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RESULTS-ORIENTED CLASS CERTIFICATION: *SCHWAB V. PHILIP MORRIS*

by
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INTRODUCTION

It is an axiom of American class action practice that merely bringing a lawsuit as a class action is not supposed to change the substantive rights of either the plaintiff or the defendant. Class actions are purely procedural aggregate actions, in which a single plaintiff stands in for a large group, and his individual proof is applied to the elements of the claim he brings against the defendant. If the plaintiff can prove his individual claim, then the class may recover as well. But if the plaintiff's lawsuit cannot be tried exclusively with classwide proof (*i.e.*, evidence presented by both plaintiff and defendant that is equally applicable to all class members), then it is not appropriate for class treatment.

Throughout his career, United States District Judge Jack B. Weinstein (E.D.N.Y.) has eschewed this modest view of the class action device. Instead, Judge Weinstein believes that class actions should be used creatively to resolve (or induce

defendants to settle) nationally prominent controversies (such as Agent Orange and asbestos) that involve huge numbers of alleged victims seeking damages based on their exposure to a common allegedly defective product. As one admirer wrote:

> Judge Jack Weinstein exemplifies public law judging, with all the virtues and vices of that phenomenon. He exhibits bold, pragmatic responsiveness to complex problems. He combines brilliant technical and deft personal abilities to manage polycentric disputes. But he treats rules like pipe cleaners to be bent or tossed aside.[1]

In his latest opinion, Judge Weinstein applies his preference for "public law judging" to the high-profile, high-stakes arena of tobacco litigation. In his September 25, 2006 decision in *Schwab v. Philip Morris*, Judge Weinstein certified a nationwide class action of millions of "light" cigarette purchasers who seek economic damages stemming from their purchases of those products — their theory being that they were duped into paying more than the cigarettes' fair market value because they believed their labeling as "light" or "low-tar" meant they were safer than regular cigarettes. And, while acknowledging the likelihood that defendants would seek interlocutory appeal of his landmark ruling via Federal Rule of Civil Procedure 23(f), he sought to undermine the practical effectiveness of that appeal by setting a trial date of January 22, 2007 and by ordering the parties to submit key trial planning materials by late-October, 2006.

The theme of Judge Weinstein's ruling is that some mass-tort lawsuits (like

tobacco) are so large that traditional due process concepts must be subordinated to litigation "efficiency" and the jury's ultimate right to decide whether the defendant has acted wrongly. In his 540-page ruling denying defendants' summary judgment motions and granting plaintiffs' class certification motion, Judge Weinstein holds that, for particularly large alleged frauds, a court can presume that all consumers relied on the allegedly fraudulent statement or omission. He also holds that a court need not hear individual proof of injury or damages in class actions like this, but may instead rely upon statistical damage theories advocated by experts. While both of these principles may to the layman appear admirable, or even necessary, when invoked against a controversial industry which produces a risky product, these principles (unless reversed by the appellate courts) regrettably establish legally questionable precedents that surely will be invoked by other plaintiffs suing other companies that do not have the same unpopular legacies.

When stripped of its context as part of the plaintiffs' bar's ongoing war on tobacco,[2] the *Schwab* class certification order is the epitome of a sweeping, results-oriented decision that will create litigation mischief unless reversed.

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[1]M. Minow, *Judge for the Situation: Judge Jack Weinstein, Creator of Temporary Administrative Agencies*, 97 COLUM. L. REV. 2010 (1997).

[2]Order at 148 ("Critical in this analysis is context: defendant's recent representations must be viewed in light of the marketing campaigns and public statements of the previous thirty years.").

I. FACTUAL BACKGROUND

The plaintiffs in *Schwab* (a group of smokers) contend that the defendants (the major tobacco companies) marketed their light cigarettes as "less harmful than 'regular' cigarettes, when in fact they were at least as harmful and defendants knew of their dangers.[3] The *Schwab* plaintiffs asserted claims for RICO fraud and sought relief primarily in the form of monetary damages.

