Avoiding Potential Pitfalls in a Class Action Settlement

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It is a fact of litigation life that nearly all class actions that survive initial motion practice settle before trial. And the numbers skyrocket when the measured group is certified class actions.[1] This is largely due to the *in terrorem* effect that class actions have on defendants: Even if the lawsuit is unfounded, with only a slight chance that the plaintiff will prevail and recover damages, the potential liability frequently is so massive that it is difficult for a company to risk litigating the case through trial.[2] Combine that with the very significant litigation costs that a plaintiff can create for a corporate class action defendant, and the overwhelming frequency of settlements in class cases is understandable.

But in the last couple of years, another difficult litigation phase has arisen for defendants in class cases, as trial and appellate

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1 *See Eubank v. Pella Corp.*, 753 F.3d 718, 720 (7th Cir. 2014) ("A high percentage of lawsuits is settled—but a study of certified class actions in federal court in a two-year period (2005 to 2007) found that *all* 30 such actions had been settled."); Emery G. Lee III & Thomas E Willging, Impact of the Class Actions Fairness Act on the Federal Courts, p. 16 (Federal Judicial Center 2008) (describing a study of 254 class actions and finding that, of the cases that were certified, 100% settled), available at https://bulk.resource.org/courts.gov/fjc/cafa1108.pdf.

2 *AT&T Mobility LLC v. Concepcion*, 131 S. Ct. 1740, 1752 (2011) ("Faced with even a small chance of a devastating loss, defendants will be pressured into settling questionable claims. Other courts have noted the risk of 'in terrorem' settlements that class actions entail . . . ."); *Kohen v. Pac. Inv. Mgmt. Co. LLC & PIMCO Funds*, 571 F.3d 672, 677 (7th Cir. 2009) (noting the "the *in terrorem* character of a class action").

courts who formerly greeted nearly all settlements with enthusiasm have begun to subject them to an unprecedented level of scrutiny. And, in a few notable recent cases, the scrutiny has moved in the direction of open hostility. Not coincidentally, a previously small group of so-called professional objectors—who come onto the scene during the settlement-approval phase and raise issues about one or more aspects of the settlement—has been nurtured by the growing body of disapproval decisions, leading to still more serious attacks on large settlements and feeding the judicial suspicions. Often missing from these objections is any serious assessment of the risks the class faces in proceeding with the litigation—including the risks to certification, risk of summary judgment, risk of loss at trial, and risk of loss on appeal—together with the benefits of certainty and avoidance of delay that led plaintiffs' counsel to agree to a discount from the maximum recovery that they might have obtained at trial. These risks also are given short shrift in many recent opinions disapproving class settlements.

In some cases, this combination of increased judicial scrutiny and professional objectors produces an apparently enhanced agreement for the class. But in many instances, despite the best intentions of the judges who oversee the approval process, class members may ultimately be worse off. A prolonged, contentious settlement-approval phase is generally contrary to the interests of both the class and the defendant, as it frequently produces an agreement that is only marginally better for the class, but at the cost of delay that significantly reduces the number of class members who actually benefit (not to mention the time-value-of-money aspects of the delay). In less than three years, for example, fully 12 percent of class members' e-mail accounts may be closed, with no forwarding address available. The drop-off is even higher with postal service mail addresses in middle-class populations.

Lawyers and clients wishing to settle class actions and deliver meaningful benefits to class members need to bear in mind the growing judicially imposed obstacles to settlement and structure their settlements to make the approval phase as smooth and predictable as possible. To that end, counsel should work with their clients to avoid the class settlement red flags that draw

objectors and frequently result in disapproval (or reversal of approvals on appeal).

In this article, we identify those recurring issues, noting jurisdictional differences where applicable, and provide practical advice for litigants facing what is becoming an increasingly difficult task: achieving finality for a client through a class settlement that receives court approval. And we conclude with a modest plea for judicial restraint—so that important policies of fairness to defendants, and speed in distribution of benefits to class members, are not sacrificed by courts distrustful of the parties to the litigation.

Recurring Themes in Settlement Disapproval

In assessing whether a proposed settlement is fair, reasonable, and adequate, courts consider such factors as the strength of the plaintiffs' case; the risk, expense, complexity, and likely duration of further litigation; the risk of maintaining class status through trial; the risk of establishing liability and damages; the amount offered compared to the likely scenario in light of the attendant risks of litigation; the stage of the proceedings and amount of discovery completed; the experience and views of counsel; and the reaction of class members.[3]

An overarching theme in recent judicial opinions disapproving class settlements is the courts' suspicion of class counsel's potential conflict of interest with the class, or collusion between class counsel and the defendant. These concerns grow from the unique incentives that play out in class action litigation.

The courts' concern is that from a purely economic standpoint, a class action defendant cares about the amount of money it must pay to achieve finality in a settlement but has little incentive to micromanage how that sum is to be divided between

[3] *See, e.g.*, *Charron v. Wiener*, 731 F.3d 241, 247 (2d Cir. 2013); *Lane v. Facebook, Inc*., 696 F.3d 811, 819 (9th Cir. 2012), *reh'g and reh'g en banc denied*, 709 F.3d 791 (9th Cir. 2013), *cert. denied sub nom. Marek v. Lane*, 134 S. Ct. 8 (2013).

the class and its lawyers. And because class counsel theoretically cares most about maximizing its own fee award, some courts have described the economically "optimal settlement" as "one modest in overall amount, but heavily tilted toward attorneys' fees."[4] Accordingly, because courts tend to view themselves as the sole disinterested guardians of the class' interests,[5] they are primed to look for signs of collusion in a class settlement.

While there is no exhaustive list, courts have identified several indicators of potential conflicts of interest or collusion, each of which we cover in detail below: (A) settlements reached early in the case, before class certification or substantial discovery or other litigation by which the plaintiffs can assess the strength of their case; (B) use of the *cy pres* device, instead of direct payments to class members; (C) so-called coupon or voucher settlements, where class members receive the right to obtain a discounted or free product, instead of cash; (D) more obvious circumstances indicating conflicts between counsel and the class, or between the class representatives and absent class members; (E) imposing onerous obligations on class members either to file objections to the settlement or to be able to participate in the settlement; and (F) ambiguous, overly complicated notices written in legalese, which tend to confuse class members about their rights and options in the settlement. And each of these issues arises against a backdrop of settlement valuation—how does the value of the

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[4] *Eubank*, 753 F.3d at 720; *see also Creative Montessori Learning Ctrs. v. Ashford Gear LLC*, 662 F.3d 913, 918 (7th Cir. 2011) ("We and other courts have often remarked [on] the incentive of class counsel, in complicity with the defendant's counsel, to sell out the class by agreeing with the defendant to recommend that the judge approve a settlement involving a meager recovery for the class but generous compensation for the lawyers—the deal that promotes the self-interest of both class counsel and the defendant and is therefore optimal from the standpoint of their private interests.").

[5] *See, e.g., In re Dry Max Pampers Litig.*, 724 F.3d 713, 718 (6th Cir. 2013) ("[U]nlike in virtually every other kind of case[,] in class-action settlements the district court cannot rely on the adversarial process to protect the interests of the persons most affected by the litigation—namely, the class.").

consideration that defendants will provide compare to what plaintiffs likely would have recovered at trial?

The general skepticism that some judges have toward class settlements, along with their concerns for potential conflicts of interest and collusion, provide the backdrop for each of these specific settlement hurdles described in this article.

A. Precertification Settlements

Due to the risks and costs associated with certifying a class, settlements are often reached very early in the litigation, even before a court certifies the case to proceed as a class action. In most instances, this means that the parties are seeking court approval of an agreement that will bind a settlement class before there has been extensive discovery or litigation on the merits of the claims. Even though such agreements can provide the class with substantial benefits, courts frequently are skeptical that such settlements may be the result of collusion between class counsel seeking to maximize a fee award without doing any real work, and a defendant looking for an inexpensive off-ramp. Accordingly, courts tend to apply increased scrutiny before approving pre-certification settlements.

1. Higher Standard of Scrutiny of Settlement and Attorneys' Fees

Where counsel negotiates a settlement agreement before certification, courts have expressed a need to be "particularly vigilant not only for explicit collusion, but also for more subtle signs that class counsel have allowed pursuit of their own self-interests and that of certain class members to infect the negotiations."[6] In these circumstances, settlement approval "requires a higher standard of fairness" and "a more probing inquiry than may normally be required under Rule 23(e)."[7] As a

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[6] *In re Bluetooth Headset Prods. Liab. Litig*., 654 F.3d 935, 947 (9th Cir. 2011).

