August 1, 2019

Class Certification Case Developments

In our first in a series of occasional alerts on updates on class certification decisions, we present two recent court decisions of potential interest. First, the Ninth Circuit's *en banc* decision in *In re Hyundai & Kia Fuel Economy Litigation (Hyundai II)*, illustrates how differently settlement classes are evaluated from other classes, because, among other things, courts need not concern themselves with issues relating to the manageability of a trial. Second, *Audet* v. *Fraser*, is an example of a rare case where a federal district court certified a class in a fraud case, even though no presumption of reliance was available.

In re Hyundai & Kia Fuel Economy Litig. (Hyundai II), 926 F.3d 539 (9th Cir. 2019).

The Ninth Circuit's recent *en banc* decision affirmed approval of a nationwide settlement, in a divided decision. A Ninth Circuit panel had initially vacated the approval in a 2-1 decision. 881 F.3d 679 (9th Cir. 2018).

Background. This litigation arose from claims alleging that defendants, Hyundai Motor America and Kia Motors America, misrepresented their vehicles' fuel economy. *Hyundai II*, 926 F.3d at 552. An initial group of plaintiffs filed a class action in California alleging state law claims and seeking to certify a nationwide class. *Id.* at 553. Before the class in that case was certified, however, defendants created a voluntary reimbursement program to compensate owners and lessees of affected vehicles for the higher fuel costs associated with the earlier fuel economy estimates. *Id.* This "sparked a surge" of new putative class action cases filed in state and federal courts nationwide but consolidated in the Central District of California. *Id.*

Mediation followed, resulting in some cases reaching a proposed nationwide settlement. Other plaintiffs, who were not participating in those cases, were allowed months of confirmatory discovery and represented by liaison counsel to "objectively evaluate the terms of the settlement." *Id.* at 553–54. The district court ultimately approved the settlement following eight separate hearings.

A divided three-judge panel vacated the certification decision, holding that the district court abused its discretion because it did not analyze whether variations in state law affected the class's ability to fulfill Rule 23's predominance requirement. *In re Hyundai & Kia Fuel Econ. Litig. (Hyundai I)*, 881 F.3d 679 (9th Cir. 2018). Then a majority of the non-recused active judges voted to rehear the case *en banc*.

This opinion. On review *en banc*, the Ninth Circuit reversed course and affirmed the settlement. Among the key issues discussed was the different standard a district court applies when certifying a class for settlement purposes, versus certifying a class for litigation purposes.

Objectors had argued that the predominance test of Rule 23(b)(3)—which requires that "questions of law or fact common to class members" must "predominate over any questions affecting only individual members"—was "precisely the same for a settlement class as it [is] for a litigation class." *Id.* at 558. But the eight judges in the majority emphasized that predominance criteria for class certification are applied differently in litigation classes and settlement classes. *Id.* at 556. This flows, in part, from the "strong judicial policy that favors settlements, particularly where complex class action litigation is concerned." *Id.*

Relying on the Supreme Court case *Amchem Prods., Inc.* v. *Windsor*, 521 U.S. 591 (1997), the majority specifically held that manageability at trial—typically a predominance concern in certifying a litigation class—need not be considered by a court when certifying a settlement, since the case, by definition, will not go to trial. *Hyundai II*, 926 F.3d at 556–57. Rather, the majority emphasized, when approving settlement classes, courts must give heightened attention to issues regarding protection of absentees by blocking unwarranted or overbroad class definitions. *Id.* at 557 (citing *Amchem*).

In perhaps the two sentences that best embody the thrust of the opinion, the majority stated:

> [W]hether a proposed class is sufficiently cohesive to satisfy Rule 23(b)(3) [the predominance requirement] is informed by whether certification is for litigation or settlement. A class that is certifiable for settlement may not be certifiable for litigation if the settlement obviates the need to litigate individualized issues that would make a trial unmanageable. *Id.* at 558 (citations omitted).

With that as its guide, the appeals court next concluded that the case fell into the variety of consumer fraud cases that, in its view, "readily me[et]" the predominance requirement because "class members were exposed to uniform fuel-economy misrepresentations and suffered identical injuries within only a small range of damages." *Id.* at 559.

