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Third Quarter 2023 Update on Class Actions

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This update provides an overview of key class action-related developments during the third quarter of 2023 (July to September).

- **Part I** summarizes an Eighth Circuit decision addressing waiver of arbitration in putative class actions;
- **Part II** covers a Fourth Circuit opinion analyzing the impact of class action waivers on class certification proceedings;
- **Part III** discusses a recent opinion from the D.C. Circuit that weighs in on certification of "issue" classes under Rule 23(c)(4);
- And **Part IV** discusses two decisions reversing attorneys' fee awards following class settlements.

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I. The Eighth Circuit Holds Defendant Does Not Waive Right to Arbitrate by Waiting Until After Class Certification to Move to Compel Arbitration as to Absent Class Members

In *H&T Fair Hills, Ltd. v. Alliance Pipeline L.P.*, 76 F.4th 1093 (8th Cir. 2023), landowners brought a putative class action against a natural gas pipeline construction company, alleging the company breached its easement contracts with the landowners. Although most of these contracts contained an arbitration clause, some did not—including the contracts with the named plaintiffs. *Id*. at 1097. After the district court certified the class, the company moved to compel arbitration of the claims of class members whose contracts contained arbitration provisions. Plaintiffs objected, arguing the company waived its right to compel arbitration because it "wait[ed] more than two years after the complaint was filed" before moving to compel as to the absent class members. *Id*. at 1098. The district court nevertheless granted the motion to compel, highlighting that the company "had no reason to raise arbitration as an affirmative defense" given that none of the named plaintiffs had easement contracts "subject to arbitration agreements." *Id*. at 1098–99.

The Eighth Circuit agreed, holding that the company did not waive its right to arbitrate. "[N]one of the named plaintiffs … have arbitration provisions in their easements," *id*. at 1100, and at least until a class was certified, it made little sense to force a defendant to compel arbitration as to absent class members—"parties who were not yet part of the case." *Id*. The Eighth Circuit concluded that the company "acted consistently with its right to arbitrate" when it moved to compel arbitration "quickly after the class was certified" as to those class members whose contracts contained an arbitration provision. *Id*.

This holding contrasts with the Ninth Circuit's recent decision in *Hill v. Xerox Business Services, LLC*, 59 F.4th 457 (9th Cir. 2023), which ruled that a defendant waived its right to compel arbitration against unnamed class members due to the defendant's *pre-certification* conduct. The court noted the defendant engaged in over six years of pre-certification litigation, having never mentioned a particular arbitration provision in its affirmative defenses or opposition to class certification. *Id*. at 466. It was only after the district court certified the class that the defendant invoked that specific arbitration

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provision—which, in the Ninth Circuit's view, was too late. In so holding, the Ninth Circuit rejected the argument pre-certification conduct can never vitiate a yet-to-exist right to arbitrate, reasoning that parties can implicitly relinquish such prospective rights at common law. *See Id.* at 469–470 & n.15. The Ninth Circuit also found it troublesome that the defendant had repeatedly asserted a right to arbitrate under a newer version of its employment contract "without also asserting the same" for the older version upon which it later tried to compel arbitration. *Id*. at 473–74.

II. The Fourth Circuit Vacates Certification Where District Court Failed to Consider Impact of Class Action Waiver Before Certifying Classes

In *In re Marriott International, Inc.*, 78 F.4th 677 (4th Cir. 2023), the Fourth Circuit addressed the impact of a contractual class waiver on certification under Rule 23. The case involved claims against a hotel chain and its IT service provider after hackers allegedly breached a guest reservations database and gained access to millions of guest records. *Id.* at 680.

After holding that the named plaintiffs had adequately alleged an injury-in-fact for purposes of Article III standing, the district court certified classes for monetary damages under Rule 23(b)(3). *Id.* at 681. Defendants argued that the named plaintiffs did not satisfy the typicality requirement because they were all members of the hotel's guest rewards program, the terms of which included a class action waiver. *Id*. at 682. By contrast, the class included absent class members who were *not* rewards members, and thus "had *not* signed such waivers." *Id.* To address these "serious typicality concerns," the district court redefined the classes to include only members of the guest rewards program. *Id.* The defendants sought interlocutory review under Rule 23(f). *Id*. at 684–85.

