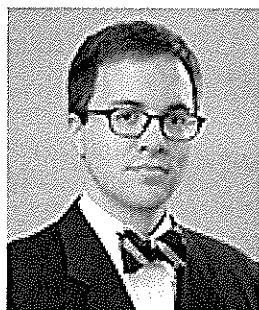

Section Name

SETTLEMENTS

TRENDS

Several recent opinions offer guidelines for crafting a class action settlement that will survive judicial review in the Ninth Circuit, say attorneys Grace A. Carter, Sean D. Unger, and Angela J. Markle in this BNA Insight. The article highlights practices to avoid and risk points that the Ninth Circuit has confirmed it will examine closely. “Particular attention to the teachings of the court’s recent case law will help assure that a settlement, once approved, truly is final,” the authors says.

Emerging Trends in Class Action Settlements in the Ninth Circuit



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Class actions are usually hard-fought, and a small but important number go to trial in any given year. But the reality is that, either before or after class certification, many class actions settle. For parties litigating in the Ninth Circuit, several recent opinions offer guidelines for crafting a class action settlement that will survive judicial review, as well as some warnings for practices to avoid. The Ninth Circuit’s most recent class action settlement opinion, *Lane v. Facebook, Inc.*,¹ squarely addresses several key issues: the transparency of the overall agreement, the suitability of the parties’ chosen *cy pres* recipient(s), and reasonableness of requested attorneys’ fees. In addition, *Lane* and the cases that precede it reveal some “best practices” that parties should consider when facing settlement negotiations.

¹ 696 F.3d 811 (9th Cir. 2012).

Ninth Circuit's Rules of the Road

Beginning in 2009, the Ninth Circuit has issued six opinions on large class action settlement agreements. The decisions differ with respect to outcomes and were issued by a variety of judicial panels. The opinions are consistent, however, in the guiding principles they offer to parties facing settlement negotiations in the class action context. While they will not guarantee that a court will approve the settlement or that it will survive appeal, these rules of the road highlight particular risk points that the Ninth Circuit has confirmed it will examine closely.

Use of a Neutral, Experienced Mediator

The use of a neutral, well-respected mediator in settlement negotiations can signal to the court that parties reached a settlement fairly, without collusion, and at arms-length. In most of the recent decisions, the court made note of the parties' use of a mediator and the mediator's credentials.² In *Rodriguez I*, for example, the Ninth Circuit, in reaching its determination that class counsel's conflicted position and the parties' clear sailing attorney fee provision did not require rejection of the agreement, favorably cited the mediator's statement that the settlement negotiations were not collusive.³ What does this mean practically? It means that engaging a mediator to assist in the settlement negotiations, and having that mediator offer a declaration in support of the settlement, increases the chance that the settlement will be approved. The Ninth Circuit understands both the role of the mediator and the reputational interest the mediator has in ensuring her credibility as a repeat player before the court. Particularly given that former judges often serve as mediators, the Ninth Circuit has suggested by its decisions that when a respected mediator says a deal was negotiated fairly, it was negotiated fairly.

But, the presence of a mediator does not obviate the district court's duty to ensure that the agreement is fair, adequate and reasonable before approving it. This points up the distinction between two different concerns: procedural fairness and substantive fairness. The mediator's involvement is a greater help on the former and less on the latter. In *Nachshin v. AOL*, for example, the Ninth Circuit approvingly cited to the mediator's active participation in selecting *cy pres* recipients but reversed the district court's approval of the agreement, because the *cy pres* relief was not sufficiently connected to the class members and claims at issue. Similarly, the court in *Bluetooth* noted that a mediator's presence is "not on its own dispositive of whether the end product is a fair, adequate, and reasonable settle-

² See *Dennis v. Kellogg Co.*, 697 F.3d 858, 862 (9th Cir. 2012) (naming the parties' JAMS mediator and remarking on JAMS' good reputation); *Nachshin v. AOL LLC*, 663 F.3d 1034, 1036-37 (9th Cir. 2011) (pointing out the mediator's credentials as well as his active role in crafting the agreement's *cy pres* provisions); *In re Bluetooth Headset Prods. Liab. Litig.*, 654 F.3d 935, 939 (9th Cir. 2011) (noting that the parties held three mediation sessions with a retired California appeals court judge); *Rodriguez v. West Publ'g Corp. [Rodriguez I]*, 563 F.3d, 948, 956-57 (9th Cir. 2009) (stating that the JAMS mediator, a retired judge, had "extensive experience in this type of case").

