

ETHICAL CHALLENGES IN CLASS ACTIONS

Absence of Specific Rules Means Applying Those Governing Individuals

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The American Bar Association Class Action Institute recently sponsored a continuing legal education program, one segment of which addressed ethics in class action suits. The program was conducted as a panel discussion among practitioners and, as the panelists surveyed the topic, a sharp divergence emerged between plaintiff's and defense attorneys concerning precertification communications and settlement. These disparate positions illustrate the unsettled area of ethics and class actions and the complexity of applying a traditional ethical analysis.

Ethical rules developed to govern actions brought by individual plaintiffs. Among some practitioners debate continues as to whether such rules apply to class actions. Although no ethical code specifically designed for class actions exists, courts routinely tailor current rules to fit the class action setting.¹ The Model Rules of Professional Responsibility (Model Rules) promulgated by the ABA and the New York Lawyer's Code of Professional Responsibility (New York Code) promote broad policies to protect and preserve the attorney-client relationship.²

Precertification Dealings

The Model Rules and the New York Code prohibit communications between a lawyer and a known represented party. The Model Rules provide that "[i]n representing a client, a lawyer shall not communicate about the subject of the representation with a person the lawyer knows to be represented by another lawyer in the matter, unless the lawyer has the consent of the other lawyer or is authorized by law to do so."³ Similarly, the New York Code sets forth that "[d]uring the course of the representation of a client a lawyer shall not: . . . [c]ommunicate or cause another to communicate on the subject of the representation with a party the lawyer knows to be represented by a lawyer in that matter unless the lawyer has the prior consent of the lawyer representing such other party or is authorized by law to do so."⁴

In addition, under both the Model Rules and New York Code a lawyer may not appear disinterested or render advice to a party not represented. Model Rule 4.3 requires that "[i]n dealing on behalf of a client with a person who is not represented by counsel, a lawyer shall not state or imply that the lawyer is disinterested."⁵ The New York Code builds upon the Model

Rules and further provides that “[d]uring the course of the representation of a client a lawyer shall not: . . . [g]ive advice to a party who is not represented by a lawyer, other than the advice to secure counsel, if the interests of such party are or have a reasonable possibility of being in conflict with the interests of the lawyer’s client.”⁶ While these restrictions on communications by an adverse party seek to protect an unassuming client, application to class action communications proves complicated.

Generally, ethical guidelines attach at the outset of the attorney-client relationship. In individual actions the relationship commences when a client retains an attorney. The challenge in class actions lies in identifying the parties represented and determining the scope of representation. In class actions, although individual named plaintiffs clearly benefit from representation at the outset, legal representation of potential members of an alleged class remains unclear.

Practitioners disagree with respect to the point in the litigation that potential class members become represented by counsel. Some deem representation of potential class members to occur before certification upon the filing of a complaint, while others find legal representation only after certification of a distinct class.⁷

Plaintiff’s attorneys argue that class representation commences upon the filing of a complaint. Following this analysis, the Model Rules and New York Code would apply upon filing, and would restrict early communications between defendant and class members.

In *Weight Watchers of Philadelphia, Inc. v. Weight Watchers International, Inc.* 455 F.2d 770, 773 (2d Cir. 1972), defendant moved to dismiss plaintiffs’ appeal of an order allowing defendant to communicate with potential class members. Plaintiff argued that “once a plaintiff brings a suit on behalf of a class, the court may never permit communications between the defendant and other members.”⁸

Later, in *Christensen v. Kiewit-Murdock Investment Corp.*, 815 F.2d 206, 213 (2d Cir. 1987), plaintiffs argued that precertification defendants violated Rule 23(e) by negotiating a settlement with potential class members absent court approval. Rule 23(e) provides that “[a] class action shall not be dismissed or compromised without the approval of the court, and notice of the proposed dismissal or compromise shall be given to all members of the class in such manner as the court directs.”⁹ In both cases plaintiffs sought a court ruling that defendants could not engage in dialogue with potential class members before class action certification.

Conversely, defense attorneys agree that until certification, a complaint provides merely an allegation of a class. Accordingly, as no formal cohesive group exists precertification, the Model Rules and New York Code provide no restraint on communications between defendant and potential class members. Defense attorneys also cite the prevailing strong public policy encouraging settlement as support for permissible precertification communications.