[7] *Hanlon v. Chrysler Corp.*, 150 F.3d 1011, 1026 (9th Cir. 1998); *see also McBean v. City of New York*, 233 F.R.D. 377, 382 (S.D.N.Y.

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result, courts reviewing precertification settlements must "carefully review the entire settlement, paying special attention to 'terms of the agreement contain[ing] convincing indications that the incentives favoring pursuit of self-interest rather than the class's interests in fact influenced the outcome of the negotiations.'"[8] "The reason for more exacting review of class settlements reached before formal class certification is to ensure that class representatives and their counsel do not secure a disproportionate benefit 'at the expense of the unnamed plaintiffs who class counsel had a duty to represent.'"[9]

Thus, besides the general factors courts consider when determining whether a settlement was fair, reasonable, adequate, and free from collusion, courts also look even more closely for signs of collusion in the precertification context.[10] In approving a precertification settlement in *Laguna v. Coverall*, the Ninth Circuit noted the following warning signs: (1) disproportionate awards to counsel relative to the class; (2) the presence of a "clear sailing" arrangement, ensuring payment of attorneys' fees separate from class funds; and (3) undisbursed funds that revert to defendants rather than the class fund.[11]

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2006) ("[W]here the settlement was negotiated between the parties prior to class certification, 'it is subject to a higher degree of scrutiny in assessing its fairness.'").

[8] *Dennis v. Kellogg Co*., 697 F.3d 858, 867 (9th Cir. 2012) (citing *Staton v. Boeing Co.*, 327 F.3d 938, 960 (9th Cir. 2003)).

[9] *Lane*, 696 F.3d at 819 (9th Cir. 2012).

[10] *In re Bluetooth*, 654 F.3d at 947; *see also Radcliffe v. Experian Info. Solutions*, 715 F.3d 1157, 1168 (9th Cir. 2013) (reversing the approval of a settlement where the settlement was negotiated prior to formal class certification, which warranted a higher level of scrutiny for evidence of collusion or conflicts of interest than is ordinarily required).

[11] *Laguna v. Coverall N. Am., Inc*., 753 F.3d 918, 924-25 (9th Cir. 2014).

When confronted with one or more of these circumstances, courts seek to assure themselves that the fees awarded in the settlement are not unreasonably high.[12] Courts have approved precertification settlements where awards to counsel were determined under a "percentage-of-recovery" method—meaning a comparison between the fee award and the aggregate value of the settlement to the class—using "a benchmark figure of 25% to gauge the reasonableness of an award."[13] Thus, attorneys' fees of about one million dollars for a settlement valued at four million dollars have been deemed to be "clearly reasonable" through application of this method.[14] Under this method, calculating the value of the settlement (the denominator) becomes critical, and courts are on the lookout for efforts by class counsel to artificially inflate the settlement value (*e.g.*, by overstating the anticipated claims rate) in order to drive up the percentage fee award.

In the alternative, courts also may determine that fees are "presumptively reasonable" through application of the "lodestar" method.[15] Under this method, fees are presumptively reasonable when "the number of hours the prevailing party reasonably expended on the litigation" is multiplied by a "reasonable hourly rate for the region and for the experience of the lawyer."[16]

Where a fee award is considered clearly reasonable following application of either the lodestar or percentage-of-recovery method, "the chance of collusion narrows to a slim possibility."[17] Though courts have discretion over which method to apply, "their discretion must be exercised so as to achieve a

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[12] *In re Bluetooth*, 654 F.3d at 947.

[13] *Laguna*, 753 F.3d at 925 (concluding that the first warning sign of collusion was not present in a case where attorneys' fees of just under one million dollars were considered reasonable where the estimated settlement was approximately four million dollars).

[14] *See id.*

[15] *In re Bluetooth*, 654 F.3d at 941-42.

[16] *Id.* at 941.

[17] *Laguna*, 723 F.3d at 925.

reasonable result."[18] For example, if awarding 25% of an extremely large settlement would result in a windfall for class counsel given the amount of time spent on the case, courts either adjust the percentage used in calculations, or apply the lodestar method.[19]

Despite fairly established standards regarding signs of collusion and the accompanying increased judicial scrutiny, courts have varied in their willingness approve precertification settlements bearing these indicia. For example, in *In re Bluetooth Headset Products Liability Litigation*, the Ninth Circuit vacated a precertification settlement where the district court had made no effort to calculate a reasonable lodestar amount or compare the amount of attorneys' fees awarded to the class relative to the degree of success in the litigation.[20] The court noted that although all three warning signs of collusion were present, the fees would constitute 37.2% of the settlement fund, and the approval order did not provide any assurance that the lower court inquired into why such a disproportionate distribution was present. The district court needed "to examine the negotiation process with even greater scrutiny than is ordinarily demanded, and approval of the settlement had to be supported by a clear explanation of why the disproportionate fee [was] justified and [did] not betray the class's interests."[21] Likewise, even where fees are not disproportionate to the total settlement fund, a court may disapprove a precertification settlement that is not clear in its method of disposing funds to potential recipients.[22]

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[18] *In re Bluetooth*, 654 F.3d at 942.

[19] *Id.*

[20] *Id.* at 943.

[21] *Id.* at 949.

[22] *See Dennis*, 697 F.3d at 867-68 (reversing approval of settlement where the settlement included a large *cy pres* component with unknown recipients, raising an inference that the disposition was being made to increase the total settlement size).

On the other hand, courts have approved precertification settlements even with terms that appear on their face to be suspect. For example, the California Court of Appeal approved a settlement even without a "definitive monetary obligation imposed on [the] settling defendant" since the likelihood of sufficient claims for compensation from the settlement was arguably very low.[23] Likewise, the Ninth Circuit approved a precertification settlement where the entire settlement fund (other than attorneys' fees) would go to set up a charity organization.[24] And in another case, the Ninth Circuit approved a settlement despite potential collusion issues where the fees were 25% of the total fund and thus "clearly reasonable." There, it was sufficient for the lower court to have balanced the "clearly reasonable" fees against "potentially collusive provisions, such as the reversion [to] the defendants of unclaimed funds" to approve the settlement.[25]

Regarding "clear sailing" provisions, in which defendants agree not to oppose fee applications seeking up to a pre-determined amount of fees, the Ninth Circuit has stated that "the very existence" of such a provision "increases the likelihood that class counsel will have bargained away something of value to the class," in exchange for an "unreasonably high" fee award that gains approval "simply because [it] is uncontested."[26] Nonetheless, even though clear sailing agreements may be "disfavored" (although "not prohibited") in the Ninth Circuit,[27]

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[23] *Cho v. Seagate Tech. Holdings, Inc.*, 177 Cal. App. 4th 734, 744 (2009).

[24] *Lane*, 696 F.3d at 817. In his dissenting opinion, Judge Kleinfeld explained why collusion is feared where there is negotiation before certification. He noted that the issue with settlements in this context is that class counsel and defense counsel share the same interests and thus have an incentive to create as broad a class as possible. This is because a broad class will increase the attorneys' fees for class counsel and would provide maximum protection from claims to defendants. *See id.* at 831-32.

[25] *Laguna*, 753 F.3d at 925.

[26] *In re Bluetooth*, 654 F.3d at 948.

[27] *Id*. at 949.

they are in fact commonplace, and other courts have recognized that "not every 'clear sailing' provision demonstrates collusion."[28]

Finally, in addition to precedent within circuits, federal courts tend to reference the reasoning of their sister circuits regarding precertification settlements,[29] and some state courts have borrowed from federal precedent in this context.[30]

2. Passing Judicial Review of Precertification Settlements

Though "[i]t is true that precertification settlements in class action cases should be scrutinized more carefully," such settlements are "routinely approved where they are found fair and reasonable."[31] In *Laguna v. Coverall*, for instance, the Ninth Circuit clarified that the approval of a pre-certification settlement will be "rarely overturn[ed]" so long as there are no signs of

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[28] *Gooch v. Life Investors Ins. Co. of Am*., 672 F.3d 402, 426 (6th Cir. 2012).

[29] *See, e.g., In re Dry Max Pampers Litig.*, 724 F.3d 713, 718 (6th Cir. 2013) (citing and quoting the Ninth Circuit to support a conclusion that increased judicial scrutiny is required in the case of precertification settlements); *Gascho v. Global Fitness Holdings, LLC*, 2014 U.S. Dist. LEXIS 46864, at *57-58 (S.D. Ohio Apr. 4, 2014) (same); *Trombley v. Bank of Am. Corp*., 2012 U.S. Dist. LEXIS 63072, at *10 (D.R.I. May 3, 2012) (citing the Ninth Circuit as support for the conclusion that "[w]hen a settlement is reached before the class is certified, the settlement agreement is subject to heightened scrutiny for fairness").

