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ETHICAL ISSUES IN CLASS ACTION SETTLEMENTS

INTRODUCTION

The complex, high stakes nature of class action litigation coupled with widespread publication of large settlements ensure that these cases will continue to garner a disproportionate share of public and legislative attention. At the same time, the significant benefits to the parties, courts and society as a whole make it equally certain that class action litigation – in some form – will remain a fixture of the legal landscape. In addition to the myriad of legal and strategic issues inherent in every such case, settlements and their attendant objections create special problems that require careful attention by class counsel. How is it possible adequately to represent the diverse interests of hundreds, thousands or even millions of class members in a single settlement? Who determines whether the proposed settlement is "fair?" How can this determination be made? In resolving these issues, class counsel may encounter significant ethical challenges. Proper resolution of these challenges is necessary to ensure adequate representation of the clients and to protect the rights of the class members.

CERTIFICATION OF A SETTLEMENT CLASS

Of course, prior to examining the fairness of a proposed settlement, the court must determine that the class may be certified for settlement purposes under the familiar strictures of Rule 23, Fed. R. Civ. P. *E.g., Amchem Prods., Inc., v. Windsor*, 521 U.S. 591 (1997). The court may certify a class only if its members are so numerous that it is impracticable to join them all individually (*i.e.* numerosity), *Pederson v. La. State Univ.,* 213 F.3d 858, 868 (5th Cir. 2000), there is at least one issue whose resolution will affect all or a substantial number of the class members (*i.e.* commonality), *Forbush v. J.C. Penney Co.,* 994 F.2d 1101, 1106 (5th Cir. 1993), the class members' claims arise from the same common course of events and are supported by similar legal arguments (*i.e.* typicality), *Robidoux v. Celani,* 987 F.2d 931, 936 (2d Cir. 1993), and the record demonstrates the "zeal and competence" of class counsel and the class representatives (*i.e.* adequacy), *Stirman v. Exxon Corp.,* 280 F.3d 554, 563 (5th Cir. 2002). Likewise, the court must be satisfied that the case meets the requirements of Rule 23(b), Fed. R. Civ. P. *E.g., Amchem*, 521 U.S. at 621. In this regard, the Court may consider the fact that settlement reduces or eliminates problems of manageability so long as the "proposed class has sufficient unity so that absent members can be fairly bound by decisions of class representatives." *Id.*

THE FAIRNESS OF THE SETTLEMENT

Only after the court has determined that the case is properly certified for settlement purposes, may it then decide whether the proposed settlement is "fair, reasonable and adequate." *DeHoyos v. Allstate Corp*., 240 F.R.D. 269, 285-86 (W.D. Tex. 2007). As a general rule, the Court should approve the settlement if it "is in the interest of the class, does not unfairly impinge on the rights and interests of dissenters and does not merely mantle oppression." *Id*. at 286; *In re: Shell Oil Refinery*, 155 F.R.D. 552, 559 (E.D. La. 1993). In making its determination, the Court is to be mindful that a "just result is often no more than an arbitrary point between competing notions of reasonableness." *See In re: Corrugated Container Antitrust Litig.*, 659 F.2d 1322, 1325 (5th Cir. 1981).

> The Court should consider the vagaries of litigation and compare the significance of immediate recovery by way of the compromise to the mere possibility of relief in the future, after protracted and expensive litigation. In this respect, it has been held proper to take the bird in the hand instead of a prospective flock in the bush.

San Antonio Hispanic Police Officers Org., Inc. v. City of San Antonio, 188 F.R.D. 433, 458-59 (W.D. Tex. 1992); *In re Shell Oil Refinery,* 155 F.R.D. at 560. The Court's power to approve or reject the settlement does not empower it to modify the terms of agreement. *Dehoyos*, 240 F.R.D. at 286. Neither may the Court substitute its own judgment as to optimal settlement terms for the judgment of the parties and their counsel. *Petrovic v. Amoco Oil Co.,* 200 F.3d 1140,1148-49 (8th Cir. 1999). Similarly, the court must bear in mind that the law does not require that a class action settlement benefit all members of the class equally so long as the settlement terms are "rationally based on legitimate considerations." *Dehoyos*, 240 F.R.D at 316.

