ANDREWS LITIGATION REPORTER

THOMSON WEST

Class Action

COMMENTARY

REPRINTED FROM VOLUME 15, ISSUE 7 / AUGUST 2008

McLaughlin v. American Tobacco Co.: Raising the Bar Even Higher for Fraud-Based Consumer Class Actions

By Richard H. Silberberg, Esq., Christopher G. Karagheuzoff, Esq., and Robert G. Manson, Esq.

Fraud-based class actions have the distinction of being one of only two types of suits the Advisory Committee Notes to Federal Rule of Civil Procedure 23 expressly designate as generally inappropriate for class treatment. While recognizing that class actions whose claims sound in fraud may be an "appealing situation for a class action" where "similar misrepresentations" were made to all putative class members, the Advisory Committee Notes to Rule 23 assert that "a fraud case may be unsuited for treatment as a class action if there was material variation in the representations made or in the kinds or degrees of reliance by the persons to whom they were addressed."[1]

Consistent with these sentiments, plaintiffs historically have encountered difficulty in obtaining class certification of fraud-based claims for economic damages brought on behalf of putative classes of consumers. Certification of such claims (which usually are based on alleged false advertising or other purported misrepresentations aimed at inducing consumers to purchase products or services) generally fails when plaintiffs attempt to comply with Federal Rule of Civil Procedure 23(b)(3) and equivalent state procedural rules that require proof that common issues of fact and law predominate over individual issues.

Despite such obstacles, fraud-based consumer class actions continue to be pursued with occasional success. However, in *McLaughlin v. American Tobacco Co.,* 522 F.3d 215 (2d Cir. 2008), the 2nd U.S. Circuit Court of Appeals rejected a particularly notable attempt to obtain certification of fraud-based claims on behalf of a putative consumer class. The *McLaughlin* decision is likely to make the demanding task of obtaining certification of consumer fraud classes all the more challenging in the future. This article will examine the *McLaughlin* opinion, its implications for certification of fraud-based consumer class actions, and the most promising avenues to certification that remain available to plaintiffs pursuing such claims.

Consumer Fraud Class Actions and The Predominance Standard

Most federal court class actions based on allegations of consumer fraud must meet the requirements of Rule 23(b)(3) to be certified. The rule provides that, in addition to satisfying other prerequisites for class certification imposed by Rule 23 (*i.e.,* numerosity, commonality, typicality and adequacy of representation), a plaintiff must establish that "questions of law or fact common to class members predominate over any questions affecting only individual members."

McLaughlin *likely will make the certification of consumer fraud classes more challenging in the future.*

Demonstrating the nexus between Rule 23(b)(3)'s "predominance" requirement and the requisite elements needed to prove a fraud-based claim on behalf of consumers (whether such claims are predicated upon common-law fraud, related common law claims such as negligent misrepresentation, or violations of consumer protection statutes proscribing deceptive conduct) is often an insurmountable

obstacle to class certification. Claims sounding in fraud typically require proof that a defendant misrepresented to the plaintiff one or more material facts and that the plaintiff acted to his or her detriment in reliance upon the misrepresentation (*i.e.,* by purchasing the product or service at issue). These requirements, by their very nature, frequently confound efforts by plaintiffs to establish predominance.

"Individualized proof is needed to overcome the possibility that a class member purchased lights for some reason other than the belief [that] lights were a healthier alternative," the 2nd Circuit said.

With respect to the requisite proof of misrepresentation, the predominance requirement mandates that a plaintiff demonstrate that all members of a putative consumer class received the same misrepresentation(s) in order to establish that common questions of fact and law outweigh individual questions. But in the context of consumer transactions, it is often difficult or impossible to offer such proof. Where the operative misrepresentations are delivered in the context of a "sales pitch," whether orally by sales personnel or through a mix of oral statements and written sales or advertising materials, it is rare indeed that a plaintiff can convincingly show that the relevant statements could not, and did not, materially vary from one presentation to the next. Absent such proof, consumer fraud class actions routinely are rejected.[2]

Moreover, proof of reliance presents a different, but equally rigorous, challenge to plaintiffs seeking certification of consumer fraud claims. In order to demonstrate the requisite predominance of common issues of fact, class plaintiffs must show that every putative class member relied upon the specific misrepresentations at issue to an equivalent degree in deciding to purchase the subject product or service.