[30] *See, e.g., Wershba v. Apple Computer*, Inc., 91 Cal. App. 4th 224, 240 (2001) (citing the Ninth Circuit and California court precedent for the proposition that precertification settlements should be scrutinized more carefully, even though state courts are not bound by federal law); *Cho*, 177 Cal. App. at 743 ("It is true that precertification settlements in class action cases should be scrutinized more carefully.") (internal quotation marks omitted).

[31] *Cho v. Seagate Tech. Holdings, Inc.*, 177 Cal. App. 4th 734, 743 (2009) (internal quotation marks omitted).

collusion indicating that the agreement was made without consideration of the class's interests.[32]

Analysis of recent decisions demonstrates that there are no clear, consistent standards regarding what it will take to survive the increased judicial scrutiny that will be applied to a precertification settlement. Nonetheless, counsel and clients may want to avoid the factors that courts have listed as signs of collusion.

In particular, as with any class settlement, litigants should take care to avoid obviously disproportionate fee awards, and they should be ready to establish facts supporting application of a presumption of reasonableness. The case law suggests that a relatively easy way to do this is to avoid fees that go beyond legally acceptable standards under either the percentage-of-settlement or lodestar methods. For instance, in *In re Bluetooth*, the court rejected a settlement in which the class members would have received $0 in direct compensation, and the attorneys' fees would have represented 84% of the total settlement amount.[33]

B. *Cy Pres* Distributions

Deriving from the French expression *cy près comme possible*, meaning "as near as possible,"[34] the phrase "*cy pres*" as used in the class action context refers to the doctrine by which courts distribute unclaimed or non-distributable funds to recipients other than the class members, in order to serve the policy objectives underlying the class action as nearly as possible.[35]

There are many reasons why settlement funds may be non-distributable or go unclaimed. For example: the identity of a

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[32] *Laguna*, 753 F.3d at 924.

[33] *In re Bluetooth*, 654 F.3d at 945.

[34] *See Dennis*, 697 F.3d at 865.

[35] *See id.*

number of class members may not be known,[36] the individual claims may be so small that it is not economically viable to distribute payments,[37] class members may fail to submit claim forms, and checks sent to class members may never be cashed.[38] Instead of allowing these unclaimed funds to revert to the defendant or escheat to the state,[39] parties use the *cy pres* doctrine to award the funds to charities whose work purportedly serves the interests of the class. Because the doctrine necessarily furthers a noble cause, *cy pres* remedies have become an increasingly common feature of class action settlements.[40]

In California, the use of *cy pres* remedies was given a significant boost when the California Supreme Court not only endorsed the *cy pres* concept but indicated that it was superior to

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[36] *See, e.g.*, *Mirfasihi v. Fleet Mortg. Corp*., 356 F.3d 781, 786 (7th Cir. 2004).

[37] *See, e.g.*, *Lane*, 696 F.3d at 821 ("Direct monetary payments to the class . . . would be infeasible given that each class member's direct recovery would be *de minimis*."); *Nachshin v. AOL, LLC*, 663 F.3d 1034, 1037 (9th Cir. 2011) (noting that where the maximum recovery for the class only entitled each member to about three cents, the cost to distribute these payments would far exceed the potential recovery).

[38] *See, e.g.*, *All Plaintiffs v. All Defendant*s, 645 F.3d 329, 330 (5th Cir. 2011) ("This appeal concerns the disposition of unclaimed funds from a class action settlement. . . . The settlement administrator sent checks to the last known addresses of plaintiffs, but many were returned as undeliverable or were never cashed.").

[39] Courts and scholars have recognized three principal alternatives to *cy pres* distributions of excess funds: reversion to the defendant, escheat to the government, and additional distributions to claimants. *See In re Baby Prods. Antitrust Litig*., 708 F.3d 163, 171-72 (3d Cir. 2013). However, "[a]mong these options, cy pres distributions have benefits over the alternative choices." *Id.* at 172.

[40] Martin H. Redish et al., *Cy Pres Relief and the Pathologies of the Modern Class Action: A Normative and Empirical Analysis*, 62 FLA. L. REV. 617, 653-61 (2010) (performing an empirical analysis to conclude that the use of cy pres awards "accelerated sharply after 2000").

direct customer relief when that relief involved small individual distributions that were costly to distribute.[41] At the same time, however, many courts have expressed skepticism of *cy pres* settlements. This is due in part to a potential conflict of interest for class counsel, whose fee may be determined as a fraction of the total settlement fund, regardless of the portion actually claimed by the class. Likewise, court have articulated concerns that a defendant could abuse the *cy pres* remedy with a settlement that superficially appears to be large charitable donations, but which in reality is an opportunity to direct funds toward a favored charity with corresponding tax benefits. Recently, Chief Justice Roberts has expressed a "fundamental concern[] surrounding the use of [*cy pres*] remedies" and suggested that "[i]n a suitable case, this Court may need to clarify the limits on the use of such remedies."[42]

1. Review of *Cy Pres* Settlements May Vary by Jurisdiction

When considering class settlements that include a *cy pres* award, some courts look for "a driving nexus between the plaintiff class and the *cy pres* beneficiaries."[43] It takes more than simply being a worthy recipient to qualify as a *cy pres* beneficiary—awards should be "guided by (1) the objectives of the underlying statute(s) and (2) the interests of the silent class members,"[44] and must not benefit a group "too remote from the plaintiff class."[45]

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[41] *State of California v. Levi Strauss & Co*., 41 Cal. 3d 460 (1986) (explaining that without cy pres, "defendants may be permitted to retain ill gotten gains simply because their conduct harmed large numbers of people in small amounts instead of small numbers of people in large amounts").

[42] *Marek v. Lane*, 134 S. Ct. 8, 9 (2013).

[43] *Nachshin*, 663 F.3d at 1038.

[44] *Id.* at 1039.

[45] *Six Mexican Workers v. Ariz. Citrus Growers*, 904 F.2d 1301, 1305 (9th Cir. 1990).

Thus, in *Dennis v. Kellogg*, the Ninth Circuit rejected a class action settlement where the *cy pres* distribution was "divorced from the concerns" of the underlying claims.[46] In *Dennis*, the class brought a claim for false advertising against a cereal company, alleging that advertisements falsely asserted that children who ate the cereal experienced increased attentiveness in school.[47] As part of the settlement, the defendant agreed to distribute more than five million dollars of food items to "charities that feed the indigent."[48] Though the Ninth Circuit recognized that feeding the indigent was a "noble goal," it had "little or nothing to do with the purposes of the underlying lawsuit"—protecting consumers from deceptive business practices.[49]

The practice in California state courts again is different. In cases governed by California Code of Civil Procedure section 384, which applies where parties have not made provision for distribution of unpaid residue in a class action, courts are specifically required to direct distribution to nonprofit organizations that support projects that benefit the class or similarly situated persons, or that promote the law consistent with the objectives of the lawsuit, or to child advocacy programs or nonprofit organizations providing legal services to the indigent.[50]

Federal courts' skepticism of *cy pres* settlements drives courts' preference for direct distributions to the class rather than indirect *cy pres* awards.[51] Although several federal courts of appeals have recognized that settlements including a *cy pres*

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[46] *Dennis*, 697 F.3d at 866.

[47] *Id.* at 861-62.

[48] *Id.* at 863. Note that these charities were not specifically identified.

[49] *Id.* at 866 (internal quotation marks omitted). In a prior case, the Ninth Circuit held that a *cy pres* distribution did not address the interests of the silent class members because it did "not account for the broad geographic distribution of the class." *See Nachshin v. AOL, LLC*, 663 F.3d 1034, 1040 (9th Cir. 2011).

[50] Cal. Civ. Proc. Code § 384.

