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Expert Analysis

Too high a price? The perilous combination of statutory damages and class certification

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For certain causes of action, Congress has provided that plaintiffs may seek statutorily defined damages, rather than proving actual damages. When combined with the class-action procedure, these statutory damages provisions sometimes create a risk of staggeringly large awards — often for merely technical violations of a statute. The threat of such awards can place intense settlement pressure on defendants in class actions. Recognizing this issue, courts have struggled with whether it is appropriate to certify cases seeking large aggregate awards of statutory damages when plaintiffs have suffered little, if any, actual harm.

Courts are divided over whether the size and disproportionate nature of such awards are permissible considerations at the class certification stage under Federal Rule of Civil Procedure 23(b)(3). And courts continue to grapple with whether the possibility of annihilating damages (*i.e.*, a damages award that would put a defendant company out of business) raises due-process concerns akin to those raised by an award of excessive punitive damages. Implicit in these disputes is a growing disagreement about whether gargantuan statutory damages awards are what Congress truly intended.

THE PERFECT STORM

Congress and the courts have developed at least two distinct methods to encourage the litigation of disputes that are arguably too small for an individual plaintiff to pursue in court. The most commonly discussed means is the use of the class-action device in Rule 23. Alternatively, Congress has authorized statutory damages for some causes of action. The availability of statutory damages, in lieu of proof of actual damages, increases the incentives for and reduces the costs of bringing these claims. *See, e.g.*, Fair and Accurate Credit Transactions Act, 15 U.S.C. § 1681(n); Truth in Lending Act, 15 U.S.C. § 1640(a)(2); Fair Debt Collection Practices Act, 15 U.S.C. § 1692k(a)(2).

When used together, however, the two methods can create a "perfect storm" because they can "combine to create commercial wreckage far greater than either could alone." *Stillmock v. Weis Mkts.*, 385 F. App'x 267, 276 (4th Cir. July 1, 2010) (Wilkinson, J., concurring).

For instance, in *Leysoto v. Mama Mia I*, 255 F.R.D. 693, 697-98 (S.D. Fla. Feb. 17, 2009), a local restaurant faced a class action under the Fair and Accurate Credit Transactions Act, which requires, among other things, that vendors truncate credit card numbers printed on receipts. FACTA provides for statutory damages between $100 and $1,000 per violation of the law. 15 U.S.C. § 1681(n). Because *Leysoto* involved an estimated class size of 46,000, the claimed damages were between $4.6 million and $46 million — amounts that would have bankrupted the restaurant, which had only $40,000 in assets.

Statutory damages provisions sometimes create a risk of staggeringly large awards ... [and] can place intense settlement pressure on defendants

In such cases, the combination of statutory damages and the class-action device can be deadly. The damages at stake are frequently large enough to destroy a company, which is why many practitioners describe the potential damages as "annihilating." Courts are facing a "veritable onslaught" of class actions under FACTA and similar statutes. *Palamara v. Kings Family Rests.*, No. 07-317, 2008 WL 1818453, at *3 (W.D. Pa. Apr. 22, 2008).

When a lawsuit involves the potential aggregation of statutory damages, the ruling on class certification is critical because the stakes are massive. As the 7th U.S. Circuit Court of Appeals has put it in another context, once a class is certified, defendants are forced to "stake their companies on the outcome of a single jury trial or be forced by fear of the risk of bankruptcy to settle even though they have no legal liability." *In re Rhone-Poulenc Rorer Inc.*, 51 F.3d at 1299 (7th Cir. Mar. 16, 1995).

The mere threat of a "potentially enormous aggregate recovery for plaintiffs" raises concerns about "an *in terrorem* effect on defendants, which may induce unfair settlements." *Parker v. Time Warner Entm't Co.*, 331 F.3d 13, 22 (2d Cir. June 2, 2003). Thus, "Judge Friendly, who was not given to hyperbole, called settlements induced by a small probability of an immense judgment in a class action 'blackmail settlements.'" *Rhone-Poulenc*, 51 F.3d at 1298.

