5 Complications That Can Derail A Class Action Settlement

By **Steven Allison, Samrah Mahmoud and Mary Kate Kamka**

In recent years, courts have more closely scrutinized class action settlement agreements to ensure that the agreements are fairly and adequately benefiting absent class members.

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Some of this increased scrutiny was brought on by changes to Federal Rule of Civil Procedure 23 at the end of 2018, which included an explicit reference to electronic notice as a means of the best practicable notice and four factors that courts must consider in approving class action settlements under Rule 23(e)(2).

While courts will of course scrutinize the direct benefit to class members, particularly in Rule 23(b)(3) classes, there are several other settlement provisions to which courts have begun to pay closer attention. Understanding these class action settlement pitfalls can be key to getting your settlement approved.

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1. Courts are starting to require some form of electronic notice to class members.

While some forms of electronic notice such as email, digital ad campaigns or social media postings, have become increasingly common in class settlements, a recent U.S. Court of Appeals for the Ninth Circuit opinion, Roes 1-2 v. SFBSC Management LLC, suggests that electronic notice may not only be an approved notice method but potentially a required one.[1]

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Rule 23 requires that notice to (b)(3) class members be "the best notice that is practicable under the circumstances."[2] In December 2018, the rule was amended to explicitly recognize electronic notice as one of the forms of notice that may be appropriate under the circumstances.

In Roes 1-2 v. SFBSC Management, the Ninth Circuit reversed approval of a class settlement in part because it found that mailed notices and posters in the defendant's clubs were not the best notice practicable.[3] The court stated there were numerous other reasonable options for notice, including email, social media and online message boards.

The court went on to note that "technological developments are making it ever easier to target communications to specific persons or groups and to contact individuals electronically at little cost." Given the public's increased reliance on social media and the internet for news and information, it is likely that more courts will follow the Ninth Circuit's lead in requiring some form of electronic notice in addition to or in lieu of traditional forms of notice.

Parties should therefore consider adding one or more forms of electronic notice to their notice schemes to provide the best notice that is practicable.

2. The class representative must have Article III standing.

In March 2019, the U.S. Supreme Court made clear that a federal court cannot approve a class settlement where the named plaintiff lacks Article III standing.[4] In Frank v. Gaos, the named plaintiffs challenged Google Inc.'s practice of sharing users' search terms with third-party websites.

The parties reached a class settlement that was approved by the U.S. District Court for the Northern District of California and upheld by the Ninth Circuit. The United States challenged the settlement through an amicus brief alleging that the class representative lacked Article III standing.

Ultimately, the Supreme Court reversed and remanded the order approving the class settlement because the district court failed to evaluate the issue of standing. In doing so, the Supreme Court made clear that a "court is powerless to approve a proposed class settlement if it lacks jurisdiction over the dispute."[5]

For class actions involving consumer protection statutes, defendants sometimes agree to class settlements with plaintiffs with questionable claims to mitigate the risk of potential liability associated with large statutory penalties. Frank v. Gaos dictates that the parties should know whether the class representative suffered a concrete injury under Article III as a result of the statutory violation before seeking approval of any class settlement.

3. Clear sailing provisions will draw heightened scrutiny.

Under Rule 23, the parties must demonstrate that a class settlement resulted from an arm's-length negotiation void of collusion. A so-called clear sailing provision is an agreement between the parties that the defendant will not challenge the plaintiff's request for attorney fees in a class settlement up to a set amount.

While such provisions are not prohibited, they will draw increased scrutiny of the plaintiffs' fee request. As the Ninth Circuit explained, clear sailing provisions are "important warning signs of collusion" because they "increase the likelihood that class counsel will have bargained away something of value to the class."[6]

A district court's failure to adequately scrutinize settlement agreements that contain clear sailing provisions is a reversible error.[7] To survive this scrutiny, practitioners must identify specific facts demonstrating the settlement resulted from fair negotiations.

Examples of facts that have appeased courts' concerns of collusion when the agreement contains a clear sailing provision include: (1) the settlement resulted from a mediator's proposal;[8] (2) the fee demand was within the range the circuit court previously held was acceptable;[9] and (3) the fee request fell below counsel's lodestar amount.[10] The most conservative option, of course, would be to omit the provision all together.[11]

4. Cy pres recipients must be closely tied to the purpose of the litigation.

Cy pres recipients in class settlements have long been preferred over provisions that revert unclaimed funds to the defendant (i.e., reversionary clauses).[12]

But courts have increasingly required parties to identify cy pres recipients whose goals are closely tied to the purpose of the lawsuit. For instance, in Johnson v. Rausch Sturm Israel Enerson & Hornik LLP, a district court in New York required the parties in a Fair Debt

Collection Practices Act lawsuit to provide additional information regarding how the parties' designated cy pres recipient, the National Consumer Law Center, aligned with the litigation's purpose before granting preliminary approval.[13] Indeed, legal services organizations, even ones that provide general legal aid, may be insufficient cy pres recipients unless they do work that aligns with the subject matter of the litigation.[14]

Parties should therefore select a cy pres recipient that is closely aligned to the litigation's purpose and be prepared to explain this connection to the court on preliminary approval.