[51] *In re Baby Prods. Antitrust Litig*., 708 F.3d 163, 173 (3d Cir. 2013).

component may be appropriate,[52] additional scrutiny is often applied in practice. For instance, when the Third Circuit considered *cy pres* distributions as a matter of first impression in *In re Baby Products Antitrust Litigation*, it concluded that in addition to the factors relevant to the approval question in all settlements, courts must also analyze the "degree of direct benefit provided to the class."[53] The court explained, "[b]arring sufficient justification, *cy pres* awards should generally represent a small percentage of total settlement funds."[54] Thus, the Third Circuit rejected a settlement that saw only $3,000,000 of a $21,500,000 award (or roughly 14%) actually distributed to class members, with the remainder benefitting *cy pres* recipients.[55] The court stopped short of "limit[ing] *cy pres* distributions to instances where all claimants have received 100% of their estimated damages," however.[56] And the court further clarified that it "[did] not intend to raise the bar for obtaining approval of a class action settlement simply because it includes a *cy pres* provision."[57]

Likewise, the Eighth Circuit in *In re BankAmerica Corp. Securities Litigation* stressed that *cy pres* distributions are appropriate only when it is not "clearly feasible" to make distributions to the class members—and that inquiry "*must* be based primarily on whether the amounts involved are too small to

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[52] *See, e.g., id.*; *Lane*, 696 F.3d at 819-20; *In re Lupron Mktg. & Sales Practices Litig.*, 677 F.3d 21, 38-39 (1st Cir. 2012) (affirming class action cy pres distribution to charitable recipient); *In re Pharm. Indus. Average Wholesale Price Litig*., 588 F.3d 24, 33-36 (1st Cir. 2009); *Masters v. Wilhelmina Model Agency, Inc.*, 473 F.3d 423, 436 (2d Cir. 2007) ("The purpose of Cy Pres distribution [in the class action context] is to put the unclaimed fund to its next best compensation use … ." (citation and internal quotations omitted)).

[53] *In re Baby Prods. Antitrust Litig.*, 708 F.3d at 174.

[54] *Id.*

[55] *Id.* at 175.

[56] *Id.* at 176.

[57] *Id.*

make individual distributions economically viable."[58] The court also required that class members must generally have a role in selecting the cy pres recipient: "unless the amount of funds to be distributed *cy pres* is de minimis, the district court should make a *cy pres* proposal publicly available and allow class members to object or suggest alternative recipients before the court selects a *cy pres* recipient."[59]

Despite the increased skepticism of settlements involving *cy pres* distributions untethered to the interests of the class, in *Lane v. Facebook* the Ninth Circuit approved a settlement in which the entire payment (minus attorney's fees) would be used to fund a new charitable organization.[60] In *Lane*, the plaintiffs had alleged that Facebook violated its members' privacy rights by "gathering and publicly disseminating information about their online activities without permission."[61] As part of the settlement, Facebook agreed to set up a charitable foundation to "fund and sponsor programs designed to educate users" about online privacy issues.[62] The court reasoned that purpose of *cy pres*—namely, to provide "the next best distribution" absent a direct monetary payment to class members—does not imply that "settling parties [must] select a *cy pres* recipient that the court or class members would find ideal."[63] Instead, the doctrine requires that the distribution "bears a substantial nexus to the interests of the class members" and accounts for the nature of the lawsuit, the objectives of the underlying statutes, and the interests of absent class members.[64] The court concluded that the parties had satisfied these criteria by

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[58] 775 F.3d 1060, 1064 (8th Cir. 2015) (quotation marks omitted).

[59] *Id*. at 1066.

[60] *Lane*, 696 F.3d at 821. Note that direct monetary payment to class members in this case was infeasible given the small size of each member's payment.

[61] *Id.* at 817.

[62] *Id.*

[63] *Id.* at 821.

[64] *Id.*

creating a charitable organization relating to online privacy education.[65]

Similarly, the First and Tenth Circuits have borrowed from the Ninth Circuit's reasoning and apply close scrutiny to *cy pres* settlements.[66] Other federal courts have been more relaxed in their standards for reviewing *cy pres* settlements. According to courts in the Seventh Circuit, for instance, the *cy pres* doctrine permits the use of funds for any public interest purpose.[67] To that end, "[t]he law in the Seventh Circuit is not [as] restrictive [as the Ninth

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[65] *Id.* In a dissenting opinion following denial of rehearing en banc in this case, Judge Milan Smith reasoned that the settlement in this case should have been disapproved for two major reasons. First, the foundation that Facebook was creating had no record of service—it was simply a creation of the settlement. *See Lane v. Facebook*, 709 F.3d 791, 793 (9th Cir. 2013) (Smith, M., dissenting). Thus, there was no way of knowing whether the newly formed organization would even use the funds to benefit the class. Second, citing *Dennis* and *Lane*, Smith reasoned that "it is not enough simply to identify *any* link between the class claims and a cy pres distribution." *Id.* at 794. Although the newly formed charitable organization may teach users how to create stronger passwords or learn about privacy settings, it could not "teach users how to protect themselves from Facebook's deliberate misconduct." *Id.* at 794-95.

[66] *See, e.g.*, *In re Lupron Mktg. & Sales Practices Litig*., 677 F.3d 21, 34 (1st Cir. 2012) (citing two Ninth Circuit opinions as support for the court's decision to apply a "reasonable approximation" test for *cy pres* distributions); *In re Motor Fuel Temperature Sales Practices Litig*., 286 F.R.D. 488, 504 (D. Kan. 2012) (citing the Ninth Circuit's caselaw to conclude that the *cy pres* provision of a settlement could not be approved where no *cy pres* recipient was specified).

[67] *See Heekin v. Anthem, Inc*., 2012 U.S. Dist. LEXIS 160864, at *12-13 (S.D. Ind. Nov. 9, 2012) ("Yet in the Seventh Circuit, 'the doctrine of *cy pres* and the courts' broad equitable powers now permit the use of funds for other public interest purposes by education, charitable, and other public service organizations.'") (quoting *Superior Beverage Co. v. Owens-Ill., In*c., 827 F. Supp. 477, 479 (N.D. Ill. 1993)).

Circuit]."[68] Further, a district court in the Second Circuit approved a settlement that failed to identify the *cy pres* recipient at all.[69]

2. Pathways to Approval of *Cy Pres* Settlements

When structuring a *cy pres* settlement, lawyers and their clients must keep in mind the common criticisms of the doctrine:

> Cy pres settlements do not compensate class members; they are used as a means to justify attorneys' fees for the plaintiffs' lawyers; they invite judges to abuse their authority by enriching nonprofits with which they have personal ties at the expense of the allegedly injured class members; and they permit plaintiffs' lawyers and defendants to collude to ensure that the plaintiffs' lawyers get paid, while permitting the defendants to limit their liability by not paying the purportedly injured class members.[70]

Although this array of criticisms can be faulted for its failure to consider the impact of disgorgement of ill gotten gains and related deterrence effect—important policy goals recited in many other cases—it nonetheless is worthwhile to distill from these criticisms and from the caselaw discussed above some guiding principles to help increase a reviewing court's comfort level with a *cy pres* settlement.

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[68] *Id.*

[69] *See In re Vitamin C Antitrust Litig*., 2012 U.S. Dist. LEXIS 152275, at *27-29 (E.D.N.Y. Oct. 22, 2012) (describing the Ninth Circuit's reasoning in *Dennis* before concluding that the lack of a *cy pres* recipient was not important in the court's opinion).

[70] Wilber H. Boies & Latonia Haney Keith, *Class Action Settlement Residue and Cy Pres Awards: Emerging Problems and Practical Solutions*, 21 VA. J. SOC. POL'Y & L. 267, 278 (2014).

The caselaw suggests that the priority of the settlement should be to compensate class members to the extent practical. *Cy pres* distributions are appropriate only when it is not feasible to distribute 100% of the settlement funds directly to class members (*e.g.*, difficulty identifying class members, low expected take rate, costs of distribution greatly exceeding per-claimant amount of proceeds).[71]

Second, many courts will be most comfortable where the organization selected bears a reasonable (in some jurisdictions "substantial") nexus to the interests of the class members and serves the objectives of the underlying statutes or claims at issue.[72] One way to help ensure a link between the class and the proposed *cy pres* distribution is to give class members the opportunity to weigh in on the proposed recipient.[73]

Third, and relatedly, in an effort to address the interests of absent class members, *cy pres* settlements should take into account the geographic make-up of the class. Where a nationwide class is at issue, a court may be disturbed by a provision that confines *cy pres* recipients to one geographic region.[74]

In short, a successful *cy pres* settlement must anticipate that the charitable nature of such a settlement alone will not likely be enough to overcome judicial skepticism and the concern that the

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[71] The Seventh Circuit reversed an order decertifying a class, explaining that in cases where individual claims are small, a *cy pres* award "would amplify the effect of the modest damages in protecting consumers." *Hughes v. Kore of Ind. Enter.*, 731 F.3d 672, 676 (7th Cir. 2013).

[72] For example, in endorsing the use of *cy pres* settlements in *State of California v. Levi Strauss & Co*., the California Supreme Court explained that the propriety of *cy pres* "in a particular case depends upon its usefulness in fulfilling the purposes of the underlying cause of action." 41 Cal. 3d 460, 472 (1986).

[73] *See In re BankAmerica Corp.*, 775 F.3d at 1066.

[74] *See supra* text accompanying note 47.

terms of a settlement advance the interests of counsel at the expense of the class.