On appeal, the Fourth Circuit held that the district court erred by certifying classes "consisting entirely of plaintiffs who had signed a putative class waiver without first addressing the import of that waiver." *Id.* at 687. The court reasoned that the "time to address a contractual class waiver is before, not after, a class is certified." *Id.* at 686. In so holding, the court explained that a "class-waiver" defense is not a merits issue, as it speaks only to the "process available" to a plaintiff in pursuit of their claim, and not the "underlying merits of that claim." *Id.* at 687. As a result, the district court should have ruled on the effect of the "[class] waiver defense before certifying a class." *Id.*

III. D.C. Circuit Holds Rule 23(c)(4) "Issue" Classes Must Still Satisfy Rule 23(a) and Be Maintainable Under One Category of Rule 23(b)

Rule 23(c)(4) states that "[w]hen appropriate, an action may be brought or maintained as a class action with respect to particular issues." Over the years, circuit courts have taken different approaches as to when certification under Rule 23(c)(4) is appropriate—and in particular, whether Rule 23(c)(4) can be used to skirt the predominance analysis under Rule 23(b)(3), since an "issue" class will have, by definition, a common issue. This past quarter, the D.C. Circuit addressed this issue and followed the Fifth Circuit's approach of rigorously applying all of Rule 23's requirements, even for classes sought to be certified under Rule 23(c)(4).

In *Harris v. Medical Transportation Management, Inc.*, 77 F.4th 746 (D.C. Cir. 2023), medical transportation drivers brought a putative class action under the Fair Labor Standards Act ("FLSA"), D.C.'s wage-and-hour laws, and for common-law breach of contract against their employer, alleging it failed to pay them their full wages. *Id.* at 753–54. The plaintiffs also sought certification of a class of drivers under Rule 23 for the wage claims. *Id.* at 754. The district court found that although the plaintiffs met the requirements of Rule 23(a), they failed to meet the predominance requirement of Rule 23(b)(3). *Id.* The district court nonetheless certified a Rule 23(c)(4) "issue" class on the issue of whether the employer was a joint employer or a general contractor. *Id.* at 754–55.

After accepting the employer's interlocutory appeal, the D.C. Circuit acknowledged that it

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had not yet addressed the question whether an "issue" class "can be certified when no lawsuit or cause of action has been certified as a class" and acknowledged the circuit split on the issue, noting "[o]ther circuits have applied Rule 23(c)(4) in a variety of ways." *Id.* at 756–57 (collecting cases).

Siding with the approach first set out by the Fifth Circuit in *Castano v. American Tobacco Co.*, 84 F.3d 734 (5th Cir. 1996), the D.C. Circuit held that, under Rule 23, all certified classes—including a Rule 23(c)(4) "issue" class—must meet both the threshold requirements of Rule 23(a) and be maintainable under one of Rule 23(b)'s categories. *Harris*, 77 F.4th at 757. Noting "Rule 23's carefully calibrated limits on class certification," the D.C. Circuit emphasized the importance of the predominance inquiry as "an important safeguard against unreasonably fractured litigation, [which] simultaneously protects the rights of named parties and absent class members alike." *Id.* at 762. The D.C. Circuit concluded that "district courts must ensure that Rule 23(c)(4)'s authorization of issue classes does not end up at war with Rule 23(b)(3)'s predominance requirement," lest courts let plaintiffs "effectively skirt the functional demands of the predominance requirement by seeking certification of an overly narrow issue class and then arguing that the issue (inevitably) predominates as to itself." *Id.* (citing *Castano*, 84 F.3d at 745 n.21). The court therefore vacated certification and remanded, instructing the district court to explain "how the use of issue classes is 'superior to other available methods for fairly and efficiently adjudicating the controversy'" (such as the alternative of "deciding a partial summary judgment motion focused on the issues proposed to be certified"). *Id*. (quoting Fed. R. Civ. P. 23(b)(3)).

