

CLASS ACTIONS, IT'S ALL ABOUT STRATEGY

PERSPECTIVE

By Brian Kabateck and Frances Ma

After the U.S. Supreme Court heard arguments last year on two separate issues involving class actions, consumers were faced with the possibility that the Court could drastically change the world of class actions. In today's world where individuals can come together to effect change through the strength of their numbers, it's always been about strategy strategy in picking a specific but not too specific case, in selecting the ideal class representative, and perhaps, most importantly, in determining where to file the lawsuit. If the Supreme Court were to decide otherwise, a new world order could force consumers to find news to confront corporate bullies.

Class actions have long been a plaintiff's instrument of choice to bring attention to problems that would otherwise have slipped through the cracks. Businesses defending class action suits, on the other hand, despise them because when a blemish on a company's reputation can mean the difference between sinking or swimming, they often have to take the hit financially and settle the cases against them rather than risk public exposure.

Take Toyota, for example. Toyota is the largest automaker in the world and has upheld a reputation of safety and reliability for decades. That is, until recently when it was slammed with at least 40 class action suits relating to brake and acceleration problems found in its cars. And while consumers are probably glad that Toyota notified them of these problems as a result of lawsuits and federal regulatory actions the company will most likely suffer a great deal from the bad publicity.

It is no surprise then that companies such as Hertz Corp. and Allstate Insurance chose to fight hard against the procedural and legal issues that surround the class actions against them. Not necessarily because they believe these particular suits could ruin their reputations, but because there always exists the *potential* for a class action to close the doors on the business in the future. So these businesses hoped to gain the upper hand in a class action's most important strategy decision: determining where to file the lawsuit.

On Feb. 23, 2010, the U.S. Supreme Court issued its first ruling on the Hertz and Allstate Insurance cases one that, in the eyes of the business industry, will be seen as a movement towards greater economic stability. But all eyes remain on the second ruling, which is still pending.

In an unprecedented decision, the Supreme Court found in favor of Hertz Corp. and reversed the 9th Circuit's decision in favor of the plaintiff. *Hertz Corp. v. Friend*, No. 08-117, 2010 WL 605601.

After a grueling debate over the true definition of a corporation's "principal place of business" for purposes of corporate citizenship, the Court found in a unanimous decision that citizenship "is best read as referring to the place where a corporation's officers direct, control, and

coordinate the corporation's activities. In practice it should normally be the place where the corporation maintains its headquarters provided that the headquarters is the actual center of direction, control, and coordination, i.e., the 'nerve center,' and not simply an office where the corporation holds its board meetings."

Prior to this ruling, there were essentially four different tests that were used to determine a corporation's "principal place of business." The 9th Circuit utilized the "place of operations" test, which considered the location of a corporation's employees, tangible property, production activities, sources of income and sales. On the opposite side of the spectrum and what Hertz contended was the best approach was the "nerve center" test that says a corporation belongs to the state where its headquarters is located. Although this was perhaps the most straightforward test, the 7th Circuit was the only circuit that strictly followed the approach. Somewhere in between lied the "center of activity" test used by the 3rd Circuit and the "totality of a corporation's activities" test used by the 5th, 6th, 8th, 10th, and 11th Circuits. Given these varying tests, the Supreme Court granted Hertz's petition for certiorari after losing its attempt to remove the case to federal court based on diversity, which requires opposing parties to be citizens of different states. In September 2007, Melinda Friend filed a class action suit against Hertz claiming damages for alleged violations of California's wage and hour laws. The class action was filed in California state court where Friend hoped to benefit from the state's labor and employment laws. Consequently, Hertz remanded the case to federal court where it undoubtedly thought it had a better chance of winning. Hertz is incorporated in Delaware and has its headquarters in New Jersey. In response, Friend moved to remand the case back to California's state court based on the 9th Circuit's "place of operations" test, in which Hertz would be considered a citizen of California for purposes of the class action.

California plaintiffs in class actions were fairly successful in using the state's "size" to keep lawsuits close to home through the 9th Circuit's test that tended to favor states with larger populations. In fact, Justice Ruth Bader Ginsberg stated during oral arguments, "California is going to be the big winner in this. It's going to be able to keep all those cases in its [s]tate courts, because so many multistate corporations, I imagine, would come out just the way Hertz does."

In the end, Justice Ginsberg's statement carried much weight in the Supreme Court's final decision. The opinion did, however, concede that the "nerve center" test was not perfect. The decision states, "this test is relatively easier to apply and does not require courts to weigh corporate functions, assets or revenues different in kind, one from the other. And though this test may produce results that seem to cut against the basic rationale of diversity jurisdiction, accepting occasionally counterintuitive results is the price the legal system must pay to avoid overly complex jurisdictional administration while producing the benefits that accompany a more uniform legal system."

When deciding where to file a class action suit, it's not only crucial to determine where the laws will be most favorably applied to a particular class. It is just as important to weigh the possible benefits of filing in federal versus state court.

Shady Grove, an orthopedic clinic, was assigned a patient's right to recover medical expenses from her insurer, Allstate, after she suffered injuries following an automobile accident. Although Allstate did not deny payment to Shady Grove, it did delay making its payment. Shady Grove consequently filed a class action suit in federal court alleging that Allstate had a practice of

failing to pay claims on time. *Shady Grove Orthopedic Associates, P.A. v. Allstate Ins. Co.*, 466 F.Supp.2d 467 (E.D.N.Y., 2006) (affirmed by 549 F.2d 137 (2nd Cir. (N.Y.) 2008)).

New York law, however, bars class actions that seek money for penalties imposed on certain types of misconduct defined by state law. In essence, New York forces parties to bring separate private actions for each instance of misconduct. In state court, Shady Grove would have been entitled to \$500 in interest for Allstate's failure to pay on time. Needless to say, \$500 is not an amount that Shady Grove would necessarily want to bring a lawsuit over. In federal court, however, Shady Grove was able to utilize Federal Rule of Civil Procedure Rule 23 to aggregate its claims and bring a class action worth more than \$5 million.

So which law trumps? Shady Grove argued that a state should never be able to pass a law that places a cap on damages or limits the remedies available for class actions in federal court, while Allstate contends that a state could end class actions altogether and possibly render Rule 23 obsolete. These are the key questions that the Supreme Court has yet to decide. The Rules Enabling Act gives the judicial branch the power to promulgate the Federal Rules of Civil Procedure but the Erie Doctrine states that federal courts must apply state substantive law in diversity cases. So is the New York law a substantive or procedural rule?

Unfortunately for the Supreme Court, it's both. And because several state legislatures have become increasingly active in passing laws to limit the scope of class actions, the outcome of the Supreme Court's ruling could give businesses another win that would send plaintiffs' attorneys back to the drawing board.

So what can we expect the U.S. Supreme Court to do? Expect the justices to look forward and render a decision that will better withstand the evolutionary nature of class action and business strategies. But with the decision from *Hertz* already handed down, perhaps the Court will find in favor of class actions just to level the playing field.

For California at least, *Hertz* will likely cut down on the number of class action suits that are pursued in state court, making federal courts the required forum.

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