Although debate concerning the ethical boundaries of precertification communication between defendants and potential class members persists, courts allow such communications to advance settlement provided no local rule or pretrial order otherwise prohibits communications.¹⁰ When faced with whether precertification communications violated Rule 23, the Second Circuit repeatedly reinforces that precertification, defendant and potential class members may properly negotiate a settlement.

In *Weight Watchers*, the panel responded to plaintiffs' position and noted that "we are unable to perceive any legal theory that would endow a plaintiff . . . with a right to prevent negotiation of settlements between the defendant and other potential members of the class who are of a mind to do this; it is only the settlement of the class action itself without court approval the F.R.Civ.P. 23(e) prohibits."¹¹ Later, in *Christensen*, the court followed *Weight Watchers* and found the defendants' precertification negotiation with potential class members outside the parameters of Rule 23(e).¹²

The Circuit reinforced this analysis in *In re Painewebber Ltd. Partnerships Litigation*, 147 F.3d 132, 138 (2d Cir. 1998). Although the panel ultimately found the settlement discussions at issue a violation of a permissible court order, the court distinguished precertification from postcertification communications, explaining that "[a]bsent certification by a court and identification of the class, the action is not properly a class action within the meaning of Rule 23(c)(1) and (c)(3) . . . [w]e therefore permitted potential members of a class not yet certified to settle their individual claims with the potential class defendant. . . . [h]owever, once a district court enters an order certifying the class, Rule 23(d)(5) authorizes it to make appropriate procedural orders to facilitate the fair and efficient conduct of the action."¹³

Joining the Second Circuit, the First Circuit has recognized that absent class members may settle with defendant free from any judicial intervention for approval. In *Duhaime v. John Hancock Mutual Life Insurance Company*, 183 F.3d 1,4 (1st Cir. 1999) the panel noted that Rule 23(e)

requires judicial approval of formal class actions only. Accordingly, settlement discussions negotiated between defendants and absent class members precertification remain permissible communications. In addition, the First Circuit further explained that no interest in settlement discussions between defendant and absent class members requires judicial protection, as the adversary system provides a sufficient safeguard to fairness.¹⁴

Individual Settlement

The Model Rules and New York Code also regulate conflicts of interest. Attorneys may not accept any employment that compromises a client's position without consent.

Model Rule 1.7(a) provides that “[a] lawyer shall not represent a client if the representation of that client will be directly adverse to another client, unless (1) the lawyer reasonably believes the representation will not adversely affect the relationship with the other client; and (2) each client consents after consultation.”¹⁵ Similarly, the New York Code sets forth that “[a] lawyer shall not accept or continue employment if the exercise of professional judgment on behalf of the client will be or reasonably may be affected by the lawyer's own financial, business, property, or personal interests, unless a disinterested lawyer would believe that the representation of the client will not be adversely affected thereby and the client consents to the representation after full disclosure of the implications of the lawyer's interest.”¹⁶

These ethical guidelines endeavor to ensure that a client's best interests prevail. Due to the magnitude of participation, however, class actions command compromise. As a result, debate among practitioners continues as to the extent to which precertification settlement of a named plaintiff implicates ethical considerations.

Plaintiff's attorneys contend that named plaintiffs owe a fiduciary duty to potential class members. If this is so, then any precertification settlement that benefits a named plaintiff at the expense of potential class members constitutes a breach. Plaintiff's attorneys regard such conduct as self dealing whereby the individual settlement compromises that interest of potential class members for that of a named party.¹⁷

Defense attorneys disagree. Consistent with the approach discussed earlier concerning precertification communications, defense attorneys argue that no formal relationship exists between a named plaintiff and potential class members precertification and that, accordingly, no

fiduciary duty exists. Accordingly, defense attorneys believe in the freedom to engage in settlement discussions with named plaintiffs within the parameters of the Model Rules and New York Code.¹⁸

Courts strike a balance. Faced with individual settlement precertification, most courts recognize such an agreement provided that the settling plaintiffs receive no premium, and that no prejudice results to absent class members. Throughout the case law, courts approach differently whether to review the issues within the context of Rule 23(e).

In *Shelton v. Pargo, Inc.*, 582 F.2d 1298, 1304-05 (4th Cir. 1978), the panel approved individual settlement. Without applying Rule 23(e), the court found that named plaintiffs owe a fiduciary duty to absent members. Accordingly, named plaintiffs must uphold that duty and avoid prejudice and improper use of the class action mechanism for personal gain. The panel rejected application of Rule 23(e) precertification and explained that the provision only relates to class actions. According to fourth Circuit, a class action comes alive upon certification. As a result, if no class action exists precertification, Rule 23(e) proves irrelevant.

