behalf of the class.<sup>237</sup> Thus, plaintiffs' counsel should endeavor to keep detailed and contemporaneous time records of all attorneys and legal assistants working on the class action. The time will be submitted by declaration or affidavit, and sometimes the district court will conduct an evidentiary hearing on the attorney's fees award.<sup>238</sup>

In addition to the baseline time data, most courts consider the following factors in establishing a class action attorney's fee award:

- (a) the number of hours spent in various legal activities by the individual attorneys;
- (b) the reasonable hourly rate for the individual attorneys;
- (c) the contingent nature of success;
- (d) the quality of the attorneys' work;<sup>239</sup> and
- (e) challenges to settlements.

As noted above, challenges to class action settlements may involve multiple issues including: whether notice to the class is adequate; whether the settlement is fair, reasonable and adequate; and whether the attorney's fee award is warranted. Counsel representing class members challenging a settlement should endeavor to provide admissible evidence, such as evidence regarding the strength of claims and amount of damages, supporting the challenge rather than simply arguing based on the existing record.<sup>240</sup>

#### **D. Incentive Awards**

Incentive awards to class representatives are meant to compensate for work done on behalf of the class and the risk undertaken of bringing the action. Incentive awards are not unusual in class action cases.<sup>241</sup> But the courts are on guard for disproportionate compensation to the class representatives or others that create actual or perceived conflicts with the class.

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<sup>237</sup> *Grunin v. International House of Pancakes*, 513 F.2d 114, 127 (8th Cir. 1975).

<sup>238</sup> *Id.*

<sup>239</sup> *Id.* (citations omitted); *Allapattah Services, Inc. v. Exxon Corp.*, 454 F. Supp. 2d 1185 (E.D. Fla. 2006).

<sup>240</sup> *Grunin v. International House of Pancakes*, 513 F.2d 114, 125 (8th Cir. 1975).

<sup>241</sup> Theodore Eisenberg & Geoffrey P. Miller, *Incentive Awards to Class Action Plaintiffs: An Empirical Study*, 53 U.C.L.A. L.Rev. 1303 (2006) (finding twenty-eight percent of settled class actions between 1993 and 2002 included an incentive award to class representatives).

Thus, in *Staton v. Boeing Co.*,<sup>242</sup> the Ninth Circuit refused to approve a settlement agreement where the incentive award requested indicated that the class representatives were "more concerned with maximizing [their own] incentives than with judging the adequacy of the settlement as it applies to class members at large."<sup>243</sup>

In *Rodriguez v. West Publishing Corp.*<sup>244</sup> class counsel filed a motion seeking incentive awards for the class representatives after preliminary approval of the \$49,000,000 settlement of an antitrust case involving certain bar review courses. As part of their retainer agreement, the class representatives had entered into a sliding scale incentive arrangement with class counsel: the greater the recovery, the greater the award that would be requested regardless of the work performed on behalf of the class. A group of objectors brought the agreement to the attention of the district court which then denied the incentive awards. The district court refused to recognize the contribution of the objectors on this issue and denied them attorney fees for the corresponding benefits to the class. The court of appeals reversed this denial and noted that the incentive agreement was inappropriate involving conflicts of interest. Notably, Congress has weighed in on the issue of incentive awards in securities cases in light of recent kickback scandals involving the certain well known class action lawyers. The Private Securities Litigation Reform Act of 1995 prohibits granting incentive awards to class representatives in securities class actions.<sup>245</sup> And CAFA also notes that class "members often receive little or no benefit from class actions, and are sometimes harmed, such as where ... (B) unjustified awards are made to certain plaintiffs at the expense of other class members."

### **Conclusion**

Franchising by nature is essentially uniform in disclosures, agreements and business practices. When a claim arises out of an aspect of that uniformity and is shared by all or many franchisees in the same manner, the class action can be an appropriate mechanism to resolve common claims and defenses. Moreover, in certain situations class adjudication (and/or settlement) may allow a franchisor to solve business problems more economically and with lower risk than a multiplicity of individual litigations, either by means of a class action brought against it or by a defensive class action brought by the franchisor. Class litigation may seem facially attractive to franchisees. But those seeking large individual damage awards may be better off going it alone or in a group action, rather than forfeiting control over their case and placing the class's interests over their own. In sum, the decision to seek to pursue litigation on a class-wide basis, like most other litigation decisions, involves a careful weighing of the pros and cons.

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<sup>242</sup> *Staton v. Boeing Co.*, 327 F.3d 938 (9th Cir.2003).

<sup>243</sup> *Id.* at 977-78.

<sup>244</sup> *Rodriguez v. West Publishing Corp.*, 563 F.3d 948, 957 (9th Cir.,2009).

<sup>245</sup> See 15 U.S.C. § 78u-4(a)(2)(A)(vi).

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