OBJECTIONS TO THE SETTLEMENT

Once the Court has given preliminary approval to a settlement, "the agreement is presumptively reasonable and an individual who objects has a heavy burden of demonstrating that the settlement is unreasonable." *Dehoyos*, 240 F.R.D. at 293. General objections without factual or legal substantiation do not carry weight in the approval process. *Id*; 4 Newburg on Class Actions (4th) § 11:58 (2002). Likewise, objections based on mere speculation should be dismissed. *In re: Cendent Corp. Litig*., 264 F.2d 201, 235 (3rd Cir. 2001). The Court should not "allow the objectors to disrupt the settlement on the basis of nothing more than their unsupported suppositions." *City of Detroit v. Grinnell Corp*., 495 F.2d 448, 464 (2nd Cir. 1974). To rule otherwise would "completely thwart the settlement process." *Id.*

While settlement objectors may play a valuable role in the class action settlement approval process, the Court must guard against those objections that are "made for improper purposes and benefit only the objectors and their attorneys." Manual at § 21.643. Because of the inherent difficulties that surround review and approval of a class settlement, "even a weak objection may have more influence than its merits justify." *Id.* Thus, objections of little or no merit "can be costly and significantly delay implementation of a class settlement." *Id*. As a result, the Manual for Complex Litigation expressly advises that Rule 11, Fed. R. Civ. P., applies to settlement objectors and their attorneys and "should be invoked in appropriate cases." *Id*. This is particularly true when the settlement allows those class members finding the settlement "unattractive" to protect their own interests by opting out of the class. *Id.*

The Court must also carefully scrutinize the withdrawal of settlement objections to "guard against an objector who is using the strategic power of objecting for private benefit." *See, e.g.*, Manual on Complex Litig. (4th) at § 21.643 (West 2007). When an objection is made in terms common to all or a portion of the class, the court should "impose on the objector a duty to the class similar to the duty assumed by a named class representative." *Id.* As a result, such an objector should not be allowed to withdraw his objection in exchange for treatment more favorable than other similarly situated class members. *Id*. An agreement that has been reached solely for "private advantage" in the face of a "class-based objection," should be disapproved. *Id*. Likewise, withdrawal of objections seeking more advantageous individual terms should be approved only upon a showing of a" reasonable relationship to facts or law that distinguish the objector's position from that of other class members." *Id*.

While consideration of individual objections may sometimes reveal intra-class conflicts requiring creation of subclasses, the court must remain cognizant of the fact that no settlement is required to "benefit all members of the class equally" so long as the settlement terms are "rationally based on legitimate considerations." *Dehoyos*, 240 F.R.D at 316. Potential conflicts among class members may be ameliorated through the creation of sub-classes or by a plan to distribute settlement benefits based on objective criteria. Manual for Complex Litig. (4th) at § 21.132. In crafting such an agreement, class counsel must keep in mind that they are charged with the responsibility of advancing the interests of the class as a whole. *See, e.g., Kincade v. Gen. Tire & Rubber Co.*, 635 F. 2d 501, 508 (5th Cir. 1981).

VAUGHN v. AMERICAN HONDA MOTOR CO.

In *Vaughn v American Honda Motor Co.,* for example, the class alleged an intentional scheme of odometer tampering. (Exhibit A – Notice of Settlement.) The settlement provided for global remediation, all class members with increased legal rights in the form of extended warranties and lease contracts and refunds of "otherwise warranted" repairs. The agreement did not provide for direct monetary relief for those class members who had already sold their cars and suffered a potential loss of value due to odometer over-registration. Class counsel preserved the rights of all class members to exclude themselves from the settlement. Of the more than six million (6,000,000) class members, approximately twenty (20) individuals objected that the settlement suffered from an intra-class conflict between lessees (who received a full refund of mileage penalties) and owners (who received no direct payments for lost resale value). The objectors did not deny that the agreement was a remarkable achievement or that it was otherwise fair to the class as a whole. By definition, none of them exercised their right to opt out of the settlement.

The presentation and consideration of this objection illustrates the challenge presented to class counsel in negotiating a comprehensive settlement on behalf of millions of class members. In that case, every class member had potentially sustained an entire range of damages including lost benefit of the bargain, out of pocket warranty expenses, lease mileage penalties and lost resale value. Class counsel worked tirelessly to achieve a full recovery for every class member on every potential category of damages. In reality, of course, compromise is the essence of settlement, and no agreement will provide 100% of all possible damages. When it became apparent that no

agreement could be reached without compromise on this demand, class counsel were forced to consider whether the agreement which could be reached would best serve the interest of the class as a whole. Ultimately, class counsel determined that the agreement which otherwise provided remarkable relief to the class could not properly be jeopardized for the sake of this single element of damages.