This requirement presents several potential pitfalls to class plaintiffs. For example, where a class plaintiff demonstrates uniform alleged misrepresentations by basing his case upon statements made in mass media advertising, the plaintiff is confronted with the daunting task of proving that every class member not only was exposed to, but affirmatively relied upon, such advertising in deciding to purchase the product or service at issue.

In a different context, where the consumer fraud claims being litigated relate to a relatively complex product (such as an automobile or a life insurance policy) and the alleged misrepresentations concern less than all of the material aspects or features of that product, class plaintiffs are faced with the seemingly hopeless task of proving that every putative class member was equally concerned about such aspects or features and equally relied upon the purported misrepresentations concerning them in making their purchasing decisions. Where the operative facts reveal that proof of reliance will vary from class member to class member, predominance cannot be demonstrated, and certification fails.[3]

The plaintiffs in *McLaughlin* managed to overcome these hurdles and obtain class certification by the trial court by invoking a creative theory that the court described as "elegant."[4] However, the 2nd Circuit rejected the plaintiffs' theory and reversed the trial court's grant of certification, finding that the requisite reliance could only be shown by individualized evidence and therefore that common issues did not predominate over individual issues.

The *McLaughlin* Decision

McLaughlin was begun as a nationwide class action by a group of consumers who smoked "light" cigarettes. The crux of the plaintiffs' case was that the defendant tobacco companies promulgated false and fraudulent advertising suggesting that light cigarettes were less harmful to a smoker's health than were "full-flavored" cigarettes. Rather than asserting state common-law or statutory claims, the plaintiffs asserted claims pursuant to the federal Racketeer Influenced and Corrupt Organizations Act,[5] contending that the promulgation of the purportedly fraudulent advertising constituted "predicate acts" of federal mail and wire fraud. The plaintiffs, asserting that light-cigarette purchasers failed to "get what they paid for" by reason of the defendants' fraudulent conduct, sought economic damages on behalf of millions of light-cigarette smokers throughout the United States.[6]

Since the *McLaughlin* plaintiffs' allegations focused on mass media saturation advertising that conveyed an essentially uniform message (*i.e.,* smoking light cigarettes is more healthful than smoking full-flavored cigarettes), they were able to avoid the pitfall of basing their class claims on differing purported misrepresentations. But establishing that all putative class members had relied upon the allegedly offending advertising in deciding to purchase light cigarettes still presented a significant barrier to certification. Borrowing from the "fraud on the market" concept in federal securities class litigation,[7] the plaintiffs contended that the tobacco companies' saturation advertising was so pervasive and effective that the general public (including, of course, smokers) mistakenly accepted as fact that light cigarettes were less harmful than

full-flavored cigarettes. They maintained that individualized proof of reliance by every putative class member was unnecessary because the public at large had "internalized" the notion that light cigarettes were more healthful than full-flavored cigarettes.[8]

In an opinion spanning more than 300 pages, the U.S. District Court for the Eastern District of New York certified the plaintiffs' proposed class.[9] Among other things, the court held that the plaintiffs met Rule 23(b)(3)'s predominance requirement and found convincing their "elegant" argument that proof of individual reliance was unnecessary. It held that "[a]dvertisement imagery and verbiage was chosen [by the defendants] to appeal to the entire prospective market of 'light' smokers" and that "[i]nformation about health risks was allegedly withheld from all ['light' cigarette smokers], not just some."[10] Rejecting the defendants' argument that reasonable reliance on such advertising was an individualized question varying from one putative class member to the next, the District Court held that "[w]here 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."[11]

McLaughlin *is a significant barrier to plaintiffs' efforts to circumvent the need for individualized proof of reliance in consumer fraud class actions.*

The 2nd Circuit granted interlocutory review of the certification order and reversed. Though failing to excuse the defendants' alleged misconduct, the court posited that "not every wrong can have a legal remedy" and said "plaintiffs' putative class action suffers from an insurmountable deficit of collective legal or factual questions."[12] The court held that "Rule 23 is not a one-way ratchet, empowering a judge to conform the law to the proof."[13]