C. Coupon Settlements

In some instances, parties settle class actions by giving class members coupons or vouchers allowing them to enjoy the defendant's products or services at a reduced price or even free. For defendants, the appeal of such settlements is obvious—they generally give class members exactly what they claim they lost (*i.e.*, the value of the good or service), and the defendants do not have to come out of pocket (beyond attorneys' fees) to settle the case. In addition, coupon settlements may represent a premium for class members because they are often valued at an amount higher than the claim itself, compared with a cash payment that would ordinarily be at a substantial discount to the asserted value of the claim had the case proceeded successfully through trial. Yet coupon or voucher settlements nonetheless ordinarily are viewed with heightened scrutiny because they are by definition non-cash consideration, they usually require class members to do business with the defendant, there is a concern that defendants may seek to increase their own sales through such settlements, and class counsel are still paid their substantial attorneys' fees in cash. There are some exceptions, such as the judge in Los Angeles who ordered class counsel to be paid in a structured stream of $10 gift cards totaling $125,000,[75] or in Texas, where lawyers who recover coupons for the class must by statute be paid in coupons.[76]

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[75] The judge was later reprimanded by California's Commission on Judicial Performance. *See* Martha Neil, Judge Rapped Over Order to Pay Class Action Attorney in Store Coupons (ABA Journal Feb. 2, 2010).

[76] Tex. Civ. Prac. & Rem. Code § 26.003(b) ("[I]n a class action, if any portion of the benefits recovered for the class are in the form of coupons or other noncash common benefits, the attorney's fees awarded in the action must be in cash and noncash amounts in the same proportion as the recovery for the class.").

In an effort to curb "abuses of the class action device,"[77] Congress enacted the Class Action Fairness Act ("CAFA") in 2005, which regulates coupon settlements in two ways.[78] First, Section 1712(a) provides that when coupons are part of class settlement awards, "the portion of any attorney's fee award to class counsel that is attributable to the award of coupons shall be based on the value to class members of the coupons that are redeemed."[79] Second, Section 1712(e) requires courts to more closely scrutinize coupon settlements.[80] These provisions were intended to lower fee awards because not 100% of the coupons end up being redeemed. Note that in practice, these provisions actually may make settlements harder for defendants to achieve, because the dollar figure plaintiffs' counsel seeks may be set by their investment in the case or their past experiences and not by the ratio the drafters of CAFA hoped to impose.

1. Federal Courts' Treatment of Coupon Settlements

The Ninth Circuit in *In re HP Inject Printer Litigation* reversed the approval of a settlement because it violated CAFA's attorney's fees provision. The court noted that when both the class and its attorneys are paid in cash, it is easier for courts to "ensure faithful representation by tying together the interests of class members and class counsel."[81] But where counsel is paid in cash and the class is paid with coupons, "comparing the value of the

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[77] *Tanoh v. Dow Chem. Co*., 561 F.3d 945, 952 (9th Cir. 2009).

[78] *See* S. REP. NO. 109-14, at 14-20 & 30 (2005); Class Action Fairness Act of 2005, Pub. L. No. 109-2, § 2, 118 Stat. 4 (2005), 28 U.S.C. § 1711.

[79] 28 U.S.C. § 1712(a).

[80] 28 U.S.C. § 1712(e) ("The court, in its discretion, may also require that a proposed settlement agreement provide for the distribution . . . of unclaimed coupons to 1 or more charitable or governmental organizations . . . . The distribution and redemption of any proceeds under this subsection shall not be used to calculate attorneys' fees under this section.").

[81] *In re HP Inkjet Printer Litig*., 716 F.3d 1173, 1178 (9th Cir. 2013).

fees with the value of the recovery is substantially more difficult."[82] The court stated that a coupon settlement is particularly less valuable to class members where the coupons are "non-transferable, expire soon after their issuance, and cannot be aggregated."[83] Adding to the complexity, it observed that coupons provide the opportunity for class counsel "to puff the perceived value of the settlement so as to enhance their own compensation."[84] Focusing on the language of § 1712, the Ninth Circuit concluded that "the parties essentially invited the error" in the coupon settlement, because the way that the agreement was written—that is, no coupons were allowed to be issued until after the entry of a final judgment—it was not possible for the court to calculate the redemption value of the coupons, as required by CAFA.[85]

Citing the Ninth Circuit's caselaw on coupon settlements, the Seventh Circuit recently reversed the approval of a settlement where some claimants were entitled only to coupons in the form of discounts on future purchases of the defendant's products. The court felt that coupons themselves are "a warning sign of a questionable settlement."[86]

Some federal courts approving coupon settlements have pointed out that CAFA does not define the term "coupon."[87] These courts reason that other courts have "blurred the distinction between 'coupons' and 'vouchers,'" requiring a different approach, namely, "distinguishing credit vouchers, which require no additional purchase to redeem and therefore operate like cash,

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[82] *Id.* at 1179.

[83] *Id.*; *accord* Robert H. Klonoff & Mark Herrmann, *The Class Action Fairness Act: An Ill-Conceived Approach to Class Settlements*, 80 TULANE L. REV. 1695, 1699-1700 (2006).

[84] 716 F.3d at 1179.

[85] *Id.* at 1186.

[86] *Eubank*, 753 F.3d at 725.

[87] *See, e.g.*, *Chaikin v. Lululemon USA Inc*., 2014 U.S. Dist. LEXIS 35358, at *13 (S.D. Cal. Mar. 14, 2014).

from coupons, which provide a discount or subsidy from a larger purchase and thus fall under the restrictions of [CAFA]."[88] In cases where vouchers are used, such courts may not view a voucher settlement as a coupon settlement at all under CAFA. Note, however, that a district court in the Third Circuit recently approved a settlement even though it rejected this line of reasoning, concluding that Third Circuit precedent before the enactment of CAFA made no distinction between coupons and vouchers, because each forces the class member to engage in future business with the defendant.[89]

Also note that the Ninth Circuit in *In re Online DVD-Rental Antitrust Litigation* expressly distinguished between coupons and gift cards—holding that the latter are not subject to CAFA's heightened scrutiny, at least where a class member need not spend any of his or her own money, can choose from a large number of potential items to purchase, and have the option of obtaining cash instead of a gift card.[90]

2. State Courts' Treatment of Coupon Settlements

State courts are not bound by CAFA's standards and are thus free to accept or reject coupon settlements without necessarily applying heightened scrutiny or any special standards.[91] In approving a coupon settlement in *Chavez v. Netflix, Inc.*, for instance, the California Court of Appeal noted the absence of any authorities holding that coupon settlements are *per se* improper.[92]

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[88] *Id.* at *13-14 (citing federal district courts in the Ninth Circuit that have made the distinction between coupons and vouchers).

[89] *See Martina v. L.A. Fitness Int'l, Inc*., 2013 U.S. Dist. LEXIS 145285, at *11-13 (D.N.J. Oct. 8, 2013).

[90] 779 F.3d 934, 951–53 (9th Cir. 2015).

[91] *See Chavez v. Netflix, Inc*., 162 Cal. App. 4th 43, 54 (2008) ("[A]lthough [CAFA is] inapplicable to this proceeding, [it] is 'highly suspicious' of coupon settlements because it requires the court to hold a special hearing to determine their value.").

[92] *Id.*; *see also Kazman v. Frontier Oil Corp*., 398 S.W.3d 377, 383 (Tex. App. 2013) (applying Texas state law to determine whether

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Thus, the court considered established California precedent to determine whether the settlement was generally fair, reasonable, and adequate, noting that several prior California decisions had approved such settlements.[93] Moreover, the court determined that the settlement was fair because the coupons were not for slight discounts for products, but actually provided free services to class members (more like a voucher). Thus, the coupons did not "induce the [class] member to make a purchase he or she would not otherwise have made, which may actually produce a net benefit for the defendant."[94]

3. Strategies for Approval of Coupon Settlements

In structuring a coupon settlement that will receive increased scrutiny under CAFA, counsel should be prepared to provide the court with a factual basis to estimate the actual value of the settlement, if practicable, so that the parties may ease concerns about inflated attorneys' fees. In some cases, it may be possible to estimate redemption rates based on past similar cases through reliance on expert reports.

One strategy for increasing redemption rates is to limit transfer restrictions on coupons. In other words, instead of limiting the redeemability of coupons to class members, the agreement may provide that coupons may be redeemed by family members, friends, or anyone else (class members can sell them or give them away). Further, parties should consider reducing any duration restrictions, giving class members more time to redeem

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class counsel was entitled to attorneys' fees in the case of a coupon settlement, and making no reference to CAFA).

[93] *See, e.g.*, *In re Microsoft I-V Cases*, 135 Cal. App. 4th 706 (2006).