Judge Weinstein is no stranger to class actions. He has been on senior status for 16 years, which allows him to select which cases he wants to hear, and he has primarily chosen to handle complex litigation.[4] Judge Weinstein has a reputation for "creative" solutions to problems posed by complex litigation, solutions that have often been reversed by the appellate courts, giving him the nickname "Reversible Jack."[5] In this case, Judge Weinstein certified a class of

> All United States residents who purchased in the United States, not for resale, cigarettes labeled as "Lights" and/or "Light" (collectively "light cigarettes") that were

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[3]Order at 16.

[4]*See, e.g., In re Agent Orange Prod. Liab. Litig.*, 506 F. Supp. 737 (E.D.N.Y. 1979); 597 F. Supp. 740 (E.D.N.Y. 1984) (certifying class action of current and future Agent Orange victims that established structure for processing claims of individual victims); *In re Joint Eastern & Southern Dist. Asbestos Litig.*, 129 B.R. 710 (E.D.N.Y. 1991) (approving class settlement in consolidated asbestos litigation); *City of New York v. Beretta U.S.A. Corp.*, 315 F. Supp. 2d 256 (E.D.N.Y. 2004) (allowing "public nuisance" lawsuit by New York City against handgun manufacturers to proceed).

[5]*See, e.g.*, Charles T. Kammett, Book Note, *Rethinking Mass Tort Law*, 105 YALE L.J. 1713, 1714 & n.8 (1996) ("[Judge Weinstein's] ad hoc 'communitarian' solutions to the problems he faces have resulted in appellate reversals frequently enough to earn him the nickname 'Reversible Jack.'").

> manufactured and/or sold by Defendants during the period commencing on the first date that Defendants began selling light cigarettes until the date trial commences (the "Class Period"), and who are not, as of the trial date, members of a certified state class seeking economics damages stemming from their purchases of light cigarettes or having obtained an award of, or a denial of, such damages.[6]

He found that plaintiffs had met their burden of showing numerosity,[7] commonality,[8] typicality[9] and adequacy.[10] He did refuse to certify a 23(b)(2) class, on the grounds that plaintiffs are primarily seeking "financial compensation for the past fraud allegedly perpetrated on them." But he found that plaintiffs had met their burden under Rule 23(b)(3) to show that common issues predominate over individualized issues,[11] and that a class action is superior to other forms of

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[6]Order at 539.

[7]Order at 178 (class "is reasonably believed to be in the tens of millions").

[8]Order at 181 (finding commonality because "Plaintiffs allege both a common course of conduct: the deliberate misleading of the public concerning the relative health risks of 'light' cigarettes through significant and widespread advertising campaigns; and a conspiracy: the collusion between the various defendant companies in perpetrating this alleged fraud through many predicate acts committed by all of them").

[9]Order at 185 ("Though the specific factual circumstances for the proposed plaintiffs may not be identical to those of everyone in the million-plus member putative class, a virtually impossible condition, they share the common traits that define the class: arguably, they purchased 'light' cigarettes under the reasonable belief in defendants' knowingly false representations that they were a safer alternative to regular cigarettes which would deliver less tar and nicotine.").

[10]Order at 193-98 (adequacy of individual named plaintiffs is irrelevant because defendant's conduct is focus of trial).

[11]Order at 220-33.

litigation.[12]

II. PRESUMING RELIANCE

Most attempts to certify fraud-based claims for classwide litigation fail due to the need to prove reliance upon either the defendants' allegedly fraudulent statements or omissions through claimant-specific testimony and trials. The *Schwab* order side-steps this impediment by declaring that all class members may be presumed to have relied upon the defendants' purported fraudulent acts to their detriment:

> [Plaintiffs] propose to avoid the other main problem with smokers' class actions: conduct and motive differences among members of the class. Individuals start and quit smoking and choose various types of cigarettes for different reasons and suffer wide variations in possible harm, creating different specific causation and damages issues attributable to each class member. If plaintiffs' experts are to be credited in the testimony promised by plaintiffs' counsel, economic loss of value in purchases of cigarettes allegedly touted as 'lighter' when they are not safer avoids this problem of human diversity: first, by the equivalent of statistical averaging and, second, should the jury determine total damages to the class, division of the damages based on claims of smokers for the relative number of cigarettes they bought during the applicable liability period, with unclaimed proceeds to be distributed on a cy pres basis.[13]