As the parties pointed out to the court, the law does not require that a class action settlement benefit all members of the class equally so long as the settlement terms are "rationally based on legitimate considerations." *Dehoyos*, 240 F.R.D at 316. In practice, settlement benefits will typically be distributed in a manner reflecting the realities of litigation. That is, while every member of the settlement class must receive consideration for the proposed release, those claims which are stronger, more readily certifiable and less subject to evidentiary challenge will receive greater attention in settlement negotiation and drafting. In *Vaughn*, the settlement recognized the fundamental difference between claims for diminished resale value -- subject to individualized proof and cross-examination – and undeniable, contractual charges for excess lease mileage. The settlement rationally apportioned relief upon such legitimate considerations as the likelihood the claims can be certified, the quantum of proof necessary to sustain the claims and the extent to which the claims are subject to cross examination. In crafting such an agreement counsel must be ever mindful of the possibility of intra-class conflicts when apportioning settlement benefits.

APPEAL BONDS

The use of appeal bonds by the district court is an important resource in managing objections and preventing unnecessary delays in settlement implementation. Rule 7, Fed. R. App. P., provides that "[i]n a civil case, the district court may require an appellant to file a bond or provide other security in any form and amount necessary to ensure payment of costs on appeal." *Id*. The purpose of an appeal bond is to ensure that the person or persons seeking to appeal a court order have set aside sufficient funds to reimburse the parties who successfully defend the district court's order on appeal for the monetary costs they incur as a result of the unsuccessful appeal. *See, e.g., Adsani v. Miller,* 139 F.3d 67, 70 (2d Cir. 1998). Appeal bonds also may be required to ensure that the appealing party pays any sanctions award that may be made due to its filing of a frivolous appeal. *See, e.g., Sckolnick v. Harlow,* 820 F.2d 13, 15 (1st Cir. 1987); *In re Heritage Bond Litig.,* MDL No. 02-ML-1475 DT, 2005 WL 2401111, at *4 (C.D. Cal. Sept. 12, 2005). According to the 1979 Amendment Advisory Committee Notes, Rule 7 "leave[s] the question of the need for a bond for costs and its amount in the discretion of the court." Fed. R. App. P. 7 (1979 Advisory Committee notes).

Where objectors to a proposed class action settlement notice an appeal of the court's final approval of the settlement, the court has the power to require such objectors to post a bond in an amount based upon the monetary harm the parties and the class would incur from defending the court's order on appeal and from the delayed implementation of the settlement. *See, e.g.*, *DeHoyos*, 240 F.R.D. at 316, 344; Exhibit B – Order Setting Appeal Bond. In *DeHoyos*, 240 F.R.D. at 316, the United States District Court for the Western District of Texas expressly held that any person wishing to appeal

the final approval order must post a bond "to cover the costs of appeal as a condition of prosecuting the appeal." *Id*. The court reasoned that"[a]s a general rule, requiring a bond is a common procedural device to protect the parties' interests" and "[a]n appeal bond is not uncommon in these circumstances given the delay and costs which may be incurred by the class by an appeal." *Id*.

Other courts have reached the identical conclusion. *See, e.g., In re Cardizem CD Antitrust Litig*., 391 F.3d 812, 815, 817-18 (6th Cir. 2004)(affirming appeal bond imposed on objector to class action settlement); *Pedraza v. United Guar. Corp*., 313 F.3d 1323, 1328 (11th Cir. 2002)(same); *Conroy v. 3M Corp*., No. C 00-2810 CW, 2006 U.S. Dist. LEXIS 96169, at *8 (N.D. Cal. Aug. 10, 2006)(requiring objector to class action settlement to post appeal bond); *Allapattah Servs., Inc. v. Exxon Corp*., No. 91-0986-CIV, 2006 WL 1132371 at *17 (S.D. Fla. Apr. 7, 2006)(requiring appeal bond if objector attempts to appeal on behalf of entire class); *In Re Compact Disc Minimum Advertised Price Antitrust Litig*., 2003 WL 22417252, at *2 (D. Me. Oct. 7, 2003)(requiring objector to class action settlement to post appeal bond); *O'Keefe v. Mercedes-Benz USA, LLC*, No. 01-CV-2902, 2003 WL 22097451, at *1 (E.D. Penn. June 4, 2003)(same); *In re Diet Drugs (Phentermine, Fenfluramine, Dexfenfluramine) Prods. Liab. Litig*., 2000 WL 1665134, at *6 (E.D. Pa. Nov. 6, 2000)(same). *But see In re AOL Time Warner, Inc., 2007 U.S. Dist. LEXIS 69510 (S.D.N.Y. Sept. 19, 2007*)(refusing to include fees on appeal, prospective sanctions or delay damages in bond amount); *Azizian v. Federated Dep't Stores Inc.,* 2007 U.S. App. LEXIS 20070 (9th Cir. Aug. 23, 2007)(error to include attorneys' fees in appeal bond and setting bond on $2.5 billion deal at $800.00).