³ *Rodriguez I*, 563 F.3d at 961.

ment agreement."⁴ Thus, with all of these suggestions, engaging a well-regarded and experienced mediator should be seen for what it is: a help but not a guarantee.

Transparently Set Forth the Terms of the Agreement

Another lesson from the recent cases is that both the agreement and the record should be clear. Not only should parties be forthright with the court about how the settlement fund will be allocated among class members, class representatives, *cy pres* recipients, and class counsel, but they should also provide some specificity about the monetary value of the benefits provided. So, for example, the actual monetary value of any in-kind *cy pres* distribution should be spelled out, along with the method used to arrive at that value. The same is true for any value the parties assign to non-monetary benefits to class members, such as injunctive relief.

In *Dennis v. Kellogg Co.*, Kellogg settled with a class of consumers who argued that Kellogg falsely advertised the beneficial effect of its Frosted Mini-Wheats on students who ate the cereal for breakfast.⁵ The parties' settlement agreement permitted class members to recoup up to \$15 for cereal purchases out of a \$2.75 million fund, and allotted any unclaimed portion of the fund plus \$5.5 million "worth" of Kellogg food products to be awarded as *cy pres* relief to charities that provide food for the indigent. The court rejected the agreement as unacceptably vague—the agreement did not specify how many claimants had applied for recovery, what amount of the \$2.75 million fund would become *cy pres* funds, what charitable groups would receive the *cy pres* relief, or whether the *cy pres* relief would be in addition to Kellogg's normal charitable giving or a part thereof.⁶ The court was particularly concerned that the parties did not disclose whether the alleged dollar value of the \$5.5 million in food donations was based on the cost to Kellogg, the retail price, or some other method. Without such detail, it was impossible to tell whether the assigned numbers were "real" or an "illusion."⁷ The court found that this dearth of specificity impermissibly "restricted [its] ability" to evaluate the settlement as a whole.⁸

Similarly, *Rodriguez I* and *II* strongly suggest that parties' failure to notify the court of agreements between the parties, or between class counsel and class representatives, creates a presumption of collusion and prevents the court from adequately considering whether class counsel and representatives can adequately represent the class. In the *Rodriguez* cases, class counsel made agreements with five of the seven class representatives to seek incentive awards based on a sliding scale that increased as the total amount of the settlement fund or verdict increased.⁹ The parties did not disclose these agreements, and the district court only became aware of them when objectors to the settlement raised the issue before the final fairness

⁴ 654 F.3d at 948.

⁵ 697 F.3d at 858.

⁶ *Id.* at 861-63.

⁷ *Id.* at 866-67.

⁸ *Id.* at 867.

⁹ *Rodriguez I*, 563 F.3d at 957.

hearing. The district court approved the settlement over those objections and granted class counsel's fee request, but denied the motion for incentive awards for all seven class representatives.¹⁰ On appeal, the Ninth Circuit reversed the award of attorneys' fees, finding that the incentive agreements created an appearance of impropriety as well as an actual conflict between class counsel and the silent class members. The conflict arose because the incentive awards "topped out" at \$75,000 for a \$10 million recovery; the contracting class representatives would have little incentive to go to trial once a \$10 million settlement was made available, while the other class members might be better served by pressing on for a larger recovery. But for the fact that two of the class representatives and their separate counsel had no such conflicts, the court indicated, the district court's approval of the settlement would have been an abuse of discretion.¹¹