The 2nd Circuit began its analysis by holding that plaintiffs asserting civil RICO claims must prove that a defendant's purported misconduct caused their injury and that, in the context of claims involving mail and wire fraud, such proof necessarily includes a showing that the plaintiff relied upon the alleged misrepresentations to his or her detriment.[14] Stating that such reliance "cannot be the subject of general proof," the court determined that "[i]ndividualized proof is needed to overcome the possibility that a member of the purported class purchased Lights for some reason other than the belief that lights were a healthier alternative — for example, if a lights smoker was unaware of that representation, preferred the taste of lights, or chose lights as an expression of personal style."[15]

The 2nd Circuit was not persuaded by the plaintiffs' argument that "defendants distorted the body of public information and that, in purchasing lights, plaintiffs relied upon the public's general sense that lights were healthier than full-flavored cigarettes."[16] "We cannot assume that, regardless of whether individual smokers were aware of defendants' misrepresentation, the market at large internalized the misrepresentation to such an extent that all plaintiffs can be said to have relied on it," the court said.[17]

While refusing to establish a "blanket rule" that "a fraud class action cannot be certified when individual reliance will be an issue," and observing that "proof of reliance by circumstantial evidence may be sufficient under certain conditions," the court nevertheless held that direct proof of reliance as to each putative class member would be required in the instant case because "each plaintiff in this case could have elected to purchase light cigarettes for any number of reasons."[18] The necessity of such proof established that individual issues of fact and law predominated over common issues, thereby defeating class certification.[19]

McLaughlin constitutes a significant new barrier to plaintiffs' efforts to circumvent the need for individualized proof of reliance in consumer fraud class actions by arguing that generalized facts applicable to all putative class members suffice to establish reliance.

The *McLaughlin* plaintiffs' "fraud on the market" theory was based upon two relatively simple — and seemingly compelling — propositions: The defendants engaged in a lengthy campaign of saturation advertising delivering the message that light cigarettes were more healthful than full-flavored cigarettes; and the supposed relative "healthfulness" of light cigarettes was accepted and relied upon by smokers who chose them over full-flavored cigarettes. Yet the 2nd Circuit, finding that smokers could have chosen light cigarettes for reasons other than their relative "healthfulness," held that reliance would not be presumed and had to be proven on a case-by-case basis, thereby precluding class certification.

Given that the strong facts and arguments the plaintiffs presented in *McLaughlin* were nevertheless deemed insufficient by the 2nd Circuit, it is difficult to conceive of more persuasive ones that would compel another court, at least within the 2nd Circuit and perhaps most others, to reach a different conclusion. Accordingly, it appears unlikely that

How to Achieve Certification In Consumer Fraud Class Actions

1. **The "Perfect" Storm**
   - Demonstrate that standardized misrepresentations were made to every putative class member
   - Show that the misrepresentations were so all-encompassing that a court can conclude that each class member must have relied upon them
2. **State Consumer Protection Statutes**
   - Eliminate the need for proof by asserting fraud claims pursuant to statutes that do not require such proof to establish liability
   - A number of state consumer protection statutes have been held not to require a plaintiff to show reliance

attempts to prove class reliance by citing the impact of alleged misrepresentations upon general impressions or public knowledge concerning a product or service will succeed in the future.

Other Avenues to Certification in Consumer Fraud Class Actions

Two primary avenues to certification remain available to plaintiffs seeking to certify fraud-based consumer class actions.

First, a limited number of cases present a "perfect" confluence of facts whereby:

- It can be demonstrated that standardized material misrepresentations were made by a defendant to every putative class member; and
- Such misrepresentations were either so fundamental or so all-encompassing as to enable a court to conclude that each class member must have relied upon them in deciding to purchase the subject product or service.

A relatively recent example of such a "perfect case" is *In re First Alliance Mortgage Co.,* 471 F.3d 977 (9th Cir. 2006). That case focused on allegedly fraudulent practices by a "subprime" mortgage lender, First Alliance, which subsequently declared bankruptcy. The plaintiffs brought class claims on behalf of themselves and all others allegedly defrauded by First Alliance against Lehman Bros., which had largely financed First Alliance's operations. The plaintiffs claimed that they and the other putative class members had been induced by misrepresentations made by First Alliance employees to sign loan agreements containing various "hidden" charges. The plaintiffs asserted common-law fraud claims and state consumer protection statutory claims against Lehman on an aiding-and-abetting theory of liability.

