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SUPREME COURT RULING IN ORTIZ V. FIBREBOARD CORPORATION

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On June 23, 1999, the Supreme Court, in a 7-2 decision, dealt a strong blow to the procedure of settling mass tort damage claims by means of a "mandatory" or "non opt-out" class action. In *Ortiz v. Fibreboard Corporation*, 119 S. Ct. 2295 (1999), the Court held that a mandatory settlement class of thousands of asbestos personal injury claimants was not properly certified under Rule 23(b)(1)(B) of the Federal Rules of Civil Procedure. The class had been certified on the basis of a theory that the resources available from the corporate defendant to settle the asbestos claims constituted a "limited fund" that would be shared by the asbestos claimants. The Supreme Court, although not eliminating entirely the possibility that a "limited fund" theory could be used to settle mass tort claims, raised serious questions about the procedure and held that it was not appropriately employed in the *Ortiz* case.

Perhaps more significantly, *Ortiz* marks the fourth time in recent years that the Supreme Court agreed to review a class action that raised significant constitutional issues relating to class action procedure. As in past cases, the Supreme Court alluded to, but did not reach, the constitutional issues in *Ortiz*, choosing instead to rest its decision upon its construction of the applicable procedural rules. (In two of the three prior cases, *Adams v. Robertson*, 520 U.S. 83 (1997) and *Ticor Title Ins. Co. v. Brown*, 511 U.S. 117(1994), the Supreme Court, after briefing and argument, decided that its decision to hear the cases had been improvident, and no decision was issued. In the other, *Amchem Products, Inc. v. Windsor*, 521 U.S. 591 (1997), the Court rested its decision upon its construction of the class action procedures embodied in Rule 23 of the Federal Rules of Civil Procedure.) In addition, to the extent it discusses constitutional issues, *Ortiz* may confuse rather than illuminate future debate concerning due process and Seventh Amendment considerations in class actions.

Background

The *Ortiz* case was initiated as part of a pre-packaged class settlement of both asbestos personal injury "futures" claims and unfiled (but accrued) present claims against Fibreboard, as well as the claims of Fibreboard against its insurers for coverage relating to asbestos liability. A "futures" claim is the claim of an individual who has been exposed to asbestos, but who has not yet manifested any actionable physical symptoms. Faced with an ever-growing number of asbestos personal injury cases, Fibreboard took action in an effort to preserve its liquidity.

Fibreboard had initiated litigation in the late-1970's against two insurers. The insurance policies had no aggregate limit and were potentially applicable to asbestos

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claims. In 1990, a court held that the insurers were required to indemnify Fibreboard for any claim based upon exposure to

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Fibreboard products prior to the policy expiration dates. The insurance companies appealed the decision, and that appeal had not yet been decided at the time that the parties agreed to the *Ortiz* class settlement in 1993.

From December 1992 through August 1993, Fibreboard, its insurers and a group of prominent asbestos plaintiffs' lawyers negotiated in an effort to reach a global settlement agreement of all present and future asbestos claims against Fibreboard. Due to the insurance companies' desire for "total peace," negotiations focused upon the possibility of a "mandatory" class action that would bind all potential claimants without providing them the opportunity to "opt out" of the settlement and pursue their own claims in separate litigation. In early August, Fibreboard settled a number of individual lawsuits that had been brought by the plaintiffs' counsel with whom Fibreboard was attempting to negotiate a global settlement. The terms of these settlements were more favorable than historical settlement values.

On August 26, 1993 (the night before the insurance companies' appeal was to be argued), the parties reached agreement on the terms of a global settlement. Specifically, Fibreboard and its insurers agreed to contribute $1.535 billion to a trust fund to settle "futures" claims against Fibreboard by means of a claim procedure requiring claimants to negotiate a settlement with the trust. If settlement negotiations were unsuccessful, the procedure required mediation, arbitration and an award. Claimants dissatisfied with their award could initiate suit, but would be limited as to the type and amount of damages they could seek, and would be paid less expeditiously than those who accepted payment under the claims procedure. Of the $1.535 billion being provided to the settlement trust, only $500,000 was to be contributed by Fibreboard. The district court later determined that, at the time, Fibreboard had a net worth (based upon sale value) in excess of $200 million. Under the settlement agreement, pending claims were to be treated separately from the mandatory class of "futures" claims, and were to receive compensation along the lines of the early-August settlements.

On September 9, 1993, the *Ortiz* case was filed. Plaintiffs and Fibreboard sought the certification of a mandatory, non opt-out class on the grounds that it was necessary to distribute equitably the "limited fund" of assets to asbestos claimants. After extensive efforts to provide notice to potentially interested parties, various objectors intervened, claiming that the action could not properly be treated as a "limited fund" class action. The federal district court, however, rejected the intervenors' objections, finding that the settlement was fair, adequate and reasonable. Specifically, the court held because of the magnitude of anticipated future asbestos claims against Fibreboard, a limited fund existed regardless of whether the court looked only to the "insurance asset" or to both the "insurance asset" and the "value" of Fibreboard.