5. Class representative incentive payments must be proportional and relate to the work performed.

Class representatives almost always receive incentive awards as compensation for the work they performed on behalf of the class and the risk they undertook in bringing the lawsuit. When evaluating class settlements, courts must scrutinize these payments carefully to ensure they do not undermine the adequacy of the class representative by creating a conflict of interest between the representative and the other class members.[15]

Though incentive awards rarely bar approval of a class settlement, courts routinely adjust the amount based on the facts of the case. Courts have decreased incentive payments when the payments were not proportional to the relief received by other class members and when the actual work performed, or risk undertaken by the class representative did not substantiate the incentive award.[16]

Therefore, when seeking approval for a class settlement, practitioners should clearly demonstrate how the incentive award relates to the work performed by the class representative and are proportional to other class members' relief.

Although parties and counsel may feel like they are nearing the finish line when class settlements are reached, the bar for class settlement approval is high, and courts are not afraid to send counsel back to the drawing board on particular settlement components or to deny settlement approval entirely. Anticipating the above pitfalls in settlement negotiations and drafting will help ensure a smooth settlement approval process and insulate such approval from reversal on appeal.

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[1] 944 F.3d 1035, 1047 (9th Cir. 2019).

[2] Fed. R. Civ. P. 23(c)(2)(b).

[3] 944 F.3d at 1047.

[4] See Frank v. Gaos, 139 S. Ct. 1041, 1046 (2019).

[5] Id.

[6] In re Bluetooth Headset Prods. Liab. Litig., 654 F.3d 935, 946 (9th Cir. 2011).

[7] See Roes 1-2 v. SFBSC Management, LLC, 944 F.3d 1035, 1049-1050 (9th Cir. 2019).

[8] See Kutzman v. Derrel's Mini Storage, Inc., No. 118CV00755AWIJLT, 2020 WL 406768, at *13 (E.D. Cal. Jan. 24, 2020).

[9] Benitez v. W. Milling, LLC, No. 1:18-CV-01484-SKO, 2020 WL 309200, at *12 (E.D. Cal. Jan. 21, 2020).

[10] Id.

[11] See Azar v. Blount Int'l, Inc., No. 3:16-CV-0483-SI, 2019 WL 7372658, at *9 (D. Or. Dec. 31, 2019) (the parties' omission of a "clear sailing" clause indicated that no collusion occurred).

[12] In re Baby Prod. Antitrust Litig., 708 F.3d 163, 172 (3d Cir. 2013) (discussing courts skepticism of reversionary clauses and the benefits of cy pres recipients in contrast).

[13] No. 19-CV-5460 (JSR), 2019 WL 6798980, at *6 (S.D.N.Y. Dec. 13, 2019) (denying preliminary approval on multiple grounds); see also Raffin v. Medicredit, Inc., No. CV154912MWFPJWX, 2018 WL 8621204, at *7 (C.D. Cal. Nov. 30, 2018) (resolving dispute between parties over cy pres recipient and choosing Legal Aid Association of California because organization's consumer privacy work was closely tied to purpose of class action under California Invasion of Privacy Act); see also See In re BankAmerica Corp. Sec. Litig., 775 F.3d 1060 (8th Cir. 2015) (vacating approval of class action settlement and remanding for court to identify cy pres recipient "more closely tailored to the interests of the class and the purposes of the underlying litigation").

[14] See Johnson v. Rausch, 2019 WL 6798980, at *6.

[15] Radcliffe v. Experian Info. Solutions, Inc., 715 F.3d 1157, 1163 (9th Cir. 2013).

[16] See e.g. Carlin v. DairyAmerica, Inc., 380 F. Supp. 3d 998, 1027 (E.D. Cal. 2019) (decreasing requested incentive award from $90,000 to $45,000 because other class members received just over $1,000 in relief); Altnor v. Preferred Freezer Servs., Inc., 197 F. Supp. 3d 746, 769 (E.D. Pa. 2016) (reducing requested incentive award from $4,000 to $1,410.80 given the class representatives limited involvement and failure to identity any specific risks they face by serving as a class representative); Ridgeway v. Wal-Mart Stores Inc., 269 F. Supp. 3d 975, 1003 (N.D. Cal. 2017) (reducing the requested incentive awards from $50,000 to $15,000 after reviewing the evidence of the actual work performed by the class representatives).