In other words, Judge Weinstein certified a light cigarette class based on a fraud-on-the-market theory — a theory that normally applies only to securities

[12]Order at 215 (given use of statistics for proof, class action superior to individual actions).

class actions. Under a fraud-on-the-market theory, a court may presume reliance in cases — like securities fraud — where a perfect information market exists, such that any fraudulent conduct can be expected to affect the sales price of the good or service at issue.[14] As the United States Supreme Court discussed in adopting the theory, "[t]he modern securities markets, literally involving millions of shares changing hands daily, differ from the face-to-face transactions contemplated by early fraud cases, and our understanding of Rule 10b-5's reliance requirement must encompass these differences."[15]

The Supreme Court took pains to point out, however, that its adoption of the fraud-on-the-market theory was based on the unique factual circumstances associated with securities markets — particularly the fact that they respond rapidly and efficiently to changes in information, making them particularly susceptible to misinformation disclosed to the public at large.[16] It is doubtful that there is an efficient market for cigarettes, which are not just consumer goods, but consumer goods that contain the addictive substance nicotine, which skews the decision-

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[13]Order at 19.

[14]*See generally Basic v. Levinson*, 485 U.S. 224 (1988).

[15]*Basic, Inc.*, 485 U.S. at 243-44 (footnotes omitted).

[16]*Basic, Inc.*, 485 U.S. at 246-47 (footnotes omitted) ("Recent empirical studies have tended to confirm Congress' premise that the market price of shares traded on well-developed markets reflects all publicly available information, and, hence, any material representations. … Because most publicly available information is reflected in market price, an investor's reliance on any public material misrepresentations, therefore, may be presumed for purposes of a Rule 10b-5 action.").

making process of the many individuals who buy them.[17] The *Schwab* opinion noted this distinction,[18] but declined to apply it, claiming that "the place of addiction in this suit remains unclear."[19]

The *Schwab* order conceded that the civil RICO statute requires proximate causation, which means that, to prove a fraud-based civil RICO claim, plaintiffs must prove that they relied upon defendants' alleged fraudulent conduct to their detriment.[20] It also conceded that the question of reliance would have significant impact in individual cases.[21] But it held that the court may presume reliance for now, and allow plaintiffs to prove it once and for all in satellite proceedings,[22]

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[17]*See, e.g.*, Gary Becker and Kevin M. Murphy, *A Theory of Rational Addiction*, 96 J. OF POLITICAL ECON. 675 (1988) (demand (and therefore price) for addictive substances depends on past consumption more than market information); Becker, Gary S., Grossman, Michael and Murphy, Kevin M., *An Empirical Analysis of Cigarette Addiction*, NBER Working Paper No. W3322 (1994-08-01) (cigarettes follow rational addiction model).

[18]Order at 151 ("Securities investors, a jury might find, are more likely to follow details of disclosure than lay smokers since the former are trying to protect their investments, while the latter are, in the main, following a habit embedded by addiction.").

[19]Order at 195.

[20]Order at 66-67.

[21]Order at 23 ("There is considerable merit to defendants' experts' position that many, if not all, the plaintiffs would have bought these light cigarettes even if they knew they provided no health advantage over regular cigarettes, and that they received full value for their money.").

[22]Order at 210-11. This is a misreading of *Carnegie v. Household Int'l., Inc.*, which did not hold that a court could presume reliance in a civil RICO class action. Instead, the *Carnegie* court held that the issue of whether the defendant violated the RICO statute could be bifurcated from the question of whether the plaintiff was harmed as a result of that violation, which might then be tried in satellite proceedings. *Carnegie v. Household Int'l., Inc.*, 376 F.3d 656, 663 (7th Cir. 2004), *cert. denied*, 543 U.S. 1051 (2005).

because the "nature of reliance is not a constant."[23] In other words, according to *Schwab*, if the case is large enough, a plaintiff should not have to prove reliance on an individual basis:

> Where … the fraudulent scheme is targeted broadly at a large population of the American public the requisite showing of reliance is less demanding. Such sophisticated, broad-based fraudulent schemes by their very nature are likely to be designed to distort the entire body of public knowledge rather than to individually mislead millions of people. From the perspective of the fraudulent actors, clear efficiencies are gained by co-opting the media and other outlets of information as unwitting tools for the pervasive scheme. [24]

