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OUTSIDE COUNSEL

Adequacy of Class Representatives and Counsel Under CPLR Article 9

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The class action rule of federal practice, Fed.R.Civ.P. 23, was amended in 2003 to state specific criteria for federal courts appointing class counsel after certifying a class action. While Rule 23, as amended, says little about the qualifications for the appointment of class representatives, in appointing class counsel Rule 23(g)(1)(A) states that courts "must consider" not only counsel's "experience in handling class actions," but also counsel's experience with "the claims asserted in the action" and "knowledge of the applicable law." Fed.R.Civ.P. 23(g)(1)(A)(ii)&(iii).

The New York Legislature has yet to mount a comparable effort to reform CPLR Article 9, the class action rules for New York practice. In 2003 the New York City Bar Association adopted a report of the Council on Judicial Administration and the Committee on State Courts of Superior Jurisdiction proposing amendments to Article 9, but adequacy of counsel was not an element of that report.[1] Those committees are working on a new report, anticipated for completion in the autumn, which will contain a proposal to adapt the new Federal Rule 23(g) to state practice. (The author has helped lead and participated in these efforts.)

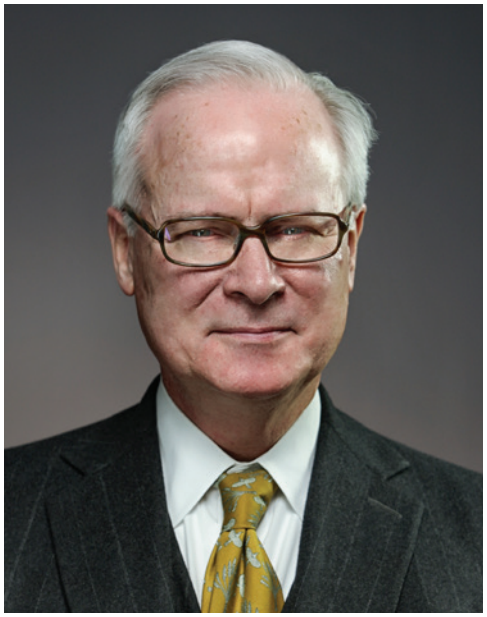
Recent decisions of New York's trial courts, however, suggest that courts already are giving greater scrutiny to class certification motions seeking the appointment of class representatives and class counsel, adopting Rule 23(g)'s focus on the experience of counsel and considering the qualifications of the proposed class representative.

This article summarizes the sparse guidance provided by the CPLR on such appointments, and reviews five recent decisions addressing adequacy issues.

Prior Case Law

Article 9 of the Civil Practice Law & Rules provides only skeletal criteria for the appointment of class representatives and virtually none for the appointment of class counsel. CPLR 901(a)(4) prescribes as one of the "prerequisites to a class action" that the plaintiffs may sue on behalf of a class "if…the representative parties will fairly and adequately protect the interests of the class."

CPLR 907(2) authorizes a court to require notice to provide class members with "the opportunity…to signify whether they consider the representation fair and adequate…." As far as they go these provisions warrant no criticism—they have been in the CPLR since enactment of the new Article 9 in 1975, and parallel language has existed in the Federal Rules of Civil Procedure since the current rules were adopted in the mid-1960s.[2]



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Under these rules New York courts traditionally have held that the factors to be considered in determining adequacy of representation are "whether any conflict exists between the representative and the class members, the representative's familiarity with the lawsuit and his or her financial resources, and the competence and experience of class counsel."[3] A representative was adequate if he or she had a "general awareness of the claims and the litigation…"[4] and retained counsel that was "competent and zealous."[5] Prior

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to amendments to Federal Rule 23 in 2003, federal courts addressing adequacy also focused on the absence of interests antagonistic to the members of the class and representation by competent counsel.[6]

Applying these two rules of the CPLR left a great deal of room for subjective judgment calls. For example, in *Ackerman v. Price Waterhouse* (cited in fn.3), the trial court criticized the proposed class representative as being "an unsophisticated investor" who failed to understand the claims of the case, and sanctioned her counsel for making the class certification motion. 252 A.D.2d at 201-02. On appeal the Appellate Division, First Department, reversed the finding of inadequacy based on the representative's "general awareness of the claims and the litigation, as demonstrated in her deposition…," and found the sanctioned class counsel to have "amply demonstrated its experience and skill in class action litigation." The court vacated the sanctions and granted the certification motion for a limited class. Id. (The author was lead counsel for the plaintiffs.)