Or, as the federal court colorfully put it in *Leysoto*, "[T]o grant the requested class relief would allow this plaintiff and his counsel to dangle the sword of Damocles over defendant without any showing of actual economic harm." 255 F.R.D. at 699. Furthermore, by creating irresistible pressure to settle, the aggregation of statutory damages often effectively eliminates the possibility of appellate review (*see Stillmock*, 385 F. App'x at 281 [Wilkinson, J., concurring]), since class certification decisions are interlocutory orders, and immediate review of class certification orders under Rule 23(f) is relatively uncommon.[1]

In some cases, Congress has responded with caps on class actions that seek statutory damages. For example, when the flood of class-action suits under the Truth in Lending Act began to loom, Congress capped the amount of damages available at $500,000. *See* Act of Oct. 28, 1974, Pub. L. No. 93-495, § 408(a), 88 Stat. 1500, 1518. This prevented the devastatingly large awards previously possible using the statute's $100 to $1,000 statutory damages clause. *See, e.g.*, *Watkins v. Simmons & Clark Inc.*, 618 F.2d 398 (6th Cir. Mar. 24, 1980) (potential award of $1 million capped at $500,000). Nonetheless, many other laws involving statutory damages (most notably in recent years, including FACTA) lack these caps.

JUDICIAL RESPONSES

While virtually all courts recognize the dangers that statutory damages and class actions can pose when combined, they have reached divergent results in crafting an

appropriate response. The dispute centers around the appropriate time for a court to intervene: Should the court consider the size and potentially annihilating nature of the award at the class certification stage or wait until the litigation has run its course to review the ultimate damages award? At the core of this dispute are three key principles: Rule 23(b)(3)'s "superiority" requirement, the due-process clause and Congress' purposes in enacting statutory damages provisions.

Rule 23(b)(3)

Rule 23(b)(3) provides the most obvious opportunity for a court to prevent the problem of annihilating damages from arising. In order to certify a class under Rule 23(b)(3), a court must determine "that a class action is superior to other available methods for fairly and efficiently adjudicating the controversy." Recognizing the enormous settlement pressures facing defendants in statutory damages cases, some courts have held that a class action is not a superior method for resolving the dispute.[2]

The facts of *Stillmock v. Weis Markets*, 385 F. App'x 267 (4th Cir. July 1, 2010), raised concerns about "practical justice" that are paradigmatic of class actions seeking statutory damages. Plaintiffs sued a chain of grocery stores under FACTA, alleging that the stores had issued credit card receipts that had deleted some (but not enough) of the digits of customers' card numbers.

Facing a class likely numbering over 1 million, and statutory damages of $100 to $1,000 per violation, the store was almost certainly facing an annihilating potential award. As the Weis Markets attorney put it, "a hundred million dollars," the low end of the potential award, "sinks my client." *Id.* at 279. The 4th Circuit vacated the District court's denial of class certification but remanded to allow the court to consider, among other things, whether the potentially annihilating damages at issue precluded class certification. *Id.* at 275.

In his concurrence, Judge James Wilkinson persuasively laid out the contours of this argument, cautioning district courts against "adopt[ing] a procedural device [class actions] that cuts against the grain of practical justice as the trial courts conceive it." *Id.* at 279. As Judge Wilkinson noted, "I worry that the exponential expansion of statutory damages through the aggressive use of the class-action device is a real jobs killer that Congress has not sanctioned." *Id.* at 276.

"Rule 23(b)(3)'s superiority requirement," Judge Wilkinson explained, "permits a district court to declare that a device is not superior when a plaintiff class whose members suffered no identity theft of any sort still threatens to wipe an entire company off the map." *Id.* at 278.

Judge Wilkinson's concurrence is supported by a long line of cases similarly denying class certification in the face of a potentially annihilating damages award. In *Kline v. Coldwell, Banker & Co.*, 508 F.2d 226, 234 (9th Cir. Dec. 20, 1974), the 9th Circuit held that while "[t]he amount of a recovery in a lawsuit is not ordinarily of concern where a wrong has been inflicted and an injury suffered," the large award in that case "would shock the conscience" and thus was a permissible consideration in the class certification decision. And the 5th Circuit has held where a potential damages award is not only "completely out of proportion" with the harm caused but also threatens to destroy the company, it is appropriately considered at the class certification stage. *London v. Wal-Mart Stores*, 340 F.3d 1246, 1255 n.5 (11th Cir. Aug. 7, 2003).

Several district courts have also acknowledged that the massive character of a potential aggregated statutory damages award should play a role in the class certification decision. As early as 1972, the seeds of this idea could be seen, when the Southern District of New York denied class certification in *Ratner v. Chemical Bank New York Trust Co.*, 54 F.R.D. 412, 416 (S.D.N.Y. Feb. 14, 1972). Class certification was inappropriate because "the proposed recovery of $100 each for some 130,000 class members would be a horrendous, possibly annihilating punishment."

And this argument continues to win adherents in more recent cases. *See, e.g.*, *Legge v. Nextel Commc'ns*, No. 02-cv-8676, 2004 WL 5235587, at *15 (C.D. Cal. June 25, 2004) ("[An award's] financial impact on a defendant, while not grounds to deny a motion, is certainly a consideration."). In March 2010 the U.S. District Court for the Western District of Missouri held that the *size* of the award was inappropriate for consideration but nonetheless weighed its "annihilating nature" in determining superiority under Rule 23(b)(3). *Hammer v. JP's Sw. Foods*, 267 F.R.D. 284, 290 (W.D. Mo. Mar. 16, 2010).

In contrast, a few courts have rejected this approach, instead regarding the settlement pressures placed on defendants as "sociological"[3] and therefore properly left to the legislative, rather than judicial, branch.[4] For example, the 7th Circuit has said "[t]he reason that damages can be substantial ... does not lie in an abuse of the Rule 23, it lies in the legislative decision to authorize [statutory] awards as high as $1,000 per person ... combined with [the defendant's] decision to obtain the credit scores of more than a million persons." *Murray v. GMAC Mortgage Corp.*, 434 F.3d 948, 953 (7th Cir. Feb. 21, 2006). Thus, these courts regard the problem of annihilating damages as one that only Congress can remedy.

Due-process clause

Courts also disagree about whether the threat to defendants imposed by massive aggregated statutory damages awards raises constitutional concerns. It is well established that the due-process clause limits the size of punitive damages awards,[5] and some defendants have argued against class certification on the basis that the potential award would be unconstitutionally large.

Though not frequently accepted, a few courts have endorsed this approach, particularly in the realm of statutory damages, which impose penalties even in the absence of any actual harm. Most notably, Judge Wilkinson argued that "[c]ertifying a class action that would impose annihilating damages where there has been no actual harm ... could raise serious constitutional concerns." 385 F. App'x at 278.

The 2nd Circuit, too, has suggested "that the potential for a devastatingly large damages award, out of all reasonable proportion to the actual harm suffered by members of the plaintiff class, may raise due-process issues. It may be that the aggregation in a class action of large numbers of statutory damages claims potentially distorts the purpose of both statutory damages and class actions." *Parker*, 331 F.3d at 22. And several district courts have similarly examined due-process considerations at the class certification stage.[6]

But even when courts recognize the danger imposed, they often hold that "constitutional limits are best applied after a class has been certified."[7] Taking such a view, the 2nd Circuit noted in *Parker* that "[i]n a sufficiently serious case the due-process clause might be invoked, not to prevent certification, but to nullify that effect and reduce the aggregate damage award." 331 F.3d at 22.[8]

However, as Judge Jon Newman noted in his concurrence in *Parker*, if due process and related concerns are not considered at the class certification stage, "the *in terrorem* threat of a massive award of the full statutory amounts will unfairly induce a large settlement once a class has been certified." *Id.* at 29. The troubling practical reality is that very few, if any, defendants will be in a position to suffer a final judgment containing a massive aggregate statutory damages award in order to raise due-process issues on appeal.