Further, where the District Court believes that an appeal of its order would necessarily be frivolous, it should take the legal costs of successfully defending that order on appeal into account in setting the amount of the bond. *See, e.g., In re Compact Disc Litig.,* 2003 WL 22417252 at *1; *In re Cardizem CD*, 391 F.3d at 817-18 In *In re Compact Disc*, 2003 WL 22417252, for example, the court reasoned that a bond "may impose attorney fees should [the court] determine that the appeal is frivolous pursuant to Fed. R. App. P. 38." *Id*. at *1. As the district court noted in *Heritage Bond*:

> Because of the high probability that these appeals will be summarily denied as frivolous and an award of attorney fees and costs of appeal will likely be assessed against them . . . an appeal bond is warranted . . . to ensure payment of the anticipated award of fees and costs on appeal and as a sanction for filing an unfounded, meritless appeal.

2005 WL 2401111 at *3; *see also In re Cardizem CD*, 391 F.3d at 817-18 (affirming the imposition of an appeal bond which included attorneys' fees when the statute authorized an award of damages where an appeal taken was found to be frivolous). Thus, when a "high probability" of sanctions exists, the court should require a bond sufficient to ensure payment of the settling parties' combined fees for defending the final approval on appeal.

In *Allapattah,* 2006 WL 1132371, the United States District Court for the Southern District of Florida required a substantial appeal bond to cover the potential costs of further proceedings and the damages to the class caused by delay in implementation of the agreement. As in most cases, the settlement tied the effective date of the agreement to the resolution of all appeals. *Id*. at *17. In that situation, the court concluded, "[T]he highly detrimental impact of an appeal of the settlement agreement as to the entire class renders it appropriate for the Court to require [the objector] to post an appeal bond . . . in an amount sufficient to cover the damages, costs and interest that the entire class will lose

as a result of the appeal." *Id*. There, the total value of the settlement was estimated to be $1,075,000,000. *Id.* The court ordered the appellate bond set at $13,500,000, or approximately 1.25% of that amount. *Id.*

UNDISCLOSED INTERESTS AMONG OBJECTORS

In considering the weight to be accorded a settlement objection including the need for and size of an appeal bond, the trial court should order full disclosure of the identities and practice histories of all counsel with a financial interest in the objection. The fact that an objector and/or his counsel routinely appear at fairness hearings to object to settlements may have a significant bearing on the court's determination of the credibility of the objection. Particularly where the objector or his counsel have previously been sanctioned or found to have lodged frivolous or oppressive objections, the court may find that a heightened level of scrutiny is appropriate. (*See, e.g.,* Ex. C – Memorandum in Support of Motion for Appeal Bond.) If the objection is nothing more than a recitation of pleas already rejected in other similar cases, the court may find that sanctions are in order. Likewise, the court may determine that a larger appeal bond is in order to protect the parties from a frivolous or vexatious appeal. In the same fashion, the disclosures may significantly impact class counsels' strategy in any negotiations to resolve the objections.

To avoid these potential "complications," serial objectors and their counsel may seek to disguise or minimize their participation through the carefully orchestrated use of inexperienced local counsel. In *Vaughn*, for example, the order of preliminary approval required full disclosure of all cases in which any class member or his counsel had

appeared as a settlement objector in the previous five years. Nonetheless, at least three attorneys with significant histories -- including a substantial list of cases in which they had filed objections, court findings of frivolous and improper conduct and, in one case, a racketeering suit alleging that they had engaged in an unlawful enterprise to extort fees from class counsel – maintained undisclosed financial interests in the objections. While at least two of these attorneys actually attended the final hearing, they signed no pleadings, failed to announce their presence at the hearing and did not provide the disclosure ordered by the court. Class counsel immediately brought the matter to the attention of the Court for consideration of appropriate action.

