



Class Action Law Update

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Annihilating Damages & the Case of Sharper Image

Overview

Despite strong efforts to implement tort reform, class action lawsuits remain a serious threat to the retail, restaurant and hospitality industries. The combination of attorneys fees, awards of statutory penalties, damages awards and/or refunds can at times be overwhelming. Some companies have successfully defeated class certification by advancing the argument that the potential monetary award, if imposed, will annihilate the business, which means essentially that no one, not even the class members or the attorneys will be paid at the end of the day. Our article addresses the legal standards applied in such cases. We also touch on the cautionary tale of how Sharper Image, chased by nationwide class action lawsuits, went from a vibrant and profitable enterprise to a bankrupt company.

General Standards for Class Certification in California

It is Plaintiffs' burden to establish all the requirements for class certification. *Hamwi v. Citinational-Buckeye Inv. Co.*, 72 Cal. App. 3d 462, 472 (1977). Plaintiffs must prove that there are 1) predominant, common questions of law or fact; 2) a representative with claims typical of the purported class; 3) a representative who can adequately represent the class; and 4) a class action is a superior to alternative methods of resolution and provides benefits to the litigants and the court. *Basurco v. 21st Century Insur. Co.*, 108 Cal. App. 4th 110, 120 (2003); *Lockheed Martin Corp. v. Superior Court*, 29 Cal. 4th 1096, 1104 (2003). Courts will not permit class actions "where there are diverse factual issues to be resolved, even though there may be common questions of law." *Basurco*, 108 Cal. App. 4th at 118. If determining liability under substantive law requires an individualized inquiry, permitting class actions "would be to confuse the means with the ends – to sacrifice the goals for the going." *Id.* at 120. Plaintiffs' burden includes establishing the propriety of class certification, and this involves the demonstration of predominance and manageability. *Washington Mutual Bank v. Superior Court*, 24 Cal. 4th 906, 913 (2001), *Richmond v. Dart Industries*, 29 Cal. 3d 462, 470 (1981).

Policy Considerations

Class actions "have the potential to create injustice." *Linder v. Thrifty Oil Co.*, 23 Cal. 4th 429, 435 (2000). The Court must analyze whether the class device is **superior** on the facts presented. *City of San Jose v. Superior Court*, 12 Cal. 3d 447, 459 (1974). To determine whether a class action is superior at the certification stage, this Court should consider the probability that class members will prosecute their claims, whether the class approach would actually serve to deter and redress alleged wrongdoing, and the suitability of alternative procedures for handling the controversy. *Linder*, 23 Cal. 4th at 445-46.

The Issue of Annihilating Damages: Defeating the Superior Method Prong


It is the plaintiff's burden to prove that having litigation proceed as a class, rather than through individual lawsuits provides the Court with a superior means by which to resolve the claims. One of the defenses available to the target of a proposed class action is to argue that the aggregate monetary award available to the class would be so high, that any effort to collect would simply wipe out the company. See *Azoiani v. Love's Travel Stops and Country Stores, Inc., et. al.*, 2007 U.S. Dist. LEXIS 96159 (C.D. Cal. 2007); *Vasquez-Torres v. StubHub, Inc.*, 2008 U.S. Dist. LEXIS 22503 (C.D. Cal. 2008); *Serna v. Big A Drug Stores, Inc.*, 2007 U.S. Dist. LEXIS 82023 ((C.D. Cal. 2007). The argument can be particularly successful when defending against a class where the members have suffered no actual injury and are proceeding based on a technical statutory violation. *Serna, supra*. In *Serna*, Judge Cormac Carney from the federal district court in Los Angeles, ruled that "when presented with a choice between class treatment that may cripple or annihilate Big A's business and individual litigation that provides for punitive damages, costs and attorneys' fees, Ms. Serna has not met her burden of convincing the Court that class treatment is the superior choice under the circumstances." *Id.* It is important to note that the California Court of Appeal, out of Los Angeles has criticized defendants who try inflate the size of a proposed class and use it as a launchpad for arguing the potential for "annihilating damages." See *Kaufman v. ACS Systems, Inc.*, 110 Cal. App. 4th 886, 926 (2003).

The Case of Sharper Image¹

This San Francisco company, achieved great success with its air-purification products and its line of massage chairs. The Chinese-manufactured air-purification products, in particular, provided the company with a high profit margin; these items were manufactured in China. Sharper Image's "Ionic Breeze" was one its most successful air-purification products, but it ultimately became a magnet for a windstorm of controversy. However, after receiving consistently negative reviews from "Consumer Reports", Sharper Image initiated an aggressive litigation strategy designed to fight the damage to its name and best-selling product. This unsuccessful strategy resulted in Sharper Image being ordered to pay several hundred thousand dollars in attorneys fees to the Consumer Union, the publisher of 'Consumer Reports.'

By 2005, the company was the target of numerous class action lawsuits filed by consumers seeking to recover damages, awards of statutory penalties and attorney fees, all relating to their status as purchasers of the "Ionic Breeze". These suits were filed in Florida, California and Maryland and alleged the product did not work and failed to filter out harmful matter from the air. These suits also alleged violations of various consumer protection and unfair business practices statutes. *Figueroa*, the suit filed in federal court in Miami, sought certification of a nationwide class, as did the *Potter* suit filed in San Francisco Superior Court. On December 12, 2005, Judge Robert Dondero certified *Potter* as a class action and rejected Sharper Images arguments, which included the assertion that some of the proposed class representatives did not suffer real damages and/or has improper financial connections to plaintiff's counsel. The effect of the *Potter* decision was to certify a nationwide class, with the exception of those suits pending in Florida.

¹Please note that the facts about the Sharper Image litigation have been gathered from the following locations: San Francisco Superior Court Electronic Docket, *Potter v. Sharper Image Corp., et. al.* Case No. CGC-03-426350; United States District Court, Southern District of Florida Pacer Electronic Docket, *Figueroa v. Sharper Image Corp., et. al.*, Case No. 05-212251-CIV-ALTONAGA/Bandista; United States Bankruptcy Court, District of Delaware, Pacer Electronic Docket, *In re: Chapter 11 Bankruptcy of Sharper Image Corporation*, Case No. 08-10322-KG.



Almost a year later, the *Potter* case was stayed based on the representation that the district court in Florida had preliminarily approved a global class action. This proposed settlement included providing a \$19 coupon to each class member and awarding \$1,875,000 in attorneys fees. Based on a number of factors, including the fact that the coupon amount had dropped from \$28.50 during final settlement negotiations, and the fact that less than 1% of the class members responded with interest to the class notices, the district court in Florida ultimately refused to approve the settlement. The denial of the settlement in August 2007 was the catalyst for the sequence of events that Sharper Image CFO Rebecca L. Roedel described in a recent affidavit, which outlined how the company's stock price plummeted after the settlement was rejected. The subsequent liquidity crisis at the company was ultimately too much to bear and by February 2008, Sharper Image filed for Chapter 11 bankruptcy protection in February 2008. At the time of the filing, there were 2,246 employees at 90 stores nationwide. All litigation has been stayed because of the bankruptcy. In effect, the threat of serial class actions, combined with the fear associated with certification, effectively resulted in the annihilation of Sharper Image.

As the bankruptcy case progresses, we will provide updates on any developments that are of particular interest for those defending against class actions.

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