[94] *See Chavez*, 162 Cal. App. 4th at 53. The court noted that while the free services provided by the coupons may induce some class members to continue the service after the free period had lapsed, the potential for the defendant to actually benefit financially from the settlement was much lower than it would be if it were a pure coupon discount program. *Id.*

coupons. If counsel can show that the terms of the settlement encourage maximum redemption, there is a greater chance of surviving the increased judicial scrutiny that CAFA imposes upon coupon settlements.

Though CAFA's statutory mandate for heightened scrutiny is applicable only to federal courts assessing settlements in cases governed by CAFA, state courts are closely watching the development of federal case law on class action settlements generally, including with respect to coupons, so lawyers and their clients should not assume that state courts will rubber-stamp a coupon settlement without asking some critical questions. Thus, following the above strategies, as well as those for creating fair and reasonable settlements in general, will increase chances of approval.

In particular, in both state and federal court, coupons that provide for free services rather than discounted services are more likely to receive approval. These types of coupons remove concerns that defendant was attempting to drive future sales. Further, at least in some cases, class members may be more likely to redeem coupons that provide for free goods or services (which operate like cash), compared with coupons that serve only as a discount.

D. More Obvious Indicia of Conflicts or Collusion

Occasionally, judges are presented with factual scenarios that present obvious indications that class counsel may not be acting in the best interest of the class. For example, the Seventh Circuit recently rejected a settlement where the lead class counsel was the son-in-law of the lead class representative.[95] As the court explained: "Class representatives are . . . fiduciaries of the class members, and fiduciaries are not allowed to have conflicts of interest without the informed consent of their beneficiaries."[96] Given the close family relationship between the class

[95] *Eubank*, 753 F.3d at 723-24.

[96] *Id*.

representative and class counsel, there was a strong incentive to agree to a fee award that was as large as possible (in the millions of dollars), at the expense of the class (who would receive awards ranging from several hundred to several thousand dollars at most).[97] Further, in that same case, class counsel were preoccupied defending against other lawsuits and requested attorneys' fees before even issuing notice of the settlement; the court held that such counsel lack the incentives and integrity necessary to obtain maximum relief for the class.[98]

Likewise, sometimes there is such an obvious diversion of interests between the named plaintiffs and the absent class members that the court rejects a settlement for lack of adequate representation. The Ninth Circuit addressed that issue in *Radcliffe v. Experian Info. Solutions, Inc*., in which, as part of the settlement, the named plaintiffs would receive "conditional incentive awards" worth $5,000 (compared to between $26 and $750 for class members), but only if they explicitly supported the settlement.[99] The court explained: "Instead of being solely concerned about the adequacy of the settlement for the absent class members, the class representatives now had a $5,000 incentive to support the settlement regardless of its fairness and a promise of no reward if they opposed the settlement. The conditional incentive awards removed a critical check on the fairness of the class-action settlement, which rests on the unbiased judgment of class representatives similarly situated to absent class members."[100]

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[97] *Id.* Likewise, the Ninth Circuit has held that class counsel's fiduciary duty to the class includes reporting potential conflicts of interest to the district court. *See Radcliffe v. Experian Info. Solutions*, 715 F.3d 1157, 1167 (9th Cir. 2013) (applying California law to conclude that representation of clients with actual or potential conflicts of interest is prohibited absent an express waiver).

[98] *Eubank*, 753 F.3d at 724 (describing class counsel's "ethical embroilment" and "the litigation against him by his former law partners" as a reason why it was in his personal interest to negotiate a quick settlement at the expense of the class).

[99] 715 F.3d 1157, 1164 (9th Cir. 2013).

[100] *Id*.

E. Obstacles for Objectors and Class Members

Another red flag for courts examining class settlements is the presence of impediments for those class members who wish to object to the settlement. Relatedly, if it would be particularly difficult to make a claim or receive payments from the settlement, courts take this as a sign of collusion between class counsel and the defendant who may be trying to limit the cost of the settlement while allowing class counsel to collect inflated fees.

1. Claim Forms Should be Simple, Clear, and Concise

In *Eubank v. Pella Corp.*, the Seventh Circuit reversed the approval of a settlement for, among other reasons, the impediments it imposed on class members attempting to receive payments from the settlement fund.[101] The court noted that the "simple" claim form for class members was 12 pages long for a payout with a $750 ceiling, while the $6,000 claim form was 13 pages and required the claimant to go through arbitration.[102] Further, claimants opting to enter arbitration would likely be without the assistance of counsel, because legal fees would quickly become prohibitively expensive relative to the payoff. No provisions of the settlement provided for shifting of legal fees of a successful claimant in an arbitration proceeding.[103] Given these circumstances, the court was unsurprised that only 1,276 claims had been filed in response to 225,000 notices that had been sent to class members.[104] The court rejected as erroneous the lower court's finding that the expected settlement fund would be $90

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[101] *Id.* at 725.

[102] *Id.* at 726.

[103] *Id.*

[104] *Id.* at 726 ("Considering the modesty of the settlement, the length and complexity of the forms, and unfamiliarity of the average homeowner with arbitration, we're not surprised that only 1276 claims (of which only 97 sought arbitration) had been filed as of February 2013, out of the more than 225,000 notices that had been sent to class members.").

million, where actual claims filed as of the date of the trial court's opinion were seeking just north of $1 million in the aggregate.[105]

The California Court of Appeal likewise reversed the approval of a class settlement where objectors were required to appear in court to have their objections heard.[106] The court concluded that this requirement violated class members' due process rights. The notice at issue clearly informed class members "[i]f you send an objection, you or your attorney will need to come to Court to talk about it or the Court will not consider it."[107] The appellate court explained:

> Requiring class members in a nationwide class or even a statewide class to appear at the final approval hearing or hire an attorney to have their objections heard works a hardship on objectors, as the benefit to the objector from the class action may be so low that it would be cost prohibitive or physically challenging to personally assert one's rights at a hearing in a potentially distant location. . . . [I]f an objector is permitted to file written objections to be considered, the burden on the court to review them is minimal and the cost to the parties remains the same.[108]

The Court of Appeal concluded that the trial court could not have accurately evaluated objections to the settlement due to the "onerous requirement that [class members] attend the final approval hearing."[109]

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105 *Id*.

106 *Litwin v. iRenew Bio Energy Solutions, LLC*, 226 Cal. App. 4th 877, 885 (2014).

107 *Id.* at 884.

108 *Id.*

109 *Id.*

2. Strategies for Approval

In light of these concerns, lawyers negotiating class settlements and drafting notices should avoid substantial impediments to objections and/or claim redemptions that are unnecessary to determine legal entitlement to payment. Of course, the facts of certain cases might justify more complicated redemption forms (*e.g.*, substantial settlement consideration, uncertainty of class membership, qualifying criteria that cannot be determined from defendants' records), but drafting lawyers should note that courts generally are reluctant to require class members to take multiple steps before they can receive payment. Thus, where feasible, settlements should include simple and concise instructions for redemption of claims.

Further, if they feel that it is prohibitively difficult to object to the settlement's terms, courts may disapprove settlements on due process grounds alone.[110] To avoid this outcome, settlements should be structured so that objectors have reasonable means to voice their concerns about the proposed settlement. To that end, class members should not be required to travel or provide an unreasonable degree of documentation in order to object. And as with claim redemption, objecting to a settlement should not be prohibitively time consuming, costly, or unreasonable relative to the settlement's value.

F. Issues Regarding Notice

Class settlement agreements generally explain how class members will be informed of the settlement and provide directions for how they may recover the settlement benefits. Adequacy of notice is a common argument raised on appeal from an approved settlement, because the inadequacy of notice may not be realized until later, especially after a large portion of the settlement proceeds go unclaimed. Adequate notice to class members helps ensure that a settlement has real value and will withstand

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[110] *See id.* ("Requiring any objector to attend the final approval hearing does not offer a meaningful opportunity to be heard, and therefore violates class members' due process rights.")

subsequent notice attacks on appeal. Courts will be wary of notice that is hard to understand or makes it unnecessarily difficult to receive the settlement proceeds.

1. Notice Must Be in Plain English and Include All Relevant Information

Courts strongly favor notice that furthers "the goal of making it easy to understand for non-lawyers."[111] Indeed, Rule 23 itself requires that notice "clearly and concisely" state the relevant information "in plain, easily understood language."[112] In general, notice should clearly explain the rights and obligations of class members regarding the settlement, and some states have specific statutory requirements for notice.[113] Notice mailed to class members should not be a lengthy document written in legalese; it should be straightforward, easy to read, and offer a clear description of class members' options and what they are entitled to.

