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Problem multiplied

Why businesses should care about class actions.

When can a minnow grow into a whale? Ask Benton Harbour, Mich.-based washing-machine manufacturer Whirlpool Corp., which recently asked the Supreme Court for help reeling in leviathan litigation filed against it. The justices, in the end, left Whirlpool to the mercy of the Ohio courts, but the case illustrates the difficulty faced by businesses sued by a "class" for a small problem.

Although the Supreme Court refused to tackle Whirlpool's case head-on, the court has been very active confronting class actions during the last 18 months. This started when the Supreme Court dissolved a class of female Wal-Mart employees in the largest employment-discrimination class action ever filed in the U.S. Rulings in favor of Philadelphia-based Comcast Corp. (sued by customers complaining of being overcharged) and Dallas-based AT&T Inc. (sued by customers over cellphone contracts) further cut back on class actions.

But, as Whirlpool can attest, the class action has hardly gone belly up. In 2005, two Ohio women each bought Whirlpool Duet washing machines. They were not fond of their purchases and alleged that their washing machines were moldy and contained a "pungent odor." Businesses never want to disappoint customers, but Whirlpool's problems became more pronounced when these two went to see some lawyers. Before long, the lawyers had retained expert witnesses in the disciplines of "laundry technology" and microbiology, and Whirlpool found itself before a federal judge, who had to decide if the two women could represent a class of persons who also purchased allegedly smelly, moldy washing machines from the defendant.

Just how hard is it for a case brought by two consumers with a small problem to morph into a massive class action? It's not very hard at all. The recipe is straightforward. First add a few paragraphs to the complaint alleging that the plaintiff is bringing the case on behalf of "others similarly situated" and that the case involves "common questions." Then find a judge who will rule that the case can proceed as a class action.

The two Ohio women found such a judge. This illustrates an important fact involving class actions: One judge, who is entrusted with broad discretion on the subject, decides whether a case should be about one plaintiff or, potentially, more than a million of them. What many businesses don't realize is that this decision — which is likely the most important one any trial judge makes in a civil case — is not based on the merits of the case. The judge makes a decision about the certification of a class on allegations, not proof. Essentially, the judge asks: Is this the kind of case that can fairly and efficiently be decided on a class-wide basis? And the decision of that one judge can be well-nigh conclusive on the subject. Although class-action rulings may be appealed, the higher court does not have to accept the case.

The legal system works if the participants believe it operates fairly. Whether you are a consumer or a business, you want a court to use facts and laws to decide the merits of your case. But obtaining that type of justice can be difficult when dealing with class actions. That is because the judge's decision whether to certify the class action is, in most cases, vastly more important than whether the underlying claims have merit. Whirlpool explained to the trial judge, among other things, that mold growth in its washing machines is quite rare. But that didn't matter to the judge. That question could be decided — on behalf of the

entire class — at a trial later in the case. But that's a superficial proposition. And it explains why class actions — and the rules governing them — are so important. There are no trials of class actions. A federal district court in Ohio will never convene a jury to decide whether washing machines are in fact moldy or smelly.

There is a simple reason for this, and it is based purely on economics. A decision by a trial judge to certify a class action transforms an ordinary, manageable dispute into "bet-the-company" litigation. Few businesspeople or their insurers want to risk the company on a collective decision made by six or 12 individuals whose life experiences and biases are barely known to them. So what do defendants do when a judge certifies a class of plaintiffs to proceed against them? They figure out a way to get the judge to change his mind, or they settle the case. This is why Judge Henry Friendly, a well-respected jurist, has stated that class actions lead to "blackmail settlements." He says these settlements are "induced by a small probability of an immense judgment in a class action."

Whirlpool's decision to settle this case won't be based on whether its washing machines work properly. Its decision will be based on a risk analysis of suffering a class-wide liability determination and the cost of defending the case. This reality is not unknown to the Supreme Court. Justice Scalia, in ruling for Bentonville, Ark.-based Wal-Mart Stores Inc., emphasized that unless there is "glue" holding all of the plaintiffs together and the "validity of each one of the claims" can be resolved in "one stroke," the case can't proceed as a class action. Federal and state trial judges pay attention to the directions provided by the Supreme Court on this subject. But make no mistake: The fight over whether a case will become a class action is not a battle. It is a war. And a business faced with this prospect must be prepared to treat it that way.

The enormity of this decision is why many businesses have begun to endorse arbitration to resolve disputes, but proceeding in arbitration is not a panacea. You are stuck with what one arbitrator thinks about the case. There is no way to get rid of a frivolous case early in arbitration, and there is no appeal. But the Supreme Court has held that a business can enter into an enforceable arbitration agreement with an individual that will prevent him from bringing a class action. So AT&T is able to resolve contentions that it promised "free cellphones" to wireless customers in individual, one-on-one arbitration proceedings. And Compucredit and Nationwide Budget Finance, each sued in New Hanover County for consumer financial violations, don't have to face class-action proceedings under a recent appellate decision by the North Carolina courts.

Although a judge's decision to certify a class is momentous, particularly because appeal prospects are uncertain, it isn't written in stone. For the most part, a class-certification decision is made reasonably early in the litigation. As the case progresses and the facts become clearer, a judge can have a change of mind. A certification decision is "conditional" and "tentative" and can be revoked at a later stage in the case. Robinson Bradshaw, for example, recently persuaded a federal district judge, who had certified a class and then denied a motion to reconsider that ruling, to reverse his decision because the evidence showed that the matters challenged were too individualized to be decided all at once. That meant the client didn't have to let a jury decide whether it had to pay more than $100 million in damages to a group of independent contractors.

Few decisions in the arena of civil litigation affect businesses like class-action rulings. They are critical to the administration of justice and the assessment of business risk. In this arena, perhaps more so than any other, what appellate courts say about the legal standards matters greatly to business.

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