Congressional intent

Many courts have pointed to what they see as the underlying debate: a fundamental disagreement about whether Congress intended, in enacting statutory damages provisions, to allow for potentially annihilating class-wide judgments. A number of courts have concluded that Congress intended to encourage *individual* litigation in adopting statutory damages provisions, not create the risk that a company would be destroyed.

Other courts hold that Congress enacted statutory damages provisions with the recognition that class actions are generally available in federal courts, and therefore that Congress should be presumed to have intended the availability of aggregated statutory damages, even if massive.

The 9th Circuit's recent change in tune illustrates this debate. Nearly four decades ago, the court in *Kline* reversed a district court's grant of class certification in part because class treatment would subject the defendants to joint and several liabilities in a conscience-shocking amount. As the court of appeals explained, "[t]he intent of Congress ... appears to have been to impose punishment upon the violator ... for his own malefactions, not to subject him to vicarious liability by the coincidence of a class action for the staggering damages of the multitude." 508 F.2d at 235.[9]

At odds with *Kline* is the 9th Circuit's recent decision in *Bateman v. American Multi-Cinema Inc*. 623 F.3d 708, 717 (9th Cir. Sept. 27, 2010). In *Bateman*, the 9th Circuit said Congress must have intended to allow aggregated statutory damages awards under FACTA because the court was required to "presume that Congress intended class relief to be available." Thus, the *Bateman* court held under FACTA that the size of a potential damages award is not a permissible consideration at the class certification stage.

Nonetheless, the appeals court did reserve the question "whether a showing of 'ruinous liability' would warrant denial of class certification in a FACTA or similar action." *Id.* at 723. Stated another way, even in the *Bateman* court's view, the question of congressional intent would be much closer when a potential award is demonstrated to be annihilating in nature.

CONCLUSION

Courts remain deeply divided about the proper judicial response, if any, to remedy this "perfect storm" of aggregated statutory damages. The courts that have addressed the issue appear to disagree fundamentally about the proper function of statutory damages. Indeed, courts have read the same statute differently. In *Bateman*, the 9th Circuit deemed it perfectly appropriate to declare that a massive potential statutory damages award involving potentially hundreds of millions of dollars is permissible under FACTA.

In contrast, as Judge Wilkinson explained in *Stillmock*, "It staggers the imagination to believe that Congress intended to impose annihilating damages on an entire com-

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pany and the people who work for it for lapses of a somewhat technical nature and in a case where not a single class member suffered actual harm due to identity theft." 385 F. App'x at 280 (Wilkinson, J., concurring).

Given this growing divide among the courts, it may be necessary for the U.S. Supreme Court to resolve the question. In the meantime, business defendants should consider raising and preserving challenges to aggregated statutory damages when opposing class certification. WJ

NOTES

[1] Under Rule 23(f), one widely applied, though not dispositive, criterion for whether to grant such review is whether liability would be "ruinous." *See, e.g., Chamberlain v. Ford Motor Co.,* 402 F.3d 952, 955 (9th Cir. 2005) (noting the court will review Rule 23(f) petitions when "there is a death-knell situation for either the plaintiff or defendant that is independent of the merits of the underlying claims, coupled with a class certification decision by the district court that is dubious"); *In re Lorazepam & Clorazepate Antitrust Litig.,* 289 F.3d 98, 102-05 (D.C. Cir. 2002) (same) (collecting cases from other circuits with similar criteria).