Of course, courts do not require "perfection" in a notice.[114] For example, the California Court of Appeal noted that "utilizing a summary notice directing class members to a Web site containing more detailed notice . . . is a 'perfectly acceptable' manner of giving notice."[115] The Court of Appeal also rejected an argument that notice was defective because it failed to disclose the size of the class. It was enough that "[b]oth the mail notice and the long-form publication notice identified the total amount of the common fund recovery, the nature of the costs and fees to be deducted from

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111 *Cellphone Termination Fee Cases*, 186 Cal. App. 4th 1380, 1390 (2010).

112 Fed. R. Civ. P. 23(c)(2)(B).

113 *See, e.g.*, *Cellphone Termination Fee Cases*, 186 Cal. App. 4th at 1390 (describing California state statutes outlining the requirements for notice).

114 *Id.* at 1392.

115 *Id.*

the common fund, and the fact that the balance of the fund would be allocated among qualified class claims."[116]

Another California decision considered whether notice with an ambiguous definition of class membership was consistent with the state rules pertaining to the management of class actions.[117] Because those rules reflect a scheme designed to provide adequate notice to all class members, they "rest upon an assumption that the definition of a plaintiff class will be clear and free from obvious ambiguity."[118] In that case, however, the notice advised recipients that they were members of the class if, between two dates, they purchased the defendant's product from an "authorized" retailer or distributor. The court took issue with this phrasing because it could reasonably have led some people incorrectly to conclude that they were not members of the class, and vice versa, since it was unclear whether indirect purchasers were members of the class (they were).[119] Noting that "[t]he goal in defining the class is to use terminology that will convey sufficient meaning to enable persons hearing it to determine whether they are members of the class plaintiff wishes to represent,"[120] the court vacated and remanded for the purpose of clarifying the scope of the class.[121]

Besides ambiguities in the notice, courts are also critical of notice that is unnecessarily long or complex. For example, in *Eubank v. Pella Corp*., the Seventh Circuit rejected a notice that contained 27 sections, some of which had a number of subsections.[122]

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[116] *Id.* at 1393.

[117] *Cho v. Seagate Tech. Holdings, Inc*., 177 Cal. App. 4th 734, 745 (2009).

[118] *Id.* at 746.

[119] *Id.* at 746-47.

[120] *Id.* at 746.

[121] *Id.* at 748.

[122] *Eubank*, 753 F.3d at 726.

On the other hand, although "[s]ettlement notices are supposed to present information about a proposed settlement neutrally, simply, and understandably[,] [these] objectives [are] not likely served by including the adversarial positions of objectors."[123] The Circuits seem to agree then that Federal Rules pertaining to class notice "[do] not require the notice to set forth every ground on which class members might object to the settlement."[124] Rather, notice must simply inform the prospective class members about the terms of the settlement so that they have fair and neutral information from which they may draw their own conclusions about whether the settlement serves their interest.[125]

Nonetheless, leaving out crucial facts upon which a class member might object will likely result in disapproval of the notice, or reversal on appeal. For example, the Sixth Circuit reversed the approval of a settlement where an individual who was sued in a debt-collection action brought a class-action counterclaim against the debt collector, alleging fraudulent collection practices.[126] The court noted that the settlement notice informed the class that by not objecting, class members released the debt collector from all claims, including all claims arising out of allegedly fraudulent affidavits relied upon in the class action lawsuit. But the notice did not sufficiently explain that by not objecting, class members would lose the right to rely on the fraudulent affidavits in defending against the debt collector in their debt-collection actions.[127] Since this was a "principal ground" on which a class member might object, the court concluded that the notice did not fairly inform the prospective class members of the terms of the settlement.[128]

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123 *Rodriguez v. W. Publ'g Corp*., 563 F.3d 948, 962-63 (9th Cir. 2009).

124 *UAW v. GMC*, 497 F.3d 615, 630 (6th Cir. 2007); *see also, e.g.*, *Rodriguez*, 563 F.3d at 962-63.

125 *Vassalle v. Midland Funding LLC*, 708 F.3d 747, 759 (6th Cir. 2013).

126 *See id.* at 759-61.

127 *Id.* at 759.

128 *See id.*

2. Strategies for Drafting Effective Notice

The case law reveals that while perfect notice is not required, an effective notice must strike a delicate balance between providing class members with all relevant information and not burdening them with unnecessary details that may be confusing. Thus, notice must be kept short, preferably with links to websites that discuss the settlement terms in greater detail for those class members who are interested in learning more. Further, the complexity and length of the notice may be proportional to the potential payment to a class member. In other words, while notice and claim forms sent to class members may reasonably be ten or more pages for complex settlements that are worth thousands of dollars, it makes little sense to provide similar notice to class members who stand to receive only a few dollars.

Counsel should be sure to include relevant information about the underlying causes of action and the effect of the release. These facts are critical so that class members may decide whether to accept the settlement terms, object, or opt-out. Though the number of objectors and opt-outs to a settlement may be quite small in practice, notice that fails to provide important information will generate suspicion by a reviewing court.

Notice also must be disseminated in such a way as to reach as many class members as practicable. But one looming concern that courts have not explicitly addressed is what happens when a court rejects a settlement for an insufficiently effective notice campaign, but in doing so the court thereby causes the eventual notice to reach fewer class members. In particular, if a court disapproves a settlement in part because the notice campaign is inadequate, the parties must go back to the drawing board, negotiate and document a settlement, prepare motion papers, and eventually be heard by the court on a motion for preliminary approval. That sequence of events, in practice, could take several months and sometimes much longer. Meanwhile, class members may change addresses, phone numbers, e-mail addresses, or even pass away. Thus, when the actual notice is sent out, it may end up being received by a substantially lower number of class members. Courts and litigants should keep this reality in mind in considering the effectiveness of a notice campaign.

Balancing the Value of the Settlement with the Potential Outcome at Trial

As noted above, courts considering whether to approve class settlements weigh various factors to determine whether the settlement agreement is fair, reasonable, and adequate for the class.[129] One of the factors courts are directed to consider is the perceived strength of the class' case, as well as the risks of proceeding further in litigation. In particular, courts are to consider whether the settlement terms are fair compared with the likelihood that the class would prevail at trial and the amount they would recover.[130] Courts must make this determination based on "the realistic, rather than theoretical, potential for recovery after trial."[131] Often, however, this issue receives inadequate attention in cases where the court is distracted by other issues affecting the settlement, so a settlement is disapproved because it provides little compensation to class members, yet the case may have even less value to class members if tried and appealed.

As a matter of common sense, the likely outcome of the case should be one of the most important considerations—if not *the* most important—in assessing the fairness of a settlement.[132] It

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[129] *See, e.g., Wal-Mart Stores, Inc. v. Visa, U.S.A. Inc*., 396 F.3d 96, 117 (2d Cir. 2005) (referencing the nine factors courts in the Second Circuit use to evaluate the fairness of a settlement); *In re Microsoft I-V Cases*, 135 Cal. App. 4th 706, 723 (2006) (describing the factor test used by California courts that was originally borrowed from the Ninth Circuit).

[130] *See UAW v. General Motors Corp*., 497 F.3d 615, 631 (6th Cir. 2013) ("[W]e cannot judge the fairness of a proposed compromise without weighing the plaintiff's likelihood of success on the merits against the amount and form of the relief offered in the settlement." (quotation marks omitted)).

[131] *Sullivan v. DB Investments, Inc.*, 667 F.3d 273, 323 (3d Cir. 2011).

[132] *Synfuel Techs., Inc. v. DHL Express (USA), Inc.*, 463 F.3d 646, 654 (7th Cir. 2006) (describing this factor as the "most important factor relevant to the fairness of a class action settlement" (quotation marks omitted)).

is exceedingly time-consuming, expensive, and risky for plaintiffs' counsel to litigate a class action from the pleadings, through discovery, then through class certification, then through summary judgment, and then through trial and appeal. At each successive step, past experience shows that there is a realistic chance that the defendant will prevail, leaving the class and their counsel with no recovery at all. For instance, at the class certification phase, a string of recent Supreme Court decisions have clarified the stringent standards that must be applied at certification.[133] Moreover, even the best trial lawyers know that trials are inherently uncertain and risky. Because plaintiffs generally bear the burdens of proof and persuasion at any trial, they are likely to prevail only about half the time at best.[134] And even if a class prevails at trial and the result is upheld on appeal, there may not be a significant recovery awaiting them at the end of the process. This is especially true in the age of the "no-injury" class action—in which uninjured purchasers of allegedly defective products bring suit under consumer-protection laws to recover the purported difference in value between the product as sold and the product as promised.[135]

In short, courts considering whether to approve settlements must use the information available at the time of settlement to make a realistic assessment of the plaintiffs' prospects going forward, and then compare those prospects to the certain benefits to be gained in the settlement. This analysis should be the most important factor in assessing the reasonableness and adequacy of a settlement.