A remaining question was what, if any, the effect of different state laws was on predominance. *Id.* at *10. Objectors had argued that the district court abused its discretion by approving the settlement without considering variations in state law that affected claims of used car purchasers. The majority disagreed. Ultimately, it held that the district court only needed to consider differences in state laws if an objector made a threshold showing, under California choice-of-law rules, that a law other than California state law should apply to the claims—and it held that no objector did. *Id.* at 562–64.

Three judges, in dissent, asserted the district court failed to discharge its threshold responsibility to determine what substantive body of law applied to plaintiffs' claims before it certified the class. *Id.* at 575. Among other things, the dissenting judges pointed to precedent that they contend establishes that a district court has an independent, *sua sponte* obligation to determine what law applies before certifying a class, even if objectors do not raise choice-of-law concerns. *Id.* at 577 (citing *Gen. Tel. Co. of SW* v. *Falcon*, 457 U.S. 147, 160–61 (1982)).

Under *Hyundai II*, the Ninth Circuit joins the Third and Seventh Circuits, which have similarly held that courts approving settlement classes need not independently conduct analyses of potential unique state law theories and instead should rely on objectors to identify relevant state law theories at the district court level. *See Sullivan* v. *D.B. Investments, Inc.*, 667 F.3d 273 (3rd Cir. 2011)*; In re: Mexico Money Transfer Litig.*, 267 F.3d 743 (7th Cir. 2001).

***Audet* v. *Fraser*, No. 3:16-CV-0940 (MPS), 2019 WL 2562628 (D. Conn. June 21, 2019)**

The court in *Audet* certified a class in a securities fraud case involving cryptocurrency. Defendant Stuart Fraser and Homero Joshua Garza owned and controlled GAW Miners and ZenMiner (the "Companies"), which offered various products and services related to virtual currency and currency "mining." The Companies eventually launched a virtual currency called "Paycoin." The plaintiffs allege that the Companies made false representations that the price of Paycoin would not drop below a $20 per coin floor, that banks and investment firms were providing financial backing, and that well-known merchants like Amazon would accept Paycoin. The plaintiffs also accused the Companies of operating a Ponzi scheme. They brought claims under federal and state securities laws and common law fraud. They sought to certify a class of all persons or entities who purchased or acquired relevant products during a particular time period.

In granting class certification, the court addressed Rule 23's numerosity, commonality, typicality, adequacy, and ascertainability requirements. *Id.* at *8–13. But the bulk of the opinion dealt with predominance under Rule 23(b)(3). Fraser argued that individualized inquiries predominated over common questions for six issues: (1) eligibility, (2) standing, (3) damages, (4) defenses, (5) loss causation, and (6) reliance. The court ultimately disagreed with most of Fraser's arguments.

1. **Eligibility**. Because the proposed class definition *excluded* any parent, subsidiary, affiliate, agent, or employee of any defendant, Fraser argued that individual inquiries would be required to determine which claimants were affiliates, agents, employees, or co-conspirators. The court concluded that (1) "affiliate" would be straightforward to determine because it should be defined to mean entities under common control with the Companies, and thus would be straightforward to determine; (2) anyone constituting an "agent" of the defendants would be swept in by other terms (like employee or co-conspirator) and so struck the term; (3) employees of defendants could be identified using common evidence; and (4) there would be no more than a few individuals who could possibly be co-conspirators, and a "handful of individualized inquiries as to potential co-conspirators does not defeat predominance." *Id.* at *18.

2. **Standing & 3. Damages**. The court analyzed standing and damages together, concluding they "raise similar concerns." *Id.* at *13. Fraser argued that individual questions as to each would predominate because there was no reliable database or clearinghouse to show who purchased the relevant products and the value they paid for them. The court was unpersuaded; it placed significant hope in the claims

process to sort out these issues, holding that members and damages could "be established by reference to more than one type of document, and as long as proposed class members can show proof of purchase by submitting such documentation during the claims stage, individual inquiries will not predominate." *Audet*, 2019 WL 2562628, at *15. It specifically noted that plaintiffs had randomly selected 20 individuals and they were able to submit documents that were "reasonably uniform and could be used during a claims process." *Id.* The court emphasized, however, that the claims process must provide the defendant a "fair opportunity to challenge the claim to class membership and to contest the amount owed each claimant," and further allowed that if "discovery shows that a material number of proposed class members" received chargebacks that affected their losses, and "that such proof is highly individualized," defendant could file a motion to decertify the class as to damages. *Id.* at *16.