In *Diaz v. Trust Territory of the Pacific Islands*, 876 F.2d 1401, 1408 (9th Cir. 1989), 252 named plaintiffs sought settlement approval precertification. The court applied rule 23(e), assuming, “for purposes of dismissal or compromise that an action containing class allegations is really a class action.”¹⁹ Noting that individual dismissal precertification provides no res judicata effect against absent class members, the court found a flexible review necessary to ensure against collusion or prejudice.²⁰

Citing both *Shelton* and *Diaz*, a district court more recently recognized plaintiffs’ individual right to settle precertification. In *Ross v. Diversified Collection Services, Inc.*, 1999 WL 672316 (N.D. Cal. 1999), the court discussed neither the fiduciary duty analysis of *Shelton* nor the Rule 23(e) analysis of *Diaz*. The court reviewed the settlement to confirm that absence of abusive measures and, upon finding no prejudice to absent members, approved that arrangement.

As an interrelated matter, courts generally agree that notice of precertification individual settlement to absent class members remains subject to judicial discretion. Trial courts typically engage in a flexible review to ascertain whether the settlement resulted from collusion, proves prejudicial to absent class members or reflects an outright abuse of the class action procedure. The debate among courts concerns the source of judicial authority to review settlements and

determine notice. Some courts find the power in Rule 23(e), while others refuse a 23(e) analysis and conclude that notice to absent members remains within the discretion of the court to ensure compliance with fiduciary duties owed.

For example, in *Diaz and Anderberg v. Masonite Corp.*, 176 F.R.D. 682, 690 (N.D. Ga. 1997) each court similarly decided that Rule 23(e) applies to dismissals and settlement precertification, and found notice not required. Comparatively, in *Shelton and Simer v. Rios*, 661 F.2d 655, 666 (7th Cir. 1981) both courts concluded that precertification settlements remain outside the scope of rule 23(e), and yet ruled that notice to potential class members was necessary.

Conclusion

In class actions, a delicate balance exists between ethical principles safeguarding a client's interest, and the strong public policy favoring settlement and the expedient, efficient, effective administration of justice. As no specific rules tailored to the unique ethical issues posed by class actions exist, the strong advocacy of plaintiff's and defense attorneys provides the landscape for analysis.

Guided by traditional ethical principles developed for individual actions, courts engage in the familiar weighing of interests to resolve ethical disputes in class actions. Until a formal ethical code designed to address the intricate issues present in complex litigation is promulgated, the standards developed by courts and influenced by attorneys on both sides of the issues will continue to shape the application of ethics to class actions.

¹ See Herbert B. Newberg & Alba Conte, *Newberg on Class Actions* §15.01 (3d ed. 1992) (noting ethical rules development for individual actions).

² See generally Model Code of Professional Responsibility (1999); The Lawyer's Code of Professional Responsibility (1999).

³ Model Code of Professional Responsibility Rule 4.2 (1999).

⁴ The Lawyer's Code of Professional Responsibility DR 7-104(A)(2)(1999).

⁵ Model Code of Professional Responsibility Rule 4.3 (1999).

⁶ The Lawyer's Code of Professional Responsibility DR 7-104(A)(2) (1999)

⁷ See Remarks at the American Bar Association Class Action Institute Panel on Ethics (October 13, 2000).

⁸ *Weight Watchers*, 455 F.2d at 773.

⁹ Fed. R. Civ. P. 23(e).

¹⁰ See Newberg at §15.14 (discussing acceptance of precertification communications between defendants and absent class members).

¹¹ *Weight Watchers*, 455 F.2d at 773

¹² *Christensen*, 815 F.2d at 213.

¹³ *In re Painewebber*, 147 F.3d at 138.

¹⁴ See *Duhaime*, 183 F.3d at 6.

¹⁵ Model Code of Professional Responsibility Rule 1.7(a) (1999).

¹⁶ The Lawyer's Code of Professional Responsibility DR-5-101(A) (1999).

¹⁷ See Remarks at the American Bar Association Class Action Institute Panel on Ethics (Oct. 13, 2000).

¹⁸ See *id.*

¹⁹ *Diaz*, 876 F.2d at 1408.

²⁰ Although the court approved the individual settlement, it denied settlement and dismissal based on insufficient notice. See *id.* at 1408-1411.