

## Texas Class Actions and Res Judicata

The Texas Supreme Court announced a new and highly restrictive approach to class action lawsuits in two opinions issued in 2000. *Intratex Gas Co. v. Beeson*, 22 S.W.3d 398 (Tex. 2000); *Southwestern Refining Co. v. Bernal*, 22 S.W.3d 425 (Tex. 2000). The bedrock premise of this new jurisprudence was the notion that Texas Rule 42, the Texas counterpart to Federal Rule 23, does not create substantive rights and does not override other Texas procedural rules. While this premise might seem innocuous, and is in fact one often stated casually by other courts, the Texas Supreme Court in *Beeson*, *Bernal*, and a number of later cases has consistently reversed class certifications because they contemplate class trials “in some sort of alternative universe outside our normal jurisprudence.” *Bernal*, 22 S.W.3d at 432.

In a recent decision, the Texas Supreme Court reviewed class certification in a lawsuit carefully stripped of the complications arising from choice of law, individualized proof of liability, individual defenses, and other familiar obstacles to damage classes. See *Citizens Insurance Co. v. Daccach*, 2007 WL 623799 (Tex., March 2, 2007). The Supreme Court conceded that the plaintiff had avoided these complications by artful pleading, but reversed anyway. Why? Because the simplified lawsuit posed a res judicata risk to class members.

Citizens Insurance, a Texas-based insurance company, sold life insurance to persons outside the United States. The insurance products assigned dividends and other benefits to offshore trusts and used the proceeds to purchase common stock in Citizens. The insurance products were arguably securities within the meaning of Texas blue sky law, but Citizens never complied with the registration requirements of the Texas Securities Act. Policyholders filed a class action lawsuit against Citizens in Texas state court alleging fraud as well as a wide variety of other causes of action. They subsequently amended the lawsuit to assert an additional cause of action under the Texas Securities Act.

Eight of the nine policyholder plaintiffs dropped their class claims, but the ninth, Daccach, continued to pursue class certification. Daccach (unlike the others) dropped all of his claims except the one arising under the Texas Securities Act because, he argued, this was the only claim that could be certified. Because of his amendment, he argued, there were no choice of law issues and, moreover, no individualized issues of any sort. He accordingly asked the court to certify a class to determine four related and common issues: 1) whether the Citizens’ policies were securities pursuant to the Texas Securities Act; 2) whether Citizens offered or sold the policies from Texas; 3) the calculation of a statutory remedy under the Texas Securities Act; and 4) attorney’s fees. The trial court granted Daccach’s motion for class certification and the intermediate appellate court affirmed.

The Texas Supreme Court reversed. Significantly, the court agreed that the Texas Securities Act applied to the conduct and that Texas law alone applied to Daccach’s claim. Moreover, the court acknowledged that plaintiffs generally, and class plaintiffs specifically, can abandon claims for tactical reasons, and it conceded that Daccach’s amendment eliminated the individual issues raised by the claims he dropped.

The Texas Supreme Court, however, focused its attention on the omitted claims rather than the one that remained. If the certification stood and a judgment was entered on the Texas Securities Act claim alone, would class members lose their right to pursue their omitted (and potentially more lucrative) claims in subsequent litigation?

Res judicata bars claims that could have been litigated in a prior lawsuit involving the same subject matter. Daccach argued that res judicata should not apply to the claims he abandoned because they would not have been certified and he was therefore “barred” from litigating them in his [class action] lawsuit. Some courts and commentators have followed Daccach’s reasoning by asking whether a plaintiff could have asserted the claim in a pending class action lawsuit rather than asking whether the same plaintiff could have asserted the claim *without* the class allegations. See *Sullivan v. Chase Inv. Servs. Of Boston, Inc.*, 79 F.R.D. 246, 265 (N.D. Cal. 1978) (allowing a plaintiff to split those claims suitable for class treatment in order to realize the savings offered by class actions); 5 HERBERT B. NEWBERG & ALBA CONTE, NEWBERG ON CLASS ACTIONS § 16.22 (4<sup>th</sup> ed. 2002).

In keeping with its general approach of refusing to permit modifications of substantive and procedural law merely to facilitate class actions, the Texas Supreme Court rejected this line of authority. As the court noted:

It is the class representative’s choice to seek certification, and the putative class members’ decision not to opt out of the class, that restricts their ability to rely on certain theories of recovery that are unsuitable for class certification. Any restrictions that class action requirements place on a trial court’s ability to

entertain specific theories of recovery in a class suit arise solely because of the choice to seek class certification. By this choice, class members may put at risk their ability to litigate certain other claims not suitable for class treatment.

2007 WL 623799 at \*18. The court did not decide which if any of the class members' claims would in fact be barred by a judgment in Daccach's lawsuit, but more narrowly decided that the **risk** of res judicata impacted adequacy of representation and the adequacy of any class notice. Because ordinary principles of res judicata apply to judgments entered in class actions, and because the trial court did not evaluate the risk that the claims Dacach dropped might be barred, the court reversed the certification.

This opinion is significant to Texas practice, but it also highlights an important set of class action issues for attorneys in other jurisdictions. In effect, Daccach used artful pleading to pare his claims down to the "issue certification" permitted by both Federal Rule 23 and Texas Rule 42. The Texas Supreme Court explicitly conceded that neither individual nor class plaintiffs have to assert all potential claims arising from a transaction, and that a narrowly defined class with a narrowly defined set of claims and issues might enjoy an efficient class trial. Unless the ordinary rules of res judicata are relaxed, however, class action judgments will affect the claims individual class members can bring later—and this consequence must be considered in the class certification analysis.

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