[2] *See, e.g., London v. Wal-Mart Stores,* 340 F.3d 1246, 1255 n.5 (11th Cir. 2003) ("[W]e also note our doubt as to whether the class certification could meet Rule 23(b)(3)'s superiority requirement. ... [E]ven though economic harm is not an element of the Florida common-law claim for restitution, it may be required for superiority under the Federal Rules of Civil Procedure. This is especially likely when, as in the present suit, the defendants' potential liability would be enormous and completely out of proportion to any harm suffered by the plaintiff.") *Schroder v. Suburban Coastal Corp.,* 729 F.2d 1371, 1377 (11th Cir. 1984) ("[S]ome violations that are sufficient to sustain liability in an individual TILA action, may be too technical to form the basis for maintaining a class action."); *Watkins*, 618 F.2d at 400 ("As a rationale for avoiding class certification, the vast majority of courts, particularly where the plaintiff had sustained no monetary damages, concluded that a class action was not 'superior to other available methods for the fair and efficient adjudication of the controversy.'") (collecting cases); *Azoiani v. Love's Travel Stops & Country Stores,* No. EDCV-07-90-OPW, 2010 WL 4811627 (C.D. Cal. Dec. 18, 2007).

[3] *See Blackie v. Barrack,* 524 F.2d 891, 899 (9th Cir. 1975); *Chakejian v. Equifax Info. Servs.,* 256 F.R.D. 492, 502 (E.D. Pa. 2009). *But see In re Rhone-Poulenc Rorer,* 51 F.3d 1293, 1298-99 (7th Cir. 1995) (Posner, C.J.) ("Judicial concern about them is legitimate, not 'sociological' as it was derisively termed in *In re Sugar Antitrust Litigation,* 559 F.2d 481, 483 n.1 (9th Cir. 1977)).

[4] *See Murray v. GMAC Mortgage Corp.,* 434 F.3d 948, 953 (7th Cir. 2006); *Domonoske v. Bank of Am.,* Nos. 5:08-cv066 and 5:09-cv-080, 2010 WL 329961 (W.D. Va. Jan. 27, 2010); *Chakejian,* 256 F.R.D. 492; *Cicilline v. Jewel Food Stores,* 542 F. Supp. 2d 831 (N.D. Ill. 2008).

[5] *State Farm v. Campbell,* 538 U.S. 408, 416 (2003) ("The due-process clause of the 14th Amendment prohibits the imposition of grossly excessive or arbitrary punishments on a tortfeasor."). *See also Philip Morris USA v. Williams,* 549 U.S. 346 (2007) (holding unconstitutional the use of punitive damages awards to punish defendants for harms to third parties); *BMW v. Gore,* 517 U.S. 559 (1996) (overturning a "grossly excessive" punitive damages award as unconstitutional). Members of Mayer Brown's supreme court and appellate practice group wrote merits or *amicus* briefs in these and similar cases.

[6] *See e.g., Najarian v. Avis Rent A Car Sys.,* No. 07-cv-588, 2007 WL 4682071, at *4 (C.D. Cal. June 11, 2007) ("[C]ase law in this jurisdiction supports adjudicating [due-process clause] claims prior to certification."); *In re Trans Union Corp. Privacy Litig.,* 211 F.R.D. 328 (N.D. Ill. 2002) (denying class certification after noting "due-process concerns" regarding the size of the award).

[7] *Murray*, 434 F.3d at 954.

[8] *See also In re Farmers Ins. Co. FCRA Litigation,* No. 03-cv-158, 2006 WL 1042450 at *11 (W.D. Okla. Apr. 13, 2006) ("[C]ourts have concluded that the fact that a damage award may implicate due-process concerns is not a reason to prevent certification. Such effect can be nullified through reduction of the award.").

[9] The concurrences in *Stillmock* and *Parker* picked up on this same concept. *See Stillmock*, 385 F. App'x at 281 (Wilkinson, J., concurring) (describing the annihilating potential damages award as "far in excess of what Congress intended"); *Parker*, 331 F.3d at 28 (Newman, J., concurring) (aiming to "avoid[ ] a result not intended by Congress").



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