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The Fifth Circuit Court of Appeals affirmed, but its opinion was vacated by the Supreme Court for reconsideration in light of the Supreme Court's opinion in *Amchem*, another asbestos "futures" class action. After remand, the Fifth Circuit promptly affirmed its prior ruling, issuing a three-paragraph opinion in support of its conclusions. The intervenors objecting to the settlement sought review in the United States Supreme Court.

<u>The Supreme Court's Opinion</u>

After reviewing the history of Rule 23 of the Federal Rules of Civil Procedure generally, the Court turned to the historical antecedents to Rule 23(b)(1)(B), which permits a court to certify a class where

> the prosecution of separate actions by . . . members of the class would create a risk of . . . adjudications with respect to individual members of the class which would as a practical matter be dispositive of the interests of the other members not parties to the adjudications or substantially impair or impede their ability to protect their interests. . . .

The Court noted that unlike class actions brought under Rule 23(b)(3), in cases under subsection (b)(1), Rule 23 does not provide for class members to "opt out" or exclude the themselves from class membership. According to the Court, "classic" limited fund class actions included cases involving competing claims to trust assets, bank accounts, insurance proceeds, company assets in a liquidation sale, proceeds of a ship sale in a maritime accident, and others.

In a relatively limited holding (joined by seven of the nine Justices, with three Justices concurring in a brief separate opinion), the Court held that there existed a presumption that mandatory class treatment on a limited fund theory is justifiable only when: (a) the "fund" is limited such that it could not pay all claims against it; (b) the fund is completely distributed to satisfy all similar claims; and (c) the distribution is equitable and made on a pro rata basis. The Court drew these factors from its review of actions that had "traditionally" been certified as limited fund class actions. Although the Court stated that this "presumption" was rebuttable, it made clear that the party seeking certification of a non-traditional limited fund class action bears a significant burden of proving the appropriateness of using this particular procedural device. The Court held that the *Ortiz* settlement did not have the traditional characteristics of a limited fund case, and that the settling parties had not carried their burden of proving that certification of a mandatory class was appropriate.

The Court identified three primary ways in which *Ortiz* did not qualify for limited fund treatment. First, the Court held that the lower courts erred in relying

too heavily upon the unsupported allegations of the settling parties regarding the existence and size of the supposed limited fund. Specifically, the Court stressed that the parties advancing the settlement bore the burden of proving the fund's upper limits, and the trial court was required to make detailed factual findings on this issue. The Court stated that it was not sufficient for the parties and the lower court to rely merely on the terms reached in a negotiated settlement agreement, particularly in a case in which the magnitude of the attorneys' fees to be paid to class counsel was sufficient to call into question their motivation in reaching the settlement. This was especially true, according to the Court, where class counsel had simultaneously negotiated a separate and more favorable settlement for the individual plaintiffs they were representing in separate lawsuits. In addition, the size of the insurance asset was a significant question. The Court held that the evidence was insufficient to establish the amount of funds reasonably available from Fibreboard's insurers and Fibreboard itself. Because of this holding, the Court did not have to decide the difficult question of how the "insurance asset" should be valued (although the Court suggested that because of litigation uncertainties it might be proper to value the asset at less than the total amount that could be paid out by the insurers before they became insolvent).

The second deficiency noted by the Court concerned the conflicts of interest among class members that, in the Court's view, precluded an equitable allocation of the alleged limited fund. The Court grouped these conflicts into two categories: those relating to the inclusiveness of the class and those relating to the fairness of the distribution. As to the first category, the Court took issue with the separate settlement by Fibreboard of the pending individual claims brought against it by clients of class counsel. Specifically, the Court held that even if it would be permissible to resolve some number of claims by means of separate settlements, the settlement of one-third of the potential claimants precluded certification of a mandatory class.

As to the fairness of the distribution, the Court noted that after its decision in the *Amchem* case, it was clear that in a class settlement involving both present and future claims it was necessary to divide the present and future claimants into subclasses, each with its own counsel. The Court held that the failure to create such subclasses precluded both a finding of adequacy of representation (under Rule 23(a)(4)) and a finding that the distribution was fair (under the limited fund criteria established by the Court). The Court also held that subclasses and separate counsel were necessary to protect fully those individuals exposed to Fibreboard products during the insurance policy period (and, therefore, possessing stronger claims for actual recovery) from receiving the same treatment as those who were exposed at a different time.

The third deficiency identified by the Court was the failure to include all available assets within the "limited fund." Concluding that its treatment of the first two deficiencies had proved fatal to the class certification, the Court merely

addressed this third point for purposes of “identify[ing] the issue” raised. The Court noted unfavorably that the settlement permitted Fibreboard to retain virtually all of its net worth. The Court questioned, but did not determine, how close to insolvency a defendant must be brought for it to be proper to certify a mandatory limited fund class and whether the savings of transactional costs (such as court costs, attorneys’ fees, etc.) factored into the certification decision. Ultimately, the Court held only that the district court’s conclusion that the settlement was “fair” was not enough to overcome the absence of an adequate analysis in this area.