Recognizing that greater guidance to courts was warranted, in 2002 the Committee on Rules of Practice and Procedure of the Federal Judicial Conference provided a report to the Chief Justice of the U.S. Supreme Court noting that "adequacy of counsel has been considered only indirectly as part of the Rule 23(a)(4) determination whether the named class representatives will fairly and adequately protect the interests of the class," referring to the language also found in CPLR 901(a)(4).

The report proposed amending the rule to "build on experience under Rule 23(a)(4) and fill the gap by articulating the responsibility of class counsel and providing an appointment procedure."[7] The result was the new Rule 23(g), an adaptation of which the city bar committees are proposing for the CPLR.[8] But even with no parallel yet in the CPLR, New York courts seem implicitly to be following Rule 23(g)'s guidance on adequacy issues.

More Objective Consideration

Recent cases suggest that New York courts may be scrutinizing certification motions more objectively, by requiring evidence of (i) the putative representative's personal stake in the case and its ability to serve as a check on counsel, and (ii) class counsel's knowledge of substantive law as well as class action practice.

For example, in two cases seeking certification of classes for wage and hour claims, courts in New York and Albany counties noted specifically that plaintiffs' counsel were well versed in both wage and hour law and in class action law. *Ryan v. Volume Services*, N.Y. Co. Index 652970/2012, 2013 NY Misc. Lexis 932 (Dec. 7, 2013); *Picard v. Bigsbee Ent.*, Albany Co. Index No. 1984/2013, 2014 N.Y. Slip. Op. 51113(U) at *1, 44 Misc.2d 1214(A)(June 24, 2014). In addition, the Picard court specifically cited to the plaintiff-representative's experience with the practices challenged by the action, finding his affidavit demonstrated his "adequate knowledge of the facts…based on his employment" during the class period. Id. at *1 & 4.

Scrutiny of a putative class representative and its counsel yielded an opposite result in an unreported decision released earlier this year by the Supreme Court for New York County, *City Trading v. Nye*, N.Y. Co. Index No. 651668/2014, 2015 WL 93894, 2015 NY Slip. Op. 50008 (Jan. 7, 2015). A summary of the facts is necessary to understanding the court's handling of the adequacy issues.

The City Trading complaint challenged the adequacy of proxy statement disclosure soliciting approval of a merger between Martin Marietta Materials, Inc. and Texas Industries, Inc. On the eve of a preliminary injunction hearing, the parties settled the case on the basis of supplemental disclosures regarding the settlement and an agreement for the payment of attorney fees. Id. at *2. The court concluded that defendants had agreed to the supplemental disclosures and the payment of attorney fees because of "significant and irreparable" costs that would be incurred by delays. Id. at *1.

The court had already criticized the terms of a release as originally proposed, because it might have precluded claims such as breach of fiduciary duty that were not raised in the complaint. Id. at *1 & 10 n.11. Even with a more limited release, however, the court found the supplemental disclosures not material and found the litigation "frivolous." Id. at *20. The court denied the motion for certification of a settlement class and approval of the settlement, and directed defendants to answer the complaint or move to dismiss. Id. at *22. The docket indicates that case was dismissed on the merits, while preserving for plaintiffs a right to appeal the order disapproving the settlement. N.Y. Co. Index No. 651668/2014, NYSCEF Docs. 112 & 113.

The case is significant to a discussion of adequacy of counsel because, in addition to finding that the settlement was not fair, adequate and in the best interests of the class, the court found that the plaintiffs and their counsel were "ill-suited to represent the class." Id. at 22. The court concluded that the plaintiff was "essentially a fictitious entity," and that "where a proposed class representative appears to be a fiction, there is the concern that it has no accountability, either to the class or to the court," and could not "act as a check on the attorneys" in order to ensure that "the interests of the members of the class will take precedence over those of the attorneys." Id.

The court agreed with defense counsel that, as a "fictitious entity," the plaintiff's interests conflicted with the interests of the class, and that this "fundamental conflict" caused class counsel "to advance meritless claims…resulting in awards of attorneys' fees that are

wholly out of proportion to any real benefit conferred on shareholders." Id. at *9.

A second recent case involving the adequacy of class counsel in negotiating a settlement is *Gordon v. Verizon*, N.Y. Co. Index No. 653084/2013, 2014 WL 7250212, 2014 N.Y. Slip Op. 33367(U) (Sup. Ct., N.Y. Co., Dec. 19, 2014). Like the City Trading case, *Gordon* involved a challenge to disclosure materials seeking shareholder approval of Verizon's acquisition of a minority interest in Verizon Wireless. Settlement once again was based on supplemental disclosures and the payment of attorney fees.

Objections made by two shareholders "moved the court to take a second look" at the settlement "and more closely scrutinize it as part of the court's final determination of whether it truly is fair, adequate, reasonable and in the best interests of class members." Id. As in *City Trading*, the court in *Verizon* was concerned that the class "was being divested of valuable rights in the form of a broad release of claims" proposed as part of the settlement, and the divestiture of these rights "cannot be justified by trivial disclosure adjustments" that did not provide material additional information about the transaction. Id. at *4.

After detailed review, the court found that the supplemental disclosures did not "materially enhance the shareholders' knowledge about the merger ..., [and] provide[d] no legally cognizable benefit to the shareholder class...." Id. at *11-12. While the court did not address directly the adequacy of the class representative or its counsel, criticism was implicit in the court's quoting authority on "the incentive of class counsel, in complicity with the defendant's counsel, to sell out the class by agreeing with the defendant" to a settlement involving "a meager recovery for the class" but legal fees for class counsel and a broad release provided to the defendant. Id. at *8-9 (citing C*reative Montessori Learning Centers v. Ashford Gear*, 662 F3d 913, 918 (7th Cir. 2011). The court rejected the proposed settlement. Id. at *14.

Notice Requirements

CPLR 908 sets forth the requirements for judicial approval and notice requirements for the settlement of class actions. They are considered here because the Appellate Division has held that providing notice should be viewed as a fiduciary responsibility and performance as a fiduciary may be considered in an adequacy determination. CPLR 908 reads:

> A class action shall not be dismissed, discontinued, or compromised without the approval of the court. Notice of the proposed dismissal, discontinuance, or compromise shall be given to all members of the class in such manner as the court directs.

The language is essentially the same as Rule 23(e) of the Federal Rules of Civil Procedure from 1966 to 2003.[9]

The question is whether the term "class action" as used in CPLR 908 includes actions pleaded as class actions but not yet certified. The First Department concluded that an action pleaded as a class action is a class action for purposes of CPLR 908, and that notice of settlement is required. *Avena v. Ford*, 85 A.D.2d 149 (1st Dept. 1982). The decision has been criticized, and some thought it had been abandoned in the 30 years that have passed, but a May 1 decision by the Supreme Court for New York County held that *Avena* is still good law. *Vasquez v. National Securities*, N.Y. Co. Index No. 155613/2014, 2015 WL 1963675 at *2 (May 1, 2015).

Avena's facts illustrate how CPLR 908 applies to pre-certification settlements. Plaintiffs brought a class action arising out of defective engine blocks. Ford Motor Company settled with the two named plaintiffs for reasonable relief and paid $6,000 for their attorney fees. The Supreme Court denied a motion for approval of the settlement because it did not provide for class notice, and the First Department affirmed. 85 A.D.2d at 151-52.

The First Department's view was that the obligations assumed by named plaintiffs pleading a class action, including the notice obligation, were fiduciary in nature, and that "[i]t is a basic duty of a fiduciary to disclose all relevant facts to his beneficiaries." 85 A.D.2d at 152-53. In a line seemingly designed to discourage class pleadings, the court stated: "Fiduciary obligations should not be lightly assumed and cannot be lightly discarded." 85 A.D.2d at 156. The Vasquez court, while appearing not to be so rigid, did acknowledge this fiduciary analysis. *Vasquez* at *1 n.1.

Of equal concern to the court, however, was potential abuse of the class action device for the plaintiff's personal benefit.

> [T]he potential for abuse in a private settlement even before certification [is] widely recognized. The requirement of notice to the class makes settlement more difficult, perhaps even impossible in some cases. But of course CPLR 908 intends to make settlement of class actions somewhat more difficult as part of the price of preventing abuse.

85 A.D.2d at 153.

It is unlikely that any party wants notice where no class has been certified. The defendant wants no publicity and the plaintiff wants no costs, which under CPLR 904(d)(1) it might have to pay. See CPLR Commentary, CPLR 908, C908.2. The CPLR commentary also points out that the settlements will have no res judicata effect without certification, and judiciary review should be enough to prevent abuse. The Vasquez court held, however, that it "must follow the Appellate Division's clear precedent," that *Avena* is still good law, and that any change should come from the Legislature or the appellate courts. *Vasquez* at *2.

In its 2003 report, the city bar advocated amending CPLR 908 to provide that any action pleaded as a class action should be dismissed only after court approval, but that notice should be required only when necessary to pro-

tect members of the putative class. At the time, a proposal was pending to amend the federal rule to remove both the judicial approval and notice requirements,[10] but the city bar proposal retained the requirement of judicial approval.[11] The final amendment of Rule 23(e) of the Federal Rules followed the approach advocated by the city bar, and is now in Fed.R.Civ.P. 23(e).

Current Class Action Practice

What do these five cases tell us? They are not a statistical sampling of class action litigation under the CPLR, but they are enough to suggest the following:

1. In considering class certification motions, courts may be following the lead of Fed.R.Civ.P. 23(g)(1)(A) and looking at the experience of class counsel in the substantive law at issue as well as its experience in class action practice.

2. This focus on both substantive and procedural law may provide defense counsel with another tool to oppose class certification. Plaintiffs' counsel not having expertise in both the substantive law and class action practice may wish to consider teaming up with a firm having the missing experience to flesh out a certification motion.

3. A certification petition should demonstrate the client's ability to serve as a check on counsel, and the putative representative's interest in the case should be sufficient to provide an incentive to do so.

4. Releases provided as part of settlements should be tailored to the wrongdoing alleged in the complaint. A class cannot be divested of valuable rights for "trivial disclosure adjustments." See *Verizon* at *4.

5. New York judges may be developing a greater willingness to take on active management of class actions. The City Trading court may have breathed new vigor into the traditional criteria that the interests of the class representative must not be antagonistic to the interests of members of the class.

6. Both plaintiff and defense counsel must be aware of CPLR 908's notice requirements. While amendments to conform to the federal approach have been proposed, the 30-year old Avena case, which many thought was outdated, is still good law.

Endnotes:

1. "Three Proposed Amendments to Article 9 of the Civil Practice Law & Rules," 58 The Record 316, 338-41 (2003) (cited here as the "City Bar 2003 Report.")

2. Rules 23(a)(4) and 23(d)(B)(iii), respectively, of the current Federal Rules of Civil Procedure. See Homburger, "State Class Actions and the Federal Rule," 71 Col.L.Rev. 609, 658-59 (1971) (discussing Fed.R.Civ.P. 23 after adoption of the 1966 amendments).

3. *Ackerman v. Price Waterhouse*, 252 A.D.2d 179, 202 (1st Dept. 1998)

4. Id.

5. *Willson v. New York Life Ins. Co.*, 1995 N.Y. Misc. LEXIS 652 (Sup. Ct., NY Co. 1995).

6. E.g., *Hoxworth v. Blinder*, Robinson, 980 F.2d 912, 923 (3d Cir. 1992); X L. Loss, et al., Securities Regulation 4647 (3d ed. 2005).

7. Judicial Conference, Committee on Rules of Practice and Procedure, Report to the Chief Justice of the Supreme Court and Members of the Judicial Conference, September 2002. The report is available on the website www.uscourts.gov .

8. The new Federal Rule 23(g)(1) states that the court certifying a class "must appoint class counsel," and in appointing class counsel that court "must consider":

(i) the work counsel has done in identifying or investigating potential claims in the action;

(ii) counsel's experience in handling class actions, other complex litigation, and the types of claims asserted in the action;

(iii) counsel's knowledge of the applicable law; and

(iv) the resources that counsel will commit to representing the class.

Fed.R.Civ. P. 23(g)(1)(A).

9. See Homburger, 71 Col. L. Rev. at 659 (text of the original Rule 23(e).

10. Advisory Committee Note on Federal Rule 23(e), Report of the Civil Rules Advisory Committee (Memorandum from David F. Levi, Advisory Committee Chair, to Hon. Anthony J. Scirica, Chair, Standing Committee on Rules of Practice and Procedure), May 20, 2002 (revised to account for action taken by the Standing Committee at its June 10-11 meeting), reprinted in Pending Rules Amendments Awaiting Final Action, Proposed Amendments to Take Effect December 1, 2003, at p. 102-03, with emphasis added. (The comments can be found at http://www.us.courts.gov/federalrulemaking.)

11. City Bar 2003 Report, 58 The Record at 338-41.

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