In contrast, a willingness to set out the agreement's terms in close detail may act as evidence of fairness and freedom from collusion, and may help the court overcome reservations it has about the terms themselves. In *Lane v. Facebook*, the parties gave substantial detail about their plan to create a foundation to administer the \$6.5 million *cy pres* award, including the fact that a Facebook executive would sit on the foundation's board of directors, and counsel for both parties would act as legal advisors to the foundation.¹² Perhaps because the parties were forthright about the foundation's operation and internal structure, a majority of the panel ruled in favor of the plan despite the fact that the foundation had no track record of service and the specific *cy pres* recipients were not yet identified.¹³

Cy Pres Relief Should Be Connected to the Class and Their Claims

Cy pres relief, the so-called "next best" distribution of settlement funds, is a key component of class action settlements and one subject to a relatively specific test. *Nachshin v. AOL* cautions that while some courts apply the "next best" principle loosely, failure to impose clear standards on the distribution of *cy pres* funds risks creating a pool of money that parties and attorneys derive more benefit from than does the class. As a result, Ninth Circuit courts require that *cy pres* distribution "must be guided by (1) the objectives of the underlying statute(s) and (2) the interests of the silent class members."¹⁴ In addition, the distribution plan should "provide reasonable certainty that [a] member will be benefitted."¹⁵

In *Nachshin*, in which a national class of plaintiffs claimed online privacy violations by AOL, the parties argued that there was no charitable organization in existence that would target the plaintiff class, and therefore attempted to distribute funds to unrelated charities chosen by the mediator.¹⁶ The court rejected the notion that there was no adequate charity or that it was obligated to "defer to the parties' freely-negotiated settle-

ment" with respect to *cy pres* awards, and rejected the agreement.¹⁷ It suggested that the parties should consider escheating the funds to the federal Treasury rather than choosing charities with no connection to the lawsuit.¹⁸

The *Kellogg* court also refused to approve the parties' *cy pres* distribution plan because it failed this connectedness test.¹⁹ There, the court concluded that the plaintiffs' false advertising claims had nothing to do with Kellogg's proposal to provide food products to the indigent and gave no assurance that any actual class member would benefit from the *cy pres* distribution.²⁰

Lane v. Facebook suggests some further nuances on this topic, however. In *Lane*, plaintiffs claimed Facebook and other online retailers violated privacy rights by publishing Facebook users' online retail activity without their permission. The court approved the parties' decision to create a foundation whose purpose would be to distribute the *cy pres* fund to programs "relating to protection of identity and personal information online through user control and the protection of users from online threats."²¹ Ninth Circuit cases generally require that *cy pres* recipients have a "substantial record of service," usually directed at members of the plaintiff class, but the court in *Lane* held that no track record is required when the agreement itself "tell[s] us exactly how funds will be used" in compliance with the *Nachshin* guidelines.²²

What does all of this mean? It means that parties have options when it comes to *cy pres* funds, but those options are limited. Either the money has to escheat to the state or it must help the class members in some way specific to the claims asserted in the lawsuit. It does not mean that in a false advertising suit a new or existing non-profit directed to consumer information should necessarily be the recipient, but it does mean the parties should discuss and explain to the court how the chosen recipient will benefit the class. Similarly, while there is law that supports funding established groups, this does not mean that only established groups can be *cy pres* recipients. Instead, dovetailing with the transparency admonition, *Lane v. Facebook* suggests that a *cy pres* award can fund a new group so long as the parties are clear and explicit about the benefits to class members.

One final practical consideration applies here. While these guidelines seem applicable to all cases in which a *cy pres* recipient is designated, the courts in recent cases have given closer scrutiny to the *cy pres* relief when it is a proportionally larger stake of the settlement. Thus, while the parties should consider the *cy pres* guidelines in all cases, even more attention should be given where *cy pres* is a bigger proportion of the whole.

Class Counsel's Attorneys' Fees Must Be Reasonable

The courts analyze class counsel fee requests using a reasonableness standard in light of the settlement as a

¹⁰ *Id.* at 958.