Analysis

Although some of the language of the *Ortiz* opinion will likely be applicable in other types of class actions, the majority opinion went to great lengths to limit the holding to the unique context of classes certified on a limited fund theory pursuant to Rule 23(b)(1)(B) of the Federal Rules of Civil Procedure. Also significant is the fact that the Court again declined to decide important constitutional questions relating to settlements of this nature, choosing instead to rely on an interpretation of the Federal Rules of Civil Procedure.

The Court was careful to clarify that it was not precluding the possibility of a limited fund class settlement of a mass tort case. In light of the limitations created by the Court and the issues left unresolved, however, a defendant would have to consider carefully the wisdom of choosing to seek such a mandatory limited fund certification, as compared to a certification that allowed class members to opt out.

Any company that decides to pursue a mandatory class action settlement in the federal system must be cognizant of several issues. The company must carefully scrutinize whether the potential for “greater peace” that may be obtained through a mandatory class action justifies certain risks. Chief among these risks is the open legal question whether the Supreme Court would ever permit a limited fund class settlement of mass tort claims. Moreover, it is virtually certain that class members in a mandatory mass tort class action will contend that the amount set aside as the limited fund does not constitute the full amount that should be contributed by the company. Although objectors often appear in settlements of opt-out class actions as well, the settlement approval issue for the Court in those cases concerns whether the settlement is “fair, reasonable and adequate” in light of a whole host of factors, not whether the company has paid out every last penny it can afford. In many instances, it will be preferable for a company to assume some risk that there will be class members who will opt out rather than to put into play before a court the question of what amount can be set aside for the class of claimants.

The Court did not attempt to fashion a line between settlements of limited fund class actions and bankruptcies. The Court appeared to indulge the notion

that the former might be a substitute for the latter, while at the same time noting that if the settlement amount in a "limited fund" action was "too small," it would allow the company to restructure its debt without providing tort claimants the protections afforded by the bankruptcy process. Not noted by the Court, however, is the possibility that a settlement which could be characterized as "too large" in size would run the risk of depriving the company's other creditors of a fair allocation of the company's assets (and might be characterized as a preference if the company went into bankruptcy soon thereafter). Substantial questions therefore remain as to the extent to which settlement of a Rule 23(b)(1)(B) class action can be utilized as an alternative to bankruptcy.

Once the risks are weighed, a company that decides to attempt a limited fund certification must take great procedural care in doing so. First, it will be critical that an adequate factual record be made demonstrating that the prerequisites identified by the Court have been satisfied. The company must be prepared with expert and financial evidence establishing the existence and size of the alleged limited fund and similarly be prepared to address the claims of objectors who will claim that the fund should be larger. Second, it will be necessary to identify categories of claimants that have substantially stronger or weaker claims vis-a-vis other claimants, and to form appropriate sub-classes with separate counsel. (Based upon *Ortiz*, it is difficult to discern how far the settling parties must go in drawing distinctions among the claimants. Obviously, the more distinctions that are drawn, the more subclasses and counsel there will be, and the more difficult it will be to reach a mutually acceptable settlement.) Third, the settling parties must assiduously avoid the appearance of any favoritism for class counsel's pending individual claims at or near the time that settlement negotiations are progressing.

In the wake of *Ortiz*, the most intriguing question is whether or when the Supreme Court actually will address various constitutional and jurisdictional questions that it repeatedly has positioned itself to review but then declined to address. Among these are questions regarding the requirements of the due process clause in the areas of notice and adequacy of representation. These questions are particularly significant with regard to resolving "futures" claims that have not even accrued at the time they are purportedly settled. Instead of resolving such troubling constitutional issues, however, *Ortiz* adds yet another issue to the mix in suggesting that the settlement of mandatory class actions may raise potential Seventh Amendment implications in depriving individuals of their right to jury trial without adequate consent.

It is becoming apparent that the Supreme Court is uncertain about the correct constitutional light in which to view class members, and the extent to which such class members must or should be accorded the full panoply of constitutional protections normally afforded litigants. The Court clearly understands, however, that treating class members in precisely the same manner as other plaintiffs from a constitutional standpoint might ultimately impair

substantially the contribution of the class action device to judicial economy. Until a majority of the Justices adopt a common approach to addressing the tensions in this area, increasingly prominent constitutional issues are likely to go unresolved.

For the time being, settling parties will be well served by "self policing" the scope and terms of class settlements in an attempt to minimize or steer clear of potential constitutional difficulties. With the recent growth of collateral attacks on class action settlements, parties that desire to settle cases must proceed with a clear view toward maximizing the res judicata effect of their judgements.

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