IV. Continuing Trend of Applying Greater Scrutiny to Class Action Settlements, Seventh and Ninth Circuits Eschew Mechanical Approaches to Calculating Attorneys' Fees and Reverse Class Counsel Fees Awards

In *Lowery v. Rhapsody International, Inc.*, 75 F.4th 985 (9th Cir. 2023), plaintiffs' counsel sought $1.7 million in attorneys' fees based on a capped $20 million settlement fund with a claims rate of less than 0.3%—effectively, only a $50,000 recovery for the class. *Id.* at 988, 990. The district court granted class counsel's full fee award based on the "lodestar" method, and the defendant appealed. Rejecting class counsel's arguments, the Ninth Circuit held that attorneys' fees should be based on the actual—and not theoretical—amount recovered by the class. *Id*. at 992. The court elaborated that district courts awarding fees "must consider the actual or realistically anticipated benefit to the class—not the maximum or hypothetical amount—in assessing the value of a class settlement" for purposes of evaluating the reasonableness of a fee award. *Id.*

The Ninth Circuit ordered the district court on remand to "disregard the theoretical $20 million settlement cap," and instead focus on the amount actually claimed by the class because "[a]ny other approach would allow parties to concoct a high phantom settlement cap to justify excessive fees, even though class members receive nothing close to that amount." *Id.* The court also "encourage[d]" the district court "to cross-check the fees against the benefit to the class and ensure that the fees are reasonably proportional to that benefit." *Id.* at 993–94. In its view, the fact that class counsel's fees "greatly exceed[ed] 25% of the value of the settlement" was a "major red flag" signifying "that lawyers [were] being overcompensated and that they achieved only meager success for the class." *Id.* at 994. *Lowery* is a timely reminder to parties litigating in the Ninth Circuit to prepare for the possibility of heightened scrutiny of the class's recovery when seeking approval of class settlements, particularly those with a claims-made structure.

In *In re Broiler Chicken Antitrust Litigation*, 80 F.4th 797, 800 (7th Cir. 2023), the Seventh Circuit vacated class counsel's $57.4 million fee award in an antitrust case based on a settlement fund of $181 million. The district court considered whether the fees represented the "market rate," and approved the award by relying on evidence that fee awards in antitrust cases in the Seventh Circuit "are almost always one-third" of the settlement value, which it viewed as a "strong indication" that this represented the "market rate." *Id*. at 801. The Seventh Circuit vacated the award, holding that the district

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court's market rate "evaluation fell short in two areas: the consideration of bids made by class counsel in auctions, and the weight assigned to out-of-circuit decisions." *Id.* at 802.

As to the first area, the Seventh Circuit faulted the district court for discounting recent bids submitted by class counsel in other cases with declining fee award structures, believing such declining fee award structures "do not reflect market realities" and "create perverse incentives" by reducing attorneys' incentives to seek a larger recovery. *Id.* at 803. The Seventh Circuit disagreed, clarifying that it "never categorically rejected consideration of bids with declining fee scale award structures" and that these prior auction bids by class counsel in other cases were probative of the hypothetical bargain that could have been struck *ex ante*. *Id*. at 802–03.

As to the second area, the Seventh Circuit disapproved of the district court's decision to give less weight to fee awards received by the same class counsel in Ninth Circuit cases because the relevant law governing fee awards differed in some meaningful ways from Seventh Circuit law. *Id*. at 804. The Seventh Circuit held that even if Ninth Circuit law differed, class counsel's economic choice to continue litigating in those Ninth Circuit cases was informative of the price of their legal services and the bargain they may have struck in this case. *Id*.

On remand, the court instructed the district court to reevaluate the bargain the parties would have struck ex ante while giving appropriate consideration and weight to the two additional factors. *Id.* at 805. The court "express[ed] no preference as to the amount or structure of the award," but said that an attorney fee award of one-third of the net settlement "warrants greater explanation." *Id.*

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