The 9th Circuit affirmed the District Court's class certification order.[20] Lehman unsuccessfully argued that the Rule 23(b)(3) predominance standard had not been met because the purported misrepresentations First Alliance employees made in "sales pitches" were not identical. But the court held that the evidence established that First Alliance had engaged in "a centrally orchestrated scheme to mislead borrowers through a standardized protocol [its] sales agents were carefully trained to perform."[21]

The court found it unnecessary for the plaintiffs to prove that the misrepresentations "consist of a specifically worded false statement repeated to each and every borrower" and said "[t]he class action mechanism would be impotent if a defendant could escape much of his personal liability for fraud by simply altering the wording or format of his misrepresentations across the class of victims."[22]

Lehman also argued that the need to prove reliance undermined class certification, but the court, saying the "whole scheme was built on inducing borrowers to sign documents without really understanding the terms," held that reliance had been demonstrated uniformly across the putative class because "First Alliance's misrepresentations were at least a substantial factor in inducing the plaintiffs to enter loan agreements."[23]

The second potential avenue to certification that remains available to consumer fraud class-action plaintiffs is to eliminate the need for proof of reliance by asserting fraud claims pursuant to statutes that do not require such proof to establish liability. Significantly, a number of state consumer protection statutes (*i.e.,* statutes that generally prohibit the use of unfair or deceptive practices in connection with the sale of goods or services) have been held not to require a plaintiff to establish reliance. Such statutes offer plaintiffs whose claims are based on allegedly

uniform misrepresentations a means of obtaining certification in circumstances where the need to establish reliance might otherwise impede success.

A stark illustration of the potential benefits of this approach to certification is *Aspinall v. Philip Morris Co.,* 813 N.E. 2d 476 (Mass. 2004), a case based on the identical allegations made by the plaintiffs in *McLaughlin*: that tobacco companies had fraudulently advertised light cigarettes as being less harmful to a smoker's health than full-flavored cigarettes. (In addition to the *McLaughlin* plaintiffs' attempt to certify a nationwide class of RICO claimants based on light-cigarette advertising, a number of actions have been initiated across the country seeking certification of state-based classes asserting state law claims predicated upon the same facts.)[24]

In *Aspinall,* the plaintiffs limited their proposed class to people who purchased a single brand of light cigarettes (Marlboro Lights) in Massachusetts and only asserted claims pursuant to the state's consumer protection statute.[25] That statute provided two significant advantages to the plaintiffs: It contained its own, somewhat more relaxed standard for class certification (as compared to Massachusetts Rule of Civil Procedure 23, which is essentially identical to Federal Rule 23), and it provided that a plaintiff need not prove that he relied upon the defendant's allegedly deceptive conduct in order to recover.[26]

Obtaining certification in the consumer fraud context is a daunting task and remains relatively rare.

The trial court certified the proposed class, and the Supreme Judicial Court of Massachusetts affirmed. The state high court emphasized that, under the statute at issue, the proper focus of the certification inquiry was on the allegedly deceptive nature of the defendants' conduct, rather than on putative class members' reactions to it. The court said:

> No individual inquiries concerning each class member's smoking behavior are required to determine whether the defendants' conduct caused compensable injury to all the members of the class — consumers of Marlboro Lights were injured when they purchased a product that, when used as directed, exposed them to substantial and inherent health risks that were not (as a reasonable consumer likely could have been misled into believing) minimized by their choice of the defendants' "light" cigarettes. … Neither an individual's smoking habits nor his or her subjective motivation in purchasing Marlboro Lights bears on the issue of whether the advertising was deceptive.[27]

First Alliance and *Aspinall* demonstrate that consumer fraud class actions can be certified in circumstances where the evidence establishes the right facts or enables the assertion of claims pursuant to the right statute. But, as the plaintiffs in *McLaughlin* learned, obtaining class certification in the consumer fraud context is a daunting task and remains, as the authors of the Advisory Committee Notes to Rule 23 could have predicted, relatively rare.