Given this sweeping standard, it is particularly striking that the *Schwab* court conceded that it does not yet know what fraudulent statement all "lights" cigarette buyers supposedly relied upon.[25]

The *Schwab* opinion conceded that the circuits have split over whether courts can presume reliance in civil RICO cases. Order at 209 (discussing *Sandwich Chef of Texas, Inc. v. Reliance Nat'l Indem.*, 319 F.3d 205 (5th Cir. 2005) (refusing to certify civil RICO class because individual questions of reliance would predominate) and *Carnegie* (suggesting violation of civil RICO could be tried in main trial, with individual reliance tried in satellite proceedings)). Oddly, however, it made no mention that the Eleventh Circuit has also weighed in against presuming reliance. *See Sikes v. Teleline, Inc.*, 281 F.3d 1350 (11th Cir. 2001) (declining to certify civil RICO class because individualized proof of reliance would predominate); *Klay v. Humana, Inc.*, 382 F.3d 1241 (11th Cir. 2004) (same).

[23]Order at 72.

[24]Order at 72, quoting without attribution *Falise v. Am. Tobacco Co.*, 94 F. Supp. 2d 316, 335 (E.D.N.Y. 2000).

[25]Order at 228 ("First, the question of what was promised has not yet been decided. Whether the promise, explicit or implicit, in defendants' advertising campaign was the delivery of less tar and nicotine or a healthier cigarette is a question … best decided by a jury …").

III. OTHER SWEEPING AGGREGATIONS

In addition to his attempt to create a fraud-on-the-market theory for cigarettes, Judge Weinstein argued that the use of statistical proof and the "law of large numbers" eliminate any other troubling questions of individualized proof:

> The question . . . [is] whether the American legal system, faced with an alleged massive fraud, must throw up its hands and conclude that it has no effective remedy for what at this stage of the litigation must be assumed to be a huge continuing violation of consumers' rights. In the American legal system, whose watchword has been, as already noted, "no right without a remedy," the answer is that modern civil procedure, scientific analysis, and the law of large numbers used by statisticians provide a legal basis for a practical and effective remedy.[26]

This is not the only sweeping aggregation the court employed. It also waved aside defendant's objections to using aggregated proof (such as marketing surveys) as evidence of group reliance.[27] It held that it could aggregate the defendants into a single, common entity for purposes of proving a generalized deception on the cigarette market.[28] And, while the court conceded that proving which class

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[26]Order at 24.

[27]Order at 226-27 ("Substantial evidence supports plaintiffs' position that the defendants used general "proof" in the form of marketing research and customer surveys, to determine how to advertise and promote their products to actual and potential smokers. ... Why, plaintiffs properly ask, should they be precluded from seeking recovery as a class when defendants treated them as a class in allegedly defrauding them.").

[28]Order at 185 ("Unfounded is defendants' objection to the aggregation of the many brands of 'light' cigarettes into one suit. Plaintiffs' expert report appears to show sufficiently that the marketing of all 'light' cigarettes was characterized by certain common advertising techniques including, but not limited to, the use of the 'light' designation.").

members were subject to the statute of limitations would be extremely complicated because the population of smokers is not static,[29] and class members' knowledge of the health risks of light cigarettes varied,[30] it held that the court could use statistical evidence (relying on the "law of large numbers") to bypass the problems in proving the statute of limitations on an individualized basis.[31]

The court also assumed (without substantial analysis) that a class action would be manageable (therefore meeting the superiority requirement of Rule 23(b)(3)) because of the use of statistics.[32] While the opinion conceded that some smokers act differently from others, it held that those differences are unimportant given the smokers' common decision to switch to light cigarettes.[33]

Leaving aside the fact that statistical surveys used for the purpose of marketing a product are not necessarily the same thing as legally admissible evidence (for one thing, they do not have to meet the standards of Federal Rule of Evidence 702), federal courts are properly reluctant to rely too much on statistical

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[29]Order at 116.

[30]Order at 123.

[31]Order at 114. The court also held that the statute of limitations was a merits issue, and so should not be considered at the class certification stage. Order at 223.

[32]Order at 215.