¹¹ *Id.* at 968.

¹² *Lane*, 696 F.3d at 817.

¹³ *See id.* at 821-22.

¹⁴ *Nachshin*, 663 F.3d at 1039.

¹⁵ *Id.* at 1040.

¹⁶ *Id.* at 1037, 1040.

¹⁷ *Id.* at 1040-41.

¹⁸ *Id.*

¹⁹ *Dennis*, 697 F.3d at 867.

²⁰ *Id.*

²¹ *Lane*, 696 F.3d at 817.

²² *Id.* at 822.

whole. If certain elements of the settlement agreement are unclear, such as the value of nonmonetary relief to the class, or the amount or eventual recipients of the *cy pres* award, it may affect what the court considers reasonable in light of the entire settlement.

For instance, in *Kellogg*, the court worried that if the \$5.5 million *cy pres* food donation was just a portion of Kellogg's normal charitable giving, rather than a separate allocation to the settlement fund, its value dropped to zero, and the fee award request could be as high as 38% of the total fund, well above the presumptively reasonable level.²³

Similarly, in *Bluetooth*, the court's inquiry was complicated by the fact that the plaintiffs, who requested \$800,000 in fees but obtained only injunctive relief for the class and \$100,000 in *cy pres* relief, did not specify what level of success they believe they had achieved in litigation, leaving the court "in the dark."²⁴ As a result, the court concluded it was unable to determine the reasonableness of the fee request and remanded the case for further proceedings.²⁵

One lesson of these cases is that the attorneys' fees should be realistic. Courts are increasingly penetrating settlement agreements to compare the fees sought to the actual relief obtained by the class members—not just the benefits recited. There must be a real relationship between the two. The other lesson is that this is not just a plaintiff side issue. While some courts have suggested that just the fees may be reduced,²⁶ other cases suggest that the whole settlement agreement may be in

jeopardy of either denial of final approval or reversal at the Ninth Circuit.²⁷ Defendants too must pay attention to the reasonableness of class counsel's fee request.

Conclusion

While the above factors provide good guidance for settling parties, open questions remain. *Kellogg* and *Bluetooth* in particular offer a warning: If a settlement agreement is disapproved by the district court or on appeal, the parties may be sent back to the negotiating table. Parties may have to expend significant additional resources modifying the agreement or negotiating a new one, and there is no guarantee that both sides will continue to prefer negotiations to litigation. Moreover, the variety of judicial panels and outcomes in recent cases suggest that parties will not necessarily be able to anticipate how appellate review will proceed if an agreement's approval is appealed. All of this suggests that all parties should give careful attention to how their settlement will be perceived by the Court. While all settlements are contextual and their reasonableness evaluated by the facts presented, the Ninth Circuit has made it clear that it is closely scrutinizing settlements. Particular attention to the teachings of the court's recent case law will help assure that a settlement, once approved, truly is final.

654-66 (9th Cir. 2012) [*Rodriguez II*] (affirming district court's denial of fees to conflicted counsel under both federal and California authority).

²⁷ See, e.g., *In re Bluetooth Headset Prods. Liab. Litig.*, 654 F.3d at 945, 949-50 (rejecting and remanding entire settlement because of "possibly unreasonable fees"); *Lane v. Facebook*, 696 F.3d 811, 819) ("[W]e will not affirm if it appears that the district court did not . . . account for the possibility that class representatives and their counsel have sacrificed the interests of absent class members for their own benefit" (emphasis added)).

²³ *Kellogg*, 697 F.3d at 867.

²⁴ *In re Bluetooth Headset Prods. Liab. Litig.*, 654 F.3d at 944.

²⁵ *Id.* at 945.

²⁶ See *Rodriguez I*, 563 F.3d at 968 (approving of the settlement while reversing and remanding attorneys' fee award for further proceedings); *Rodriguez v. Disner*, 688 F.3d 645,