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[133] *See Comcast Corp. v. Behrend*, 133 S. Ct. 1426 (2013); *Wal-Mart Stores, Inc. v. Dukes*, 131 S. Ct. 2541 (2011).

[134] According to data collected by the Justice Department in 2005, plaintiffs won approximately 54% of state-court jury trials in tort, contract, and real property cases; plaintiffs won about 50% of the time in federal court. http://www.bjs.gov/index.cfm?ty=tp&tid=451.

[135] *See, e.g.*, *Kwikset Corp. v. Superior Court*, 51 Cal. 4th 310 (2011) (lawsuit by purchasers of locks labeled "Made in the U.S.A.," seeking to recover economic loss because the locks allegedly contained foreign-made parts).

1. Settlement is Obviously Less Risky than Proceeding to Trial

Because "the outcome of litigation is never certain," settlements are favored where the litigation would be particularly complex, long, or expensive.[136] Where it has been established that litigation will involve the use of experts, extensive discovery, and multiple factors for the class to prove, "an immediate and certain recovery for class members . . . favors settlement" of the lawsuit.[137]

Courts have also noted that "[a]s a general matter, the more complex, expensive, and time consuming the future litigation, the more beneficial settlement becomes as a matter of efficiency to the parties and to the Court."[138] These courts have nonetheless clarified that "complexity of [the] litigation going forward is difficult to evaluate."[139] Yet the bar for a case's "complexity" is often quite low. For example, a federal district court in New York concluded that although neither the plaintiffs nor the defendants had argued that a trial would be "an extremely burdensome affair," and the parties agreed that the legal issue involved was "a simple one," the processes of trial, including "summary judgment motions, pre-trial motions, additional discovery . . . and additional delays before a final judgment could be obtained," were factors favoring settlement.[140] Although courts perform this inquiry, they are not required to adjudicate the disputed issues or decide unsettled questions. Rather, they must

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136 *See, e.g., Hartless v. Clorox Co.*, 273 F.R.D. 630, 640 (S.D. Cal. 2011) ("Defendant further asserts that if litigated through trial, the case would be unmanageable as the court would have to engage in individual inquiries for thousands of class members. Additionally, the parties assert that litigating the class action through trial would be time-consuming and expensive as the issues are complex and require expert analysis.") (internal citations omitted).

137 *See id.*

138 *McBean v. City of New York*, 233 F.R.D. 377, 385 (S.D.N.Y. 2006).

139 *Id.*

140 *See id.*

simply assess the risks of litigation—*e.g.*, facts suggesting that there is a risk of class decertification[141]—against the certainty of recovery under the settlement.

When considering the reasonableness of settlement in light of the perceived strength of the case and complexity of potential litigation, courts take "a broader view, examining the settlement as a whole, and comparing it to other settlements negotiated and approved in similar circumstances."[142] Thus, courts will consider examples of various awards in similar factual circumstances provided by each party and determine whether the settlement's terms appear reasonable.[143] Intermediate courts reviewing settlement approvals attempt to determine whether the trial court was given sufficient information to make this determination. Courts may ask whether approval orders contain "a substantiated explanation of the strengths and weaknesses of the class's claims, as well as the potential total recovery by the class under various damage theories."[144] If such an explanation appears, it is more likely that courts will approve the settlement.[145]

By contrast, where no such explanation appears in the record, as the Seventh Circuit explained in *Synfuel Techs., Inc. v. DHL Express (USA), Inc.*, it "undermine[s]" the reviewing court's "confidence in the fairness of the settlement."[146] While the Seventh Circuit does not demand a "high degree of precision" in

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141 *See In re Pet Food Prods. Liab. Litig*., 629 F.3d 333, 352 (3d Cir. 2010) (concluding that where a class of pet owners had pets that varied in size and health, there were risks of decertification at trial, supporting approval of a settlement).

142 *McBean*, 233 F.R.D. at 388.

143 *See id.*

144 *Nordstrom Com. Cases*, 186 Cal. App. 4th 576, 588 (2010).

145 *See, e.g.*, *id.* at 592 (affirming the approval of a settlement challenge on the grounds of strength of the case, where the trial court provided a sufficient explanation of their assessment of the fairness of the settlement given the valuation of the case).

146 463 F.3d 646, 654 (7th Cir. 2006).

valuing the litigation, it at least requires the parties to present evidence sufficient to enable the district court to estimate the range of possible outcomes—but the district court in *Synfuel* did not even "attempt to quantify the value of plaintiffs' case [or] estimate how many class members' claims would be barred by the statute of limitations."[147]

2. Weighing a Case's Value as Part of the Fairness Assessment

As mentioned, courts must assess a variety of factors to determine whether a settlement is fair, reasonable, and adequate. Many of those factors appear to point toward the same general conclusion: if a case appears to have little chance of success on the merits and little chance of a substantial recovery for the class, then settlement should be preferred to protect the interests of class members.[148]

That said, courts do not always accept counsel's risk assessment and discount calculations. In the recent *Eubank* decision, for instance, the Seventh Circuit noted "the remarkable statement in [counsel]'s brief defending the settlement that 'in comparison to this $90 million independent valuation of the Settlement, a trial of the certified claims here, even with a complete victory, would result in an award of $0.' Zero? But if [defendant] has no liability, why would it agree to a $33.5 million settlement . . . ?"[149] And in one recent case where there had been a

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147 *Id*. at 653-54.

148 *See, e.g.*, *Tennille v. Western Union Co*., -- F.3d --, 2015 WL 1948493, at *7–8 (10th Cir. May 1, 2015) (approving settlement where "serious legal and factual questions placed the litigation's outcome in doubt," and noting that to the extent class members did not obtain everything they sought in the litigation, "that is the nature of a settlement").

149 *Eubank*, 753 F.3d at 727.

prior settlement, the trial court rejected a later settlement based on its view that later settling defendants should pay more.[150]

For this reason, settlements stand a better chance of being approved where the parties provide enough information for the court to perform the necessary analysis, and where parties are able to contextualize the reasonableness of the settlement within the history of the case (including any prior settlements). Examples of settlements from factually analogous cases are also helpful, as are the results of similar cases that proceeded to trial. Further, counsel should provide realistic estimates of the costs of litigating the case through trial, factoring in the perceived complexity of the legal issues involved. And if there are facts available at an early stage that demonstrate a risk of not certifying a class (or having the class decertified later), the unlikelihood of prevailing on the merits, or a low (or zero) anticipated recovery, counsel should bring those facts to the court's attention.

Conclusion

Counsel and clients engaged in class litigation should appreciate the most frequent concerns raised during the approval phase. Especially in high-profile class actions where a lot of money is at stake, professional objectors are sure to spot these issues even if the court does not. Accordingly, defendants, class members, and class counsel are all best served by settlements that anticipate and address these oft-recurring issues in advance, so that the approval process goes as efficiently as possible.

Moreover, in many of the recent decisions rejecting class settlements, the appellate courts have taken the lower courts to task

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[150] *In re: High-Tech Employee Antitrust Litig*., No. 11-cv-02509-LHK , Dkt. 974 (N.D. Cal. Aug. 8, 2014) (rejecting $325 million settlement in an antitrust class action because it was lower than the proportional amount paid by other co-defendants in an earlier settlement, and the court opined that plaintiffs' case had grown stronger since then). This case in effect established a "most favored nations" rule for the prior settlements, even though the parties had not negotiated one, and many courts have disapproved such provisions.

for granting approval without adequately explaining their reasoning. Thus, it is vital to establish a complete record demonstrating arms-length negotiations, the reasonableness of attorneys' fees, and a clear explanation of why certain settlement provisions were agreed to. As noted, where a "compromised settlement" can be shown, courts will "rarely overturn" the approval of such agreements.[151]

The increased judicial scrutiny applied to class settlements in recent years has had both positive and negative effects for class members. On the one hand, weeding out collusive settlements of course is a worthy goal. On the other hand, practically speaking, courts are making it more difficult and costly to settle cases, which may harm class members because they may never recover any value at all from a case that is not settled. And obstacles to settlement that make settlement far more costly and create multiple rounds of publicity make litigating these cases to conclusion a more appealing option to a defendant with strong arguments against certification, liability or both.

The upshot of all of this is that courts considering whether to approve a settlement ought to take a hard look at the value of the case if it goes forward, thinking carefully about the costs and risks of each stage of the litigation, and discounting the "best case scenario" by a sizable percentage where such a discount is appropriate to reflect the realities of litigation.

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[151] *Laguna*, 753 F.3d at 924.