Notes

[1] *Advisory Committee Notes to Federal Rule of Civil Procedure 23, 1966 Amendment, comments concerning Rule 23(b)(3).* Mass torts involving personal injuries are the other type of claim that the Advisory Committee Notes identify as being "ordinarily not appropriate for a class action." *Id.*

[2] *See, e.g., Moore v. PaineWebber Inc.*, 306 F.3d 1247, 1253-56 (2d Cir. 2002); *In re LifeUSA Holding*, 242 F.3d 136, 144-47 (3d Cir. 2001); *Walker v. Sunrise Pontiac-GMC Truck Inc.*, 249 S.W.3d 301, 311-13 (Tenn. 2008); *Chiarella v. Sprint Spectrum*, 921 So. 2d 106, 126 (La. Ct. App. 2005).

[3] *See, e.g., Castano v. Am. Tobacco Co.*, 84 F.3d 734, 744-45 (5th Cir. 1996); *Univ. Fed. Credit Union v. Grayson*, 878 So. 2d 280, 286-89 (Ala. 2003); *Weinberg v. Sun Co.*, 777 A.2d 442, 446 (Pa. 2001); *Gonzalez v. Proctor & Gamble Co.*, 247 F.R.D. 616, 623-26 (S.D. Cal. 2007).

[4] *Schwab v. Philip Morris USA*, 449 F. Supp. 2d 992, 1019 (E.D.N.Y. 2006).

[5] *See* 18 U.S.C. § 1961.

[6] *See McLaughlin*, 522 F.3d at 219-20. While the *McLaughlin* plaintiffs were pursuing their case in New York federal court, the Justice Department was prosecuting a separate civil RICO action in the U.S. District Court for the District of Columbia against the same tobacco company defendants based on essentially identical allegations: that the defendants had conspired to defraud the public by promulgating advertising touting the purportedly less harmful nature of light cigarettes. That prosecution resulted in a judgment against the tobacco companies. *See United States v. Philip Morris USA*, 449 F. Supp. 2d 1 (D.D.C. 2006).

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

[8] *See McLaughlin*, 522 F.3d at 223-24.

[9] *Schwab*, 449 F. Supp. 2d 992 (E.D.N.Y. 2006). Although the title of the action changed, *Schwab* and *McLaughlin* are one and the same.

[10] *Id.* at 1127.

[11] *Id.*

[12] *McLaughlin*, 522 F.3d at 219.

[13] *Id*. at 220.

[14] *Id*. at 222-23.

[15] *Id.* at 223.

[16] *Id*.

[17] *Id.* at 224.

[18] *Id*. at 224-25.

[19] The court also held that proof of injury with respect to each putative class member could only be made by means of individualized evidence, calculation of damages also raised additional individualized issues and the assertion of affirmative defenses such as the statute of limitations required further individualized proof. 522 F.3d at 227-34. Ultimately, the court held that "because we find that numerous issues in this case are not susceptible to generalized proof but would require a more individualized inquiry, we conclude that the predominance requirement of Rule 23 has not been satisfied." *Id.* at 234.

[20] Prior to the appeal of the class-certification order, a jury trial resulted in a finding of liability in favor of the class against Lehman. The 9th Circuit affirmed that finding but remanded for further proceedings on the ground that the jury had applied an improper measure of damages in rendering its award on the class's statutory claim. *See First Alliance Mortgage Co.*, 471 F.3d at 1001-03.

[21] *Id.* at 991.

[22] *Id.* at 992.

[23] *Id.*

[24] Some such actions have produced successful results for plaintiffs (*see, e.g., Craft v. Philip Morris Co.*, 190 S.W.3d 368 [Mo. Ct. App. 2006]; *Curtis v. Philip Morris Co.*, No. PI 01-018042, 2004 WL 2776228 [Minn. Dist. Ct. Nov. 29, 2004]), while others have not (*see, e.g., Mulford v. Altria Group,* 242 F.R.D. 615 [D.N.M. 2007]; *Benedict v. Altria Group,* 241 F.R.D. 668 [D. Kan. 2007]).

[25] *See* Mass. Gen. Laws ch. 93A.

[26] *See Aspinall*, 813 N.E.2d at 484-85, 486.

[27] *Id.* at 488-89.

Richard H. Silberberg *is a partner and chairman of the advocacy group at* ***Dorsey & Whitney*** *in New York.* ***Christopher G. Karagheuzoff*** *is a partner at the firm, and* ***Robert G. Manson*** *is of counsel.*