[33]Order at 221 ("All these objections are based on defendants' position that each smoker differs from every other smoker – and any one smokers' behavior differs from one day, or one cigarette, to the next. While superficially true, the argument is overstated. The putative class contains only smokers of 'light' cigarettes, one segment of the cigarette market.").

proof in consumer fraud class actions.[34] In this case, however, the *Schwab* opinion was not so much concerned with how those statistical procedures may properly be applied as it was with the conduct of the defendants.[35] In fact, it used the same justification for aggregating proof as it did for presuming reliance — that the defendants' conduct justifies certifying a class all on its own:

> Where a defendant specifically targets a large group and knowingly relies on the group's dynamics and communications to succeed in a fraud, that group may assert its 'group rights' in holding the defendant accountable for its conduct. The RICO mail and wire fraud federal substantive law and the Rule 23 federal procedural law together provide a powerful tool for satisfying the community's basic sense of fairness while protecting defendants' due process rights. Utilization of the class action does not change the lawful conduct to be expected of the defendants when the alleged conspiracy was operative.[36]

IV. BAD CASES MAKE BAD LAW

Judge Weinstein's attempts to justify certifying an enormous, admittedly diverse, class for *en masse* litigation by adopting a presumption of reliance in civil RICO cases, aggregating the defendants into a common entity, and using only

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[34]*See, e.g., Barnes v. Am. Tobacco. Co.*, 161 F.3d 127, 135 (3d Cir. 1998) (generalized statistical proof cannot be used as substitute for individualized proof of causation in proposed tobacco class action); *In re Ford Motor Co. Ignition Switch Liab. Litig.*, 194 F.R.D. 484, 491-95 (D.N.J. 2000) (refusing to allow statistical proof of causation to create "rebuttable presumption" of liability in proposed class action).

[35]Order at 225 ("In such a case, attention is properly trained on defendants' alleged misconduct, not minor differences in plaintiffs' reaction to it.").

[36]Order at 227.

aggregated proof, are all troubling holdings that depart noticeably from well-established precedents of other federal district courts. More troubling still are the court's attempts to justify the presumption of reliance in this case. First, the opinion argues that the presumption applies because it is required by the "group rights" of the defrauded.[37] Later, it pushes this idea even further, and ties it to the size of the alleged fraud:

> The equity in allowing statistical proof of reliance and causation is underscored by the massive nature of the fraud alleged. ... By carrying out this alleged widespread scheme, it was the defendants themselves who made a claim-by-claim showing virtually impossible. [38]

This sweeping "size matters" doctrine raises disturbing questions. How large does the group of defrauded individuals have to be before normal legal principles will be cast aside in order to facilitate *en masse* litigation? How massive does the alleged fraud have to be before courts will water-down the traditional requirement of reliance in order to facilitate recovery?

It is an "age old maxim" that bad cases make bad law.[39] In this case, because a single district court judge apparently believes that an entire industry engaged in a massive conspiracy to defraud the public, he has set a precedent that any allegation

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[37]Order at 227.

[38]Order at 488.

[39]*See Gichner v. Antonio Troiano Tile & Marble Co.*, 410 F.2d 238, 249 (D.C. Cir. 1969) (Tamm, J., dissenting in part).

of a "widespread scheme" allows a court to sweep aside the requirement of causation and the necessity of proof specific to individual plaintiffs and individual defendants. This is not "creative" judicial management; it is the same kind of "certify now, ask questions later" approach that has led to many appellate reversals of results-oriented activist class certification orders. If the U.S. Court of Appeals for the Second Circuit has the chance to hear this appeal,[40] it will likely do so again here. The big question, however, is whether Judge Weinstein's famous ability to insulate his decisions from effective appellate review — displayed here by his scheduling of a massive trial before any interlocutory appeal can likely be heard — will force defendants to settle a case that, procedurally, should not qualify for *en masse* litigation.

[40]The court refused to certify its order for interlocutory appeal (Order at 538), refused to stay the proceedings (*id.* at 539), and set a trial date beginning in January, 2007. (*Id.* at 540.) These holdings all appear designed to discourage any appeals, and make any Rule 23(f) petition (which does not stay proceedings in the lower court) ineffective.