4. **Defenses**. Fraser argued that individual inquiries were required to determine which putative class members engaged in independent fraudulent activity or were *in pari delicto* with the Companies. The court rejected this argument as speculative, since Fraser did not cite evidence that any proposed class member engaged in such fraud, but held that "[i]f Fraser later identifies specific class members who engaged in such fraud, he may raise affirmative defenses as to those individuals." *Audet*, 2019 WL 2562628, at *18.

5. **Loss Causation**. The court rejected Fraser's arguments against loss causation for the same reason it rejected his arguments on reliance, discussed below. The court found that plaintiffs could establish, on a class-wide basis, that it was foreseeable for the Companies' services and products to fail because the representations made regarding computing power and the virtual currency were false.

6. **Reliance**. The most extended predominance discussion centered on reliance. Fraser argued that in a securities fraud case, class certification would generally be denied on reliance/predominance grounds, unless plaintiffs benefitted from presumptions of reliance, either based on fraud-on-the-market or where the misrepresentation was an omission of information—neither of which applied here. *Id.* at *20. But the court held that "[t]he absence of a presumption simply means that the plaintiffs must prove actual reliance; it does not dictate the nature of that proof." *Id.* So the court then considered on what type of proof the class would need to rely to demonstrate reliance. *Id.* at *21 (internal citations and quotations omitted).

The plaintiffs argued that they could establish reliance through common evidence of uniform misrepresentations. Fraser countered that individualized inquiries would predominate as to (i) which mix of information was presented to investors; (ii) how sophisticated each customer was; and (iii) the amount of due diligence that customers performed. To conclude that common questions predominated, the court engaged in a fact- and even document-specific analysis, looking at the specific pieces of evidence Fraser referenced. It also invoked a soft omission/failure-to-disclose argument by noting that all of the information "failed to disclose . . . that the Companies were operating a Ponzi scheme." *Id.* at *22–*23.

The court *did* agree with Fraser on one of his arguments. After a certain point in time, it became clear that there was not, for example, a $20 floor, hundred-million-dollar reserve fund, or adoption of Paycoin by any merchants. *Id.* at *24. Accordingly, the court abbreviated the class period, selecting a final date after which there was clear, publicly available evidence that representations made by the Companies were false.

This decision arguably pushes the bounds of principles that have guided courts in securities fraud cases at the class certification stage. Plaintiffs often rely on the fraud-on-the-market presumption, which did not apply here; they also did not argue *Audet* as an omission case; nor was there a uniform misrepresentation upon which all class members relied. Instead, the court found a mix of misstatements common across the class, and appeared most influenced by the argument that defendants' business was, unbeknownst to investors, a Ponzi scheme. This context will likely limit the applicability of the court's ruling in future cases.

The court's relegation of individual damages issues to the claims administration process was unusual. It is plaintiffs' burden to show that there exists a common damages methodology that can be applied across the class. The court's proposal to manage that aspect of the case entirely through claims administration, by requiring claimants to submit documentary evidence of chargebacks and other third-party transactions, coupled with "audits, verification procedures, and challenges" for defendants, appears to invite the sort of minitrials that the predominance requirement is intended to avoid. Notably, the court invited defendants to pursue further discovery on these issues and move to decertify the class as to damages if the evidence later showed the individual damages issues were material.

* * *

This memorandum is not intended to provide legal advice, and no legal or business decision should be based on its content. Questions concerning issues addressed in this memorandum should be directed to:

Craig A. Benson
+1-202-223-7343
cbenson@paulweiss.com

Jessica S. Carey
+1-212-373-3566
jcarey@paulweiss.com

William A. Clareman
+1-212-373-3248
wclareman@paulweiss.com

Jane B. O'Brien
+1-202-223-7327
jobrien@paulweiss.com

Associates Jessica Finberg and Bethlehem Mebratu contributed to this Client Memorandum.