CONSTITUTIONAL STANDING TO APPEAL

Moreover, in determining whether an appeal by a class member would necessarily be futile and demonstrably frivolous, the court should consider carefully whether the potential appellant has constitutional standing to pursue his objection on appeal. Only those parties who are "aggrieved by a district court's order or judgment may exercise the statutory right to appeal therefrom." *Deposit Guar. Nat'l Bank v. Roper*, 445 U.S. 326, 333 (1980). Thus, a party who "receives all that he has sought is generally not aggrieved by the judgment affording the relief and cannot appeal from it." *Id*. More succinctly, simply being a member of a class is not sufficient to confer appellate standing – the class member seeking to appeal "must be an ***aggrieved*** class member." *Wolford v. Gaekle*, 33 F.3d 29, 30 (9th Cir. 1994)(emphasis added). As the Ninth Circuit has observed, the term "aggrieved" is a "necessary, not merely descriptive term." *Id*.

In *Wolford*, 33 F.3d at 29, for example, the court approved settlement of claims against various life insurance companies. The agreement entitled class members to reinstate their policies, regain contractual benefits and recover all charges paid for early termination. *Id*. A member of the settlement class appealed the district court's determination that the settlement was fair, adequate and reasonable. In reviewing the record, the appellate court found that the appellant was a member of the class but that she had suffered no injury and therefore had no standing to appeal. In particular, the court noted that the class member had already terminated her policy with defendants and received not only a full return of her investment but also a profit of nearly $6,000.00. *Id*. Likewise, she paid no surrender charge, penalty or fee. Under these facts, the court held, the class member had suffered "no injury likely to be redressed by a favorable decision" and dismissed the appeal. *Id*. at 30.

ATTORNEYS' FEE NEGOTIATIONS

As a general rule, negotiations over the amount of attorneys' fees to be paid to class counsel should be deferred until the parties have reached a final agreement on the scope of relief to be provided to the class. At the same time, class counsel should not neglect to employ Rule 23(g)(2)'s provision for appointment of interim class counsel "to act on behalf of the putative class before determining whether to certify the action as a class action." *Id*. at 23(g)(2)(A). The rule further expressly empowers the court to "include provisions about the award of attorneys' fees or non-taxable costs under Rule 23(h)." *Id*. at 23(g)(2)(C). Having the court consider issues such as whether the fee should be calculated as a percentage of the potential recovery or on an hourly/lodestar

basis, the extent to which contemporaneous time records will be required and any concerns regarding expenses or staffing of the case can greatly simplify the fee negotiation process when the appropriate time arrives.

MULTIPLE CASES IN DIFFERENT JURISDICTIONS

Class counsel should further be constantly aware of competing cases filed in other jurisdictions. While Class counsel are powerless to prevent such filings, they must take an active role in the coordination of the cases in discharging their responsibilities to protect the interests of the class. Multiple filings can trigger a request for transfer and consolidation of cases before the Judicial Panel on Multidistrict Litigation. 28 U.S.C. § 1407(a) (West 2007). Competing cases can also provide opportunities for collusive settlement discussions and reverse auctions by defendants anxious to resolve their exposure at the most economic cost. In such instances, a case filed by less aggressive, less experienced or less well-funded counsel may be a great comfort to a defendant seeking closure.

As in most other instances, the challenge presented for class counsel is to remain mindful of the best interests of the class. To the extent possible, class counsel should coordinate with counsel in competing cases to determine the most ideal venue for the proceedings, the selection of lead counsel and assignment of roles among cooperating counsel and the coordination of discovery and pre-trial proceedings. Where such coordination is not possible, class counsel should move quickly to have the court formally appoint interim class counsel and to stay or dismiss the competing cases. Competing cases in federal courts may be stayed or dismissed in favor of the first filed action. While a federal court has limited power to interfere with a state court proceeding, both the Anti-Injunction Act and the All Writs Act empower a federal court to enjoin state court proceedings when necessary to aid its jurisdiction as when, for example, it is administering a global settlement. Manual on Complex Litig. at § 21.15.