

**CAFA CASE STUDY:
SETTