CLASS ACTIONS & DERIVATIVE SUITS

SECTION OF LITIGATION

Spring 2017, Vol. 27 No. 3

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ARTICLES

Stay in Your Lane and Stick to the Text: Justice Gorsuch on Class Actions

By Ashley Bruce Trehan

On April 10, 2017, former Tenth Circuit Judge Neil Gorsuch was sworn in as Associate Justice for the United States Supreme Court. Legal news outlets have extolled Justice Gorsuch's writing style. Partisan commentators have praised or condemned—depending, obviously, on their political leanings—his view of the Constitution. But for class action practitioners, what impact might his confirmation have?

While the Tenth Circuit is not known for having an extensive repertoire of class action opinions compared with, for example, the Seventh or Ninth Circuits, Justice Gorsuch has written opinions that shed light on the position he might take in class action disputes before the high court. This article highlights a handful of opinions that confirm that—at the very least and true to his reputation—Justice Gorsuch will interpret statutes and rules strictly and will endeavor to ensure the U.S. Supreme Court does not overstep its bounds.

Hammond v. Stamps, Inc. (10th Cir. 2016): Reverses Remand Order; Finds CAFA Matter "In Controversy" to Be Met

Last year, Justice Gorsuch dug through the "old soil" of jurisdictional jurisprudence to unequivocally hold that the amount "in controversy" refers to the amount "a fact-finder *might* legally conclude" is at issue in the case, as opposed to the amount that is probably or likely at issue, thus deciding that the matter in controversy threshold under the Class Action Fairness Act (CAFA) was satisfied. *Hammond v. Stamps.com, Inc.*, 844 F.3d 909, 912 (10th Cir. 2016).

In *Hammond*, the court looked to term's "traditional meaning," citing sources dating back to the eighteenth century and noting that the term "in controversy" was "heavily encrusted with meaning." In the opinion, Justice Gorsuch observed that reliance on history and plain meaning was "not some empty formalism" but was also pragmatic: "At this stage, we're just trying to decide the forum for the dispute, not liability or damages."

BP America, Inc. v. Oklahoma (10th Cir. 2010): Grants Defendants Leave to Appeal Remand Order under CAFA

Justice Gorsuch also had the opportunity to analyze appellate jurisdiction over remand orders under CAFA in *BP America, Inc. v. Oklahoma*, 613 F.3d 1029 (10th Cir. 2010). There, the state of Oklahoma, through its attorney general, sued BP. The district court ordered the case to be remanded to state court, thereby disagreeing with BP's argument that the case was a "mass action" under CAFA.

On appeal, the court decided that it had jurisdiction to decide the district court's remand order. Justice Gorsuch's appellate opinion cited 28 U.S.C. § 1453(c)(1) (the section governing removal of class actions under CAFA) for the proposition that the appellate court "*may*" accept an appeal of an order remanding a putative class action. The court noted that this section of CAFA serves as an exception to the general rule remand orders generally are not reviewable. (*See* 28 U.S.C. § 1447(d).)

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To reach that conclusion, Justice Gorsuch first analyzed the court's jurisdiction to consider BP's appeal, noting that "[w]hen we interpret a statute we begin, of course, with its plain terms." *Id. BP America*, 613 F.3d at 1033. Then, moving to the substance, he acknowledged the lack of Tenth Circuit authority addressing its discretion to review remand orders and looked instead to factors enumerated by the First Circuit. Those factors included the presence of an important CAFA-related question, whether the question is unsettled, and whether the question is likely to recur. Ultimately, applying those factors, the court found that each of the factors favored granting appellate review of the district court's remand order.

***Howard v. Ferrellgas Partners, L.P.* (10th Cir. 2014): Remands so District Court Will Try Issue of Arbitration—Quickly**

Unlike the other opinions discussed in this article, *Howard* does not squarely address a class action issue. Instead, it addresses arbitration, a subject often intertwined with class actions and currently before the U.S. Supreme Court. *Howard v. Ferrellgas Partners, L.P.*, 748 F.3d 975 (10th Cir. 2014).

In *Howard*, there was a factual dispute as to whether the parties to the putative class action agreed to arbitrate. The district court found as much. However, rather than trying the factual issue as to whether the parties did or did not agree to arbitrate, the district court entered an order denying arbitration outright—almost a year and a half after the defendant filed its motion to compel arbitration.

The Tenth Circuit held that the determination of *whether* parties agreed to arbitrate is an issue that should be (and should have been) decided "quickly"—and, if necessary, should be tried as opposed to decided on the papers.

Regarding the parties' (and, generally, civil litigants') willingness to let the case linger, Justice Gorsuch observed that the parties "seemed content enough to haggle along together in the usual way of contemporary civil litigation . . . with only the most glancing consideration given the possibility of trial." *Id.* at 978. The district court was also to blame: Justice Gorsuch wrote that the proceedings "veer[ed] badly off course [and] ended in an impermissible place" and that "[o]ne thing the district court may never do is find a material dispute of fact *does* exist and then proceed to *deny* any trial to resolve that dispute of fact." *Id. Howard* demonstrates Justice Gorsuch's pointedness and pragmatism.

***McClendon v. City of Albuquerque* (10th Cir. 2011): Dismisses Appeal of Order Withdrawing Approval of Class Settlement**

Despite a lengthy and convoluted history, *McLendon* answers the straight-forward question of whether an order withdrawing approval of a class settlement constitutes a "final" order under 28 U.S.C. § 1291. *McClendon v. City of Albuquerque*, 630 F.3d 1288 (10th Cir. 2011). This opinion demonstrates Justice Gorsuch's views of the courts and of statutory construction: He begins his analysis by stating that "[t]he courts of appeals are creations of Congress and the boundaries of their jurisdiction are staked by statute." *Id.* at 1292.

Even though the court ultimately ruled in favor of the plaintiffs-appellees, Justice Gorsuch gave a nod to the defendant's practical concerns, noting that "the delays and costs associated with civil litigation in modern America are substantial and worrisome, and even the most hard-boiled litigator may raise an eyebrow at a case lasting as long as this one" (at that time, for over 15 years). Still, in dismissing the appeal, Justice Gorsuch and the Tenth Circuit made no exception to section 1291 or to the court's "finite bounds of authority."

***Shook v. Board of County Commissioners* (10th Cir. 2008): Affirms Denial of Certification under Rule 23(b)(2)**

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In what appears to be his only opinion directly ruling on a class-certification appeal, Justice Gorsuch affirmed the district court's denial of class certification under Federal Rule of Civil Procedure 23(b)(2) in *Shook v. Board of County Commissioners*, 543 F.3d 597 (10th Cir. 2008).

The 2008 *Shook* opinion was the Tenth Circuit's second opinion regarding class certification in that matter.

In the first opinion, the Tenth Circuit reversed the district court's denial of 23(b)(2) certification of the inmate-plaintiffs' section 1983 claims because the district court had failed to address the Rule 23 requirements, focusing instead on the Prison Litigation Reform Act (PLRA). Following remand, the district court again denied class certification. And even though it still focused on the PLRA, it also conducted the appropriate analysis under Rule 23(b)(2). Back at the Tenth Circuit, the appellate court analyzed the district court's Rule 23(b)(2) analysis, focusing primarily on the required "cohesiveness" of the class, and found that the district court did not abuse its discretion in denying class certification.

Justice Gorsuch's opinion in that second appeal explored class certification from a variety of angles, from courts' general willingness to certify Rule 23(b)(2) classes to issues regarding ascertainability and the extent to which a court can delve into the merits of a case. In dicta, the opinion notes that the plaintiffs may have been able to meet the class-certification requirements if they had sought certification of subclasses under Rule 23(c)(5), instead of "choosing to seek certification of a single broad class" and "an even broader alternative [class]. . . ." *Id.* at 607.

***Heller v. Quovadx, Inc.* (10th Cir. 2007): Affirms Order Denying Objection to Proposed Class Settlement**

In this pithy opinion by Justice Gorsuch, which at times reflects what might be a faint amusement, the court denied a shareholder's objection to a class action settlement. *Heller v. Quovadx, Inc.*, 245 F. App'x 839 (10th Cir. 2007). The case centered on the defendant's allegedly false and misleading financial statements during the period between October 22, 2003, and March 15, 2004.

The problem was that, while the objector was a shareholder of the defendant, he was not—and did not even purport to be—a member of the proposed settlement class. The crux of his objection was that, in his view, the defendant corporate officers, and not the corporation, should have to pay the settlement or judgment. In addition to filing his objection, he filed a number of motions with the court seeking various types of relief.

The district court denied all of the objector's motions but deferred ruling on his objections until the fairness hearing, at which time the district court denied the objection. The court later issued a written order denying the objections on the grounds that (1) the objector lacked standing because he failed to disclose that he purchased shares of stock during the class period, and (2) his statements to the district court did not constitute valid objections.

On appeal, the objector asserted that the denial of standing violated his Fifth Amendment right of due process and violated the Takings Clause of the Fifth Amendment.

The Tenth Circuit affirmed the district court's denial of the objection based on three independent reasons. First, the objector failed to challenge the district court's second, independent ground for denying the objection. Second, the appellate court agreed with the district court that the objector lacked standing under Rule 23(e)(4), which provides that *only* class members may object to a proposed settlement and, thus, non-class members have no standing to object. Finally, Justice Gorsuch noted that the shareholder's filings "fail[ed] to identify any relevant evidence or legal

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authority supporting his various theories about class action litigation" and that the shareholder's objection was the *only* objection to the settlement.

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Class Actions 101: Does the Fairness in Class Action Litigation Act of 2017 Spell Doom for Class Actions as We Know Them?

By Paul Karlsgodt

On March 9, 2017, the House of Representatives passed H.R. 985—the Fairness in Class Action Litigation and Furthering Asbestos Claim Transparency Act of 2017—by a vote of 220 to 201. The bill has been praised by business interests as a necessary check on abuses in class action litigation and derided by consumer advocates as a tool to destroy consumers' ability to protect themselves against corporate abuses. Some are worried that the bill will destroy class action litigation altogether. In this edition of Class Actions 101, we explore some of the history of H.R. 985, the likelihood of its passage into law, and its potential impacts on class action litigation if enacted.

A Brief History of the Fairness in Class Action Litigation Act
The Fairness in Class Action Litigation Act of 2017 is the sequel to the Fairness in Class Action Litigation Act of 2015, a similar bill that also passed in the House but was defeated when Republicans in the Senate could not muster the 60 votes needed to overcome a Democratic filibuster. The 2015 bill was introduced in response to a spate of what had become known as "no injury" class actions, exemplified by the recent trend in suing food manufactures for false advertising for statements made on their product labels, regardless of whether any significant number of proposed class members even paid attention to the statements on the product label when they purchased the product. Various iterations of the bill have included different provisions aimed at curbing perceived abuses in the class action system, but the central feature has been a requirement that all the members of the proposed class have suffered injuries of the same type and scope as the named plaintiffs.

Features of the Proposed Law as Passed by the House

> **Provisions relating to "type and scope" of claimed injuries.** The centerpiece of the legislation would create a new statutory requirement for class certification in damages class actions, to be codified as 28 U.S.C. § 1716 and titled "Class action injury allegations." It would require a federal court to conduct a rigorous analysis of whether the plaintiff had affirmatively demonstrated that "each proposed class member suffered the same type and scope of injury as the named class representative or representatives" before certifying a class action seeking "monetary relief for personal injury or economic loss."
>
> **Prohibitions on conflicts of interest.** Another new statutory provision, titled "Conflicts of interest," would require plaintiff's counsel to state in the complaint whether any of the proposed class representatives have a family or business relationship with the attorneys and, if so, to explain the circumstances in which the plaintiff agreed to serve as class representatives and any other class action in which the plaintiff served in a similar role. (Curiously, the draft legislation refers to plaintiffs' counsel as "class counsel"—as opposed to "putative class counsel," for instance—which would be a misnomer because the provision deals with requirements that must be met at the pleading stage, before any class has been certified.) It also would prohibit class certification in any class action in which the proposed class representative is a relative or employee of class counsel.

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Requirements relating to ascertainability, distribution of class benefits, and attorney fees. A section titled "Class member benefits" would codify the concept of "ascertainability" as a requirement for class certification. As articulated in the courts, ascertainability looks to whether there is an objective, administratively feasible way of identifying class members and notifying them of the availability of the class action and any class benefits. There is currently a split among the federal circuits about whether ascertainability should be a prerequisite for class certification and, if so, whether a relaxed or heightened standard should apply in determining whether it is met. The proposed law would codify the standard that requires heightened proof. It would also require the court to find that there is a method for distributing any monetary award or settlement benefits "directly to a substantial majority of class members."

The proposed law has several new requirements relating to the award of attorney fees. One provision would prohibit any determination or payment of attorney fees in a class action settlement until after distribution of a monetary recovery to class members is completed. Under existing procedure, it is common for attorney fees to be determined at the final fairness hearing and paid shortly thereafter, even though settlement claims administration may still be ongoing. Another section would limit the total fees to "a reasonable percentage of any payments directly distributed to and received by all class members." Currently, fees are often determined using either the "lodestar" method, in which the attorneys are paid based on a calculation of the number of hours reasonably expended, or a percentage of a common fund that may or may not be distributed to class members in its entirety, or they are simply negotiated separately from any class benefits available as part of the settlement. Finally, the new law would require that any fees awarded based on a judgment or settlement for injunctive or other equitable relief cannot exceed "a reasonable percentage of the value of the equitable relief."

Provisions requiring an accounting of money distribution data. The bill contains several provisions requiring class counsel in a class action settlement to provide an accounting of the amounts claimed as part of the settlement before being eligible to recover attorney fees. The accounting must include information about the size of the class, the number of class members who received payment, and the range of payments, among other statistics. The accounting is to be provided to the director of the Federal Judicial Center, who would be required to provide an annual report to Congress on the statistics compiled from the settlement accountings.

Restrictions on issue classes. In a trend best exemplified by cases involving claims for breach of warranty against the manufacturers of allegedly moldy washing machines, courts have increasingly been relying on Federal Rule of Civil Procedure 23(c)(4) as a way of resolving discrete issues of fact or law that are common to a class of plaintiffs, even though other aspects of the dispute would be left for resolution in individual proceedings. The "Issue classes" provisions of H.R. 985 would put an end to this trend by requiring that the prerequisites of Rule 23(a) and (b) (numerosity, typicality, commonality, adequacy, predominance, superiority, etc.) be satisfied as to the case as a whole before the court may certify a class with respect to particular issues under existing Rule 23(c)(4).

Stays of discovery in class actions. The proposed law would require all discovery in a putative class action to be stayed until after an initial dispositive motion, such as a motion to dismiss, transfer, or strike class allegations, has been resolved. The stay could be lifted, in the trial court's discretion, if particularized discovery were necessary to preserve evidence or prevent undue prejudice. The provision also would not apply in certain securities class actions. Currently, some federal courts and complex divisions of state courts follow this approach anyway, and federal courts can effectively order a stay by delaying the issuance of an order

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setting a Rule 16 scheduling conference. However, many other courts currently apply a reversed presumption that discovery should move forward almost immediately, absent good cause for a stay.

Third-party litigation funding disclosure requirements. Another growing trend in the U.S. courts is the emergence of litigation-funding providers who provide financial support to litigants pursuing private litigation in exchange for a contingent payment if the litigation is successful. Litigation funding is common in other parts of the world, especially in those countries where the "loser pays" fee-shifting rule creates a risk of exposure to the party pursuing litigation if it is not successful. H.R. 985 contains a provision that would require "class counsel" in a class action to identify any person or entity who has a contingent right to receive compensation from a settlement or judgment. (Again, presumably, the reference to "class counsel"—as opposed to "putative class counsel"—is just inartful drafting, as the provision seems to require the disclosure at the beginning of a case, before any class is certified.)

Appeals of class certification orders. The final provision of the bill would make class-certification orders appealable as of right. Currently, Rule 26(f) of the Federal Rules of Civil Procedure allows appeals of orders granting or denying class certification, but the appeals are accepted only in the discretion of the circuit courts of appeals.

Other provisions relevant to class action procedure. In addition to the portions of H.R. 985 that deal directly with the procedure governing class certification, class action settlements, and appeals, there are a few other provisions in the bill that would affect class action practice. The bill would revise the removal statute to avoid situations where the joinder of plaintiffs in personal injury and wrongful death actions has the effect of destroying diversity jurisdiction under 28 U.S.C. § 1332(a). It would also introduce new requirements to 28 U.S.C. § 1407, the statute governing multidistrict litigation (MDL), including a requirement that the attorney for each plaintiff seeking damages for personal injury in an MDL consolidated proceeding must provide evidentiary support for his or her client's claimed injuries within 45 days after the case is transferred. The bill would allow the transferee judge to dismiss the plaintiffs' case if the submission is found to be insufficient.

What Are the Prospects of H.R. 985 Becoming Law?

Like the current bill, the 2015 iteration of the Fairness in Class Action Litigation Act also passed in the House of Representatives. But the 2015 bill ultimately died in the Senate. The obvious change that has occurred between then and now is the election of a pro-business Republican president who is likely to sign the bill into law if it reaches his desk. However, the current bill still faces challenges in the Senate. Republican supporters in the Senate would likely have to obtain 60 votes in order to overcome a Democratic filibuster, something they were unable to do in 2015. Some political commentators have suggested that this and other proposed judicial reforms will not be given high priority in the Senate anytime soon, especially given what is expected to be a contentious process for many of President Trump's political appointments. So, while the Fairness in Class Action Litigation Act in its current iteration appears closer than ever to becoming reality, it is by no means a foregone conclusion that any of its reforms will ever be passed into law.

What Are the Possible Effects on Class Action Litigation if H.R. 985 Becomes Law?

Although the stated goal of H.R. 985's sponsors is to eliminate incentives for lawyer-driven class actions, whether it would actually achieve that goal as a practical matter is a matter of some debate.

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The “type and scope” requirement would certainly be another key tool for defendants to avoid class certification in many types of class actions, especially in food-labeling cases and other so-called “no injury” class actions decried by the bill’s sponsors. However, that does not necessarily mean that plaintiffs’ attorneys would stop looking for creative ways to pursue those cases. Moreover, the presence of significant variations in injury among class members already provides a strong basis for defeating class certification, even given Rule 23’s existing predominance and superiority requirements, as illustrated by the Supreme Court’s decision in *Amchem Products, Inc. v. Windsor*, 521 U.S 591 (1997). Thus, it is unclear how codifying the “type and scope” requirement will change how courts actually resolve class-certification motions. In the short term, the law would likely generate significant litigation over the meaning of the words “type and scope,” with some courts taking a restrictive view and others taking a more liberal view of that phrase, potentially leading to forum shopping.

The settlement restrictions of H.R. 985 would certainly make federal class actions much more difficult to settle, but that does not necessarily mean that fewer class actions would be filed, especially in the short term. And it certainly does not guarantee that businesses will be burdened any less with litigation expense. The settlement restrictions may instead have the effect of forcing more cases to judgment and trial, increasing litigation expense for businesses and reducing their options to limit litigation risk. Many of the proposed settlement reforms are already being adopted by individual judges in various parts of the country. It remains to be seen whether more restrictions on class action settlement approval will affect the incentives to bring class action lawsuits in the first place.

Even if the law has the intended effect of reducing the amount of class action litigation in the federal courts, a potential side effect could be to drive more plaintiffs’ attorneys to pursue more class actions in state court on behalf of only those class members who reside in the state in which the defendant is headquartered, where there are barriers to removal under the Class Action Fairness Act (CAFA). This was a tactic often seen in the immediate aftermath of the 2005 passage of CAFA.

Certain of the proposed reforms, such as reforms to clarify the requirements pertaining to ascertainability and issues classes, were previously the subject of proposed changes to Rule 23 itself. Even if H.R. 985 never becomes law, these are issues that could be resolved by the U.S. Supreme Court over the next several years.

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How Designation of Expert Witnesses Can Make or Break Privilege

By Daniel Barsky

Expert witnesses, through their testimony, provide that link to establish causation and damages and are therefore necessary in most complex commercial cases. A good expert can provide compelling testimony that assists you in advancing your theory of the case, telling a story that captivates the trier of fact and convinces the judge or jury of the merits of your case.

At the same time, using an expert introduces the risk of losing certain privileges and protections, and the rules governing experts underwent significant amendments in 2010. Under the current scheme, identifying whether your expert is (1) reporting or non-reporting and (2) consulting or testifying—then following the rules for the type of expert you are using—is critical to protecting your key trial theory and strategy.

Reporting or Non-Reporting?
Prior to 2010, the cautionary rule of thumb was that whatever you share with the expert is discoverable. This guidepost typically was applied to drafts of, and revisions to, expert reports. Following the 2010 amendments to the Federal Rules, the pendulum seemed to shift to the other extreme—that is, whatever you share with the expert is protected from discovery. Unfortunately, the current rules are not nearly so cut-and-dried. The extent of the privilege depends on whether your expert is "reporting" or "non-reporting."

The Federal Rules of Civil Procedure allow for experts to be reporting (Rule 26(a)(2)(B)) or non-reporting (Rule 26(a)(2)(C)). A witness is a "reporting" expert if "retained or specially employed to provide expert testimony in the case or . . . whose duties as the party's employee regularly involve giving expert testimony." Fed. R. Civ. P. 26(a)(2)(B).

Examples of reporting experts are causation experts, outside accountants retained to calculate damages or business valuations, and engineers retained for testimony regarding patented technology. Non-reporting experts include a party's own accountants, treating physicians, and business owners.

The 2010 amendments made explicit that "Rules 26(b)(3)(A) and (B) [which protect trial preparation materials from discovery] protect drafts of any report or disclosure required under Rule 26(a)(2), regardless of the form in which the draft is recorded." Fed. R. Civ. P. 26(b)(4)(B). The new rule also "protect[s] communications between the party's attorney and any witness required to provide a report under Rule 26(a)(2)(B), regardless of the form of the communications" with limited exceptions. Fed. R. Civ. P. 26(b)(4)(C). The advisory committee notes to the 2010 amendments make clear that draft reports and communications between counsel and the reporting expert are protected from discovery. (There are exceptions to this rule, as when an attorney becomes so involved in the drafting of the report that the attorney effectively becomes the expert, but those exceptions are an article unto themselves.)

However, the rule protects communications only between the party's attorney and "any witness *required* to provide a report." Fed. R. Civ. P. 26(b)(4)(C) (emphasis added). Note that the rule does not expressly protect communications involving non-reporting experts. Moreover, use of the language "required to provide" suggests that one cannot gain protection over a non-reporting expert

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by voluntarily providing a report. Therefore, you should determine whether your expert is a reporting or non-reporting expert prior to engaging in substantive communication with your expert. If your expert is non-reporting, then the adage that communications with experts are discoverable still applies. *See Luminara Worldwide, LLC v. RAZ Imports, Inc.*, 2016 U.S. Dist. LEXIS 158183 (D. Minn. Nov. 15, 2016).

Another implication of the rule is the potential limited waiver of protection with corporate employees if those employees are going to be called as non-reporting expert witnesses. In *Luminara Worldwide*, the court held that documents "considered" by a non-reporting employee/inventor were discoverable and that "considered" would be broadly interpreted as "encompass[ing] material not only used, but generated, seen, reviewed, and/or reflected upon. . . ." Therefore, practitioners must be careful when deciding to use corporate employees as non-testifying experts as their witness preparation materials will become discoverable.

Consulting or Testifying?
Rule 26(b)(4) also differentiates between consulting and testifying experts. Consulting experts are experts who are retained in anticipation of litigation and who are not expected to testify at trial—for example, consumer survey experts retained to conduct research before bringing a trademark infringement action. As in the case of reporting experts, "[o]rdinarily, a party may not, by interrogatories or deposition, discover facts known or opinions held by an expert who has been retained or specially employed by another party in anticipation of litigation or to prepare for trial and who is not expected to be called as a witness at trial." Fed. R. Civ. P. 26(b)(4)(D).

However, practitioners need to be careful not to inadvertently expose their consulting expert to potential discovery. In *Apple Inc. v. Amazon.com, Inc.*, 2013 WL 1320760 (N.D. Cal. Apr. 1, 2013), the court addressed whether initial pre-suit survey work conducted by two assistants to Apple's testifying expert was discoverable. The court held that the two assistants must be made available for limited deposition to probe their activities and involvement in the testifying expert's report, including their activities relating to the four pre-suit surveys.

It is therefore important for practitioners to ensure that their consulting experts do not become entangled with their testifying experts to avoid waiver of privilege covering critical trial preparation and strategy materials.

Conclusion
Expert witnesses are essential team members in most complex commercial litigation. A good expert witness can seamlessly weave the testimony and exhibits introduced through numerous lay witnesses into a coherent story that convinces the trier of fact of the merits of your case.

The rules governing disclosure and production of discovery from experts are tricky and fraught with pitfalls. "Reporting" experts are subject to certain protections, while documents "considered" by non-reporting experts—a term that will likely be broadly construed—are subject to production. It is thus critically important for practitioners to properly identify and classify their experts early in litigation lest they inadvertently make otherwise protectable work product fair game for discovery.

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Calculating Damages in Price-Fixing Cases in the United States, Canada, and the European Union

By Pierre Crémieux, Marissa Ginn, and Marc Van Audenrode

This is the second part of a series on damages in price-fixing cases in the United States, Canada, and the European Union. Part I, a comparison of damage theories across these regions, was published on January 31, 2017.

The Economic Building Blocks of a Damage Award

When calculating private damage awards in price-fixing litigation, economic theory can make a real-world difference. In their simplest form, awards are based on the difference between the price actually paid under the collusion and the price that would have been paid absent the collusion. The more units that are sold with an embedded overcharge, the higher the overcharge damages, all else being equal.

In reaction to the increase in their costs, purchasers may decide to raise their own prices to the next step in the distribution chain by an amount equal to or greater than the overcharge (full pass-on), by a portion of the overcharge (partial pass-on), or not at all (no pass-on). If they pass on some or all of the increase, then their own customers pay higher prices as a result of the collusive actions. These customers (or these customers' own downstream customers) may become indirect purchaser plaintiffs in jurisdictions where indirect purchasers are allowed to claim damages (such as in Canada, in the European Union, or in U.S. state courts, but not in U.S. federal courts).

However, if overcharges increase consumer prices, they may also reduce sales, resulting in lost profits on those lost sales for companies that were victims of the overcharge. This is where calculating damages becomes more complicated and requires some further economic analysis, including the calculation of elasticities.

A price elasticity is the relationship between price changes and changes in purchases by consumers. Demand for a product is said to be highly elastic if a small change in price (up or down) has a large impact on units purchased. Demand for a product is highly inelastic if changes in the price of a product have little effect on units sold.

This article explains the impact that price elasticities can have on damages awards in three different jurisdictions—the U.S. federal courts, Canada, and the European Union—and provides some basic examples to show some of the mathematical underpinnings of overcharge damages calculations, pass-on, and lost profits on lost sales.

Sources of Damages in Different Jurisdictions

Currently, these three components of private damage awards are treated differently, depending on where the suit is brought. In the United States, federal courts treat all price-fixing cases as if no pass-on

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has occurred, awarding damages solely on the basis of the increase in the direct purchasers' costs attributable to the collusion. The impact on indirect purchasers is not considered. (Some U.S. state courts also give indirect purchasers standing in price-fixing cases. These cases are very active in the U.S. state court dockets, often migrating from one state to the next over a period of years.) However, private damage awards in antitrust cases are automatically trebled in the United States to increase the deterrent effect of the awards.

In Canada or the European Union, indirect purchasers (whether they are end consumers or the next link in the distribution chain) may also sue alleged illegal cartels for damages. If they do so, compensation for plaintiffs must be divided among the direct and indirect purchasers in proportion to the harm each party suffers.

The formal introduction of indirect purchasers is a comparatively recent development in both jurisdictions, following Canadian high court rulings in 2013 (*Sun-Rype Prods. Ltd. v. Archer Daniels Midland Co.* (2013); *Pro-Sys Consultants Ltd. v. Microsoft Corp.* (2013); *Infineon Techs. AG v. Option consommateurs* (2013)), and the 2014 issuance of the Directive on Damages (2014/104/EU) in the European Union.

Finally, in the European Union, the 2014 Directive on Damages also allows direct purchasers (or others along the distribution chain) to seek damages for lost profits on lost sales. These damages are in addition to direct damages from overcharges. In this regard, the European Union framework stands apart from the other two, which do not consider lost profits.

Table 1 summarizes the sources of private damages considered in each of the three jurisdictions.

Table 1: Sources of Private Damages

Source of Damages	U.S. Federal	Canada	European Union
Overcharge to direct purchasers	YES (damage awards automatically trebled)	YES	YES
Price increases from overcharge passed on to indirect purchasers	NO	YES	YES

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Lost profits on lost sales	NO	NO	YES

How Economics Makes a Difference
What does economics have to do with all of this? The answer, it turns out, depends on where the suit is being brought.

In Canada and the European Union, where price-fixing litigation may involve indirect as well as direct purchasers, the allocation and amount of awards can change depending on the combination of two factors: (1) how much of the collusive price increase is passed on by purchasers to their own customers and (2) how sensitive those customers are to changes in price. If the goods in question are very price-sensitive, then a price increase may result in substantially lower sales; the same price increase in less price-sensitive markets will have less of an impact.

In economics, the degree to which changes in pricing affect purchases, known as the price elasticity of demand, is most often indicated by a negative number. For example, a demand elasticity of -1 means that when prices increase by 1 percent, the quantity demanded decreases by 1 percent. An elasticity of -2 means that when prices increase by 1 percent, the quantity demanded decreases by 2 percent.

In Canada and the European Union, if some of the overcharge is passed on by purchasers to the next level in the distribution chain, the size of awards based on the overcharge must be adjusted correspondingly, both because fewer transactions take place and because the purchasers should not be compensated for the share of the overcharge passed on to the next level in the chain of distribution. In the European Union, however, lower sales volume due to pass-on effects also translates into higher damages calculations for purchasers in the form of lost profits on lost sales. In those cases, profit margins matter because the higher the plaintiff's margins on the relevant transactions, the higher the loss to compensate on lost sales.

In the following sections, we provide some basic examples of damage calculations in each of the three jurisdictions to illustrate how this works out in practice. For the sake of comparison, we use dollars as the currency in all the examples.

Examples of Damage Calculations
In any of the three jurisdictions, if direct purchasers do not pass on any of the cost increase to their own customers by holding their own prices steady, damages are driven by the cost increase to direct purchasers. If there is no pass-on, indirect purchasers, elasticity of demand, and profit margins are irrelevant, and damage calculations require applying the increase in the direct purchasers' unit costs to the volume of commerce affected.

Direct purchasers. The "pass-on defense" is not available in U.S. federal courts following the U.S. Supreme Court's decisions in *Illinois Brick Co. v. Illinois*, 431 U.S. 720 (1977), and *Hanover Shoe, Inc. v.*

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United Shoe Machinery Corp., 392 U.S. 481 (1968). Table 2 shows a pro forma illustration of how the damages might be calculated in a U.S. federal antitrust suit, assuming, of course, very simplistic and uniform facts.

In this market, prior to the collusive action, the unit price is $10. We assume that the collusion increases the unit costs to the direct purchasers by $1, but we make no assumption about pass-on because that is irrelevant to the calculation in U.S. federal court. Sales volume can be directly observed from sales records during the conspiracy period.

In this example, assuming that 100 units were sold during the conspiracy period, the direct purchasers' total costs will be raised by $100 (the $1 unit cost increase multiplied by 100, which is the number of units sold). The direct purchasers can claim the entire overcharge of $1 per unit, multiplied by the number of units.

Of course, the United States is unique in that antitrust damage awards are automatically trebled to provide additional deterrence to anticompetitive actions. Therefore, the total award to the plaintiffs paid by the defendants in our example would be $300, not $100.

Table 2: U.S. Federal Example with No Pass-On

Before Conspiracy	
Quantity Sold	Not relevant
Price to Customers (Indirect Purchasers)	$10
During Conspiracy	
Increase in Costs of Direct Purchasers (Overcharge)	$1
Quantity Sold	100
(1) Damages to Direct Purchasers due to Higher Costs (Overcharge)	100 * $1 = $100

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(2) Damages to Indirect Purchasers due to Higher Price (Overcharge Passed on)	Not considered
(3) Damages due to Lost Profits on Lost Sales	Not considered
Total Direct Plaintiffs Damages Award	**$100**
Treble Award to Direct Plaintiffs (U.S. only)	$300

Indirect purchasers. When indirect purchasers are added into the mix, as in the Canadian and European Union regimes, the numbers change, and the elasticity of demand first comes into play. If the price to the consumer increases above the non-collusive market price, then economic theory predicts that fewer units of the product will sell. We can estimate the decrease in purchases based on the elasticity of demand and, in turn, calculate the amount of the damage awards.

As shown in Table 3, direct purchasers in the example pass on the entire cost increase of $1 per unit and increase the price to indirect purchasers by that amount. If the elasticity is low, then unit sales are relatively unaffected by this price increase, and the product of sales volume and the aggregate price increase may remain high at $95 (95 units sold instead of 100 with a $1 embedded overcharge). But if the elasticity is high, sales may fall to, say, 75, and total damages from overcharges would amount to $75. (In either scenario, the overcharge damages to the direct purchasers are zero because they passed on the entire cost increase.)

Table 3: Canadian Example with Full Pass-On

Elasticity of Demand	**Low** **-0.5**	**High** **-2.5**
Before Conspiracy		
Quantity Sold	100	

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Price to Customers (Indirect Purchasers)	$10	
During Conspiracy		
Increase in Cost for Direct Purchasers	$1	
Full Pass-On		
Cost Increase Passed On	$1	
Unit Price	$11	
Quantity Sold	95	75
(1) Damages to Direct Purchasers due to Higher Costs (Overcharge)	$0	$0
(2) Damages to Indirect Purchasers due to Higher Price (Overcharge Passed on)	95 * $1 = $95	75 * $1 = $75
(3) Damages to Direct Purchasers due to Lost Profits on Lost Sales	Not considered	Not considered
Total Damages Assessed (Owed to Indirect Purchasers)	**$95**	**$75**

Now, let's assume that the direct purchasers pass on only half the cost increase. As illustrated in Table 4, changing the unit price still changes the quantity sold given any non-zero elasticity, but because the price increase for the end consumer is not as high, the decrease in sales is also less. This means that more sales are affected by the (lower) price increase, resulting, in our example, in a total damage

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assessment of $97.50 if the elasticity is low (97.5 units sold with $1 embedded overcharge), and of $87.50 if it is high (only 87.5 units sold). However, the total damages must be split between direct and indirect purchasers in the case of partial pass-on, whereas the damage to direct purchasers from the overcharge is zero with full pass-on.

Table 4: Canadian Example with Partial Pass-On

Elasticity of Demand	**Low** **-0.5**	**High** **-2.5**
Before Conspiracy		
Quantity Sold	100	
Price	$10	
During Conspiracy		
Increase in Cost for Direct Purchasers	$1	
Partial Pass-On		
Cost Increase Passed on	$0.50	
Unit Price	$10.50	
Quantity Sold	97.5	87.5
(1) Damages to Direct Purchasers due to Higher Costs (Overcharge)	97.5 * $0.50 = $48.75	87.5 * $0.50 = $43.75
(2) Damages to Indirect Purchasers due to Higher	97.5 * $0.50 = $48.75	87.5 * $0.50 = $43.75

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Price (Overcharge Passed on)		
(3) Damages to Direct Purchasers due to Lost Profits on Lost Sales	Not considered	Not considered
Total Damages Assessed (Owed to Direct and Indirect Purchasers)	**$97.50**	**$87.50**

Lost profits from lost sales. In the European Union, one more component of damages remains: lost profits on lost sales. Awards consequently may be calculated as a combination of overcharge (based on price increases) plus the value of profits (based on margins) that would have accrued to direct purchasers, and possibly others along the distribution chain, had they not lost unit sales because of the inflated collusive price.

The combinations of high and low margins with high and low elasticities will yield different total damages amounts, as shown in Tables 5 and 6. Note that, the higher the margin, the larger the awards for lost sales because each unsold unit results in a loss proportional to the corresponding margin.

However, firms operating in industries that are characterized by higher profit margins, such as high-end luxury goods and heavy equipment manufacturing, tend to face lower elasticities of demand. This may be, for example, because products are differentiated. Conversely, firms in industries where there are many available substitutes for an item (such as substituting whole wheat bread for white bread in grocery stores), typically operate with low profit margins and face higher elasticities of demand. This may be, for example, because products are commoditized and firms have to compete away their margins to secure sales.

Consequently, the most likely outcomes in our examples will be a high-margin/low-elasticity case or a low-margin/high-elasticity case. Comparing results in Tables 5 and 6 for such outcomes (that is, high-margin/low-elasticity versus low-margin/high-elasticity) shows that full pass-on results in higher total damages than partial pass-on. However, if direct purchasers pass on the full amount of the increase, they may only claim damages from lost profits on lost sales (and not on the overcharge itself), which shifts a larger portion of the damage assessment from direct purchasers to indirect purchasers.

Table 5: EU Examples with High Margins (Full and Partial Pass-On)

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Elasticity of Demand	**-0.5**	**-2.5**
Before Conspiracy		
Quantity Sold	100	
Price	$10	
Unit Cost	$5	
Margin	$5	
During Conspiracy		
Increase in Cost	$1	
Full Pass-On		
Cost Increase Passed on	$1	
Unit Price	$11	
Quantity Sold	95	75
(1) Damages to Direct Purchasers due to Higher Costs (Overcharge)	$0	$0
(2) Damages to Indirect Purchasers due to Higher Price (Overcharge Passed on)	95 * $1 = $95	75 * $1 = $75
(3) Damages to Direct Purchasers due to Lost Profits on Lost Sales	5 * $5 = $25	25 * $5 = $125

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Total Damages Assessed	$120	$200

Partial Pass-On		
Cost Increase Passed on	$0.50	
Unit Price	$10.50	
Quantity Sold	97.5	87.5
(1) Damages to Direct Purchasers due to Higher Costs (Overcharge)	97.5 * $0.50 = $48.75	87.5 * $0.50 = $43.75
(2) Damages to Indirect Purchasers due to Higher Price (Overcharge Passed on)	97.5 * $0.50 = $48.75	87.5 * $0.50 = $43.75
(3) Damages to Direct Purchasers due to Lost Profits on Lost Sales	2.5 * $5 = $12.50	12.5 * $5 = $62.50
Total Damages Assessed	$110	$150

Table 6: EU Examples with Low Margins (Full and Partial Pass-On)

Elasticity of Demand	-0.5	-2.5
Before Conspiracy		
Quantity Sold	100	
Price	$10	

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Unit Cost	$8	
Margin	$2	
During Conspiracy		
Increase in Cost	$1	
Full Pass-On		
Cost Increase Passed on	$1	
Unit Price	$11	
Quantity Sold	95	75
(1) Damages to Direct Purchasers due to Higher Costs (Overcharge)	$0	$0
(2) Damages to Indirect Purchasers due to Higher Price (Overcharge Passed on)	95 * $1 = $95	75 * $1 = $75
(3) Damages to Direct Purchasers due to Lost Profits on Lost Sales	5 * $2 = $10	25 * $2 = $50
Total Damages Assessed	**$105**	**$125**

Partial Pass-On	
Cost Increase Passed on	$0.50
Unit Price	$10.50

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Quantity Sold	97.5	87.5
(1) Damages to Direct Purchasers due to Higher Costs (Overcharge)	97.5 * $0.50 = $48.75	87.5 * $0.50 = $43.75
(2) Damages to Indirect Purchasers due to Higher Price (Overcharge Passed on)	97.5 * $0.50 = $48.75	87.5 * $0.50 = $43.75
(3) Damages to Direct Purchasers due to Lost Profits on Lost Sales	2.5 * $2 = $5	12.5 * $2 = $25
Total Damages Assessed	**$102.50**	**$112.50**

Summary: Tradeoffs Between Overcharge Damages and Lost Profits on Lost Sales
Our simplified illustration shows that when elasticities of demand are high (greater than 1 in absolute value), unit sales shrink faster for any given level of price increase. With lower sales (assuming pass-on to final customers), the overcharge (cost increase) is applied to a smaller number of transactions.

However, introducing lost profits on lost sales has the potential for reversing this effect. When the volume of actual sales goes down, then the volume of lost sales goes up. If the elasticity is high enough, it can more than offset the deflating effect on damages of low margins characteristic of highly elastic markets. The result is likely to be higher awards for direct purchaser plaintiffs, as well as higher total claims against the defendants.

The opposite is true in inelastic markets, where consumers will not substantially reduce their purchases in response to any price increase even under high pass-on. Consequently, plaintiffs will have a relatively higher volume of sales on which to calculate damages from the overcharge alone. Even though margins on lost sales are likely to be higher, the result may still be lower awards for direct purchaser plaintiffs and lower total claims against the defendants.

Looking across jurisdictions, the most straightforward case is in U.S. federal courts, where pass-on does not apply. The volume of sales used to calculate damages to direct purchasers is based solely on the overcharge and the actual number of units sold. Of course, as explained above, the volume of actual units sold is ultimately affected by the elasticity of demand, but U.S. federal courts are not concerned with this effect because lost profits on lost sales are irrelevant.

In Canada, the situation will be identical to that in U.S. federal courts when direct purchasers do not pass on any of the collusive price increase. If they do, indirect purchasers can join in on the claims, but

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as in the U.S. federal courts, damages awards are based solely on the volume of units actually sold, and no estimation of price elasticity of demand is necessary to ascertain awards, given that lost profits on lost sales are not considered.

Estimates of price elasticities of demand become relevant for courts in the European Union, where lost profits on lost sales are added into the mix. For example, in industries with high elasticities and low margins, the low margins will result in significant pass-on of the collusive increase in costs. This will result in large losses of unit sales, as fewer customers are willing to pay the higher price. Given significant pass-on, the final consumers will be compensated by overcharge-based calculations, while direct and indirect purchasers along the distribution chain will be compensated mainly through lost profits on lost sales.

Conversely, in industries with low elasticities and high margins, direct purchasers are less likely to pass on the collusive increase in costs, which means that sales volumes are less likely to be affected. The direct purchasers then will be compensated for all portions of the overcharge they did not pass on, and damages related to lost profits on lost sales will be minimal.

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PRACTICE POINTS

Shrink-Wrap Arbitration Clauses Must Be Conspicuously Displayed: Ninth Circuit

By Adam E. Polk

On January 19, 2017, in *Norcia v. Samsung Telecommunications Am.*, LLC, 845 F.3d 1279 (9th Cir. 2017), the Ninth Circuit held that no agreement to arbitrate had been formed when Samsung placed a warranty brochure containing an arbitration clause within a product box, but neither the box nor the cover of the brochure prominently disclosed the clause.

A customer filed a class action complaint against Samsung, asserting that Samsung made certain misrepresentations regarding its Galaxy S4 phone. Samsung moved to compel arbitration based on an arbitration clause contained in a 101-page warranty brochure that came in the phone's box. The district court denied Samsung's motion to compel, holding that even though the customer was deemed to have received the brochure, mere receipt does not form an agreement to arbitrate all claims. The customer appealed.

Applying basic principles of contract law, the Ninth Circuit affirmed, holding that "no contract is formed 'when the writing does not appear to be a contract and the terms are not called to the attention of the recipient.'" The court explained that "Samsung has not pointed to any principle of California law that imposed a duty on [plaintiff] to act in response to receiving the Product Safety & Warranty Information brochure," and that "the outside of the Galaxy S4 box did not notify the consumer that opening the box would be considered agreement to the terms set forth in the brochure."

In a companion case also involving Samsung, the Ninth Circuit applied the same reasoning to reverse an order compelling arbitration. *Dang v. Samsung Elecs. Co., Ltd.*, No. 15-16768, — F. App'x —, 2017 WL 218896 (9th Cir. Jan. 19, 2017).

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Individual Issue of Interpretation or Understanding Does Not Predominate with Form Contracts: Third Circuit

By Caroline E. Oks

In class actions involving uniform or standard form contracts, a common strategy for defeating class certification on commonality or predominance grounds has been to focus on individual customers' interpretations of consumer agreements or warranties. However, in *Gillis v. Respond Power, LLC*, the Third Circuit reversed the denial of class certification, finding that the district court erroneously relied upon irrelevant extrinsic evidence of plaintiffs' individualized subjective understandings a provision in the standard form contract. Because, as a matter of law, "extrinsic evidence of one party's undisclosed, subjective understanding, intent, or opinion about the meaning of ambiguous contract language cannot be used to substantiate a particular interpretation of that language," evidence of individual understandings of standard form contracts is "especially irrelevant."

Respond Power LLC is an energy supply company. The putative class consisted of approximately 50,000 customers who entered variable rate energy agreements with Respond. All of Respond's variable rate agreements included a uniform disclosure statement, which included a variable rate provision stating that Respond's "goal each and every month is to deliver [customer's] power at a price that is less than what [customers] would have paid had [they] purchased [their] power from [their] local utility company," but that Respond could not always guarantee that every month customers would see savings.

Plaintiffs alleged that Respond promised customers in its marketing campaigns that customers would save on their monthly electricity bills if they switched from their local utility company to Respond for their electricity supply, but did not explain how the variable rate changed over time. The district court denied Respond's motion to dismiss or strike the class allegations and ordered the plaintiffs to file a motion for class certification. After class discovery, the plaintiffs moved to certify the class as to their claims for declaratory judgment and breach of contract/breach of implied covenant of good faith and fair dealing but did not seek certification on their negligent misrepresentation or Pennsylvania consumer protection law claims.

The district court denied certification on the ground that the need for individualized, transaction-specific proofs defeated commonality. Looking ahead to the merits of plaintiffs' claims, the district court reasoned that if it were to decide that the variable rate provision was ambiguous as a matter of law, it would consider extrinsic evidence of the parties' intent in order to resolve the ambiguity. Extrinsic evidence in the record revealed that the named plaintiffs had different understandings—or no understanding at all—about whether the variable rate provision provided a "rate cap" for electricity services. These different understandings, according to the district court, exposed the named plaintiffs to certain defenses that might not apply to other class members, foreclosing a finding of typicality and

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adequacy. Further, the district court reasoned, because the named plaintiffs did not share the same understanding of the variable rate provision, the 50,000 putative class members likely did not either. This suggested that resolving any ambiguity would require proof of each plaintiff's individual understanding, rather than proof common to the class.

The Third Circuit granted interlocutory review under Rule 23(f) and reversed, holding that, under Pennsylvania law, the putative class members' individual understandings and interpretations of the variable rate provision had no place in the district court's contract construction and thus should not have factored into the class certification analysis. If the district court were to conclude as a matter of law that the variable rate provision was ambiguous, the court could then consult extrinsic evidence to ascertain the mutual intent of the parties and resolve the ambiguity. But, to the extent that extrinsic evidence reflected only "[t]he uncommunicated subjective understanding or intent of one party" about the meaning of ambiguous contract language, such evidence would be irrelevant, because the court's objective is to discover the meaning "that . . . each party *had reason to know* would be given to the words by the other party."

Further, the Third Circuit explained that standard form contracts are particularly well-suited for class treatment because individual signatories to such contracts understand that they have no bargaining power and expect to be treated like all other signatories to the form document. Thus standard form contracts should be interpreted uniformly as to all similarly situated signatories whenever it is reasonable to do so, rendering individual, transaction-specific interpretations inapposite.

The Third Circuit's decision is certainly a win for consumers. But while putative class members' divergent understandings of the meaning of provisions in standard form contracts may not be an impediment to proving commonality in cases involving form contracts, individual issues of putative class members' *conduct or performance* under the contracts may nonetheless be critical issues for determining whether the predominance and superiority requirements of Rule 23(b)(3) can be proven particularly for *misrepresentation*-based claims where reliance and causation plays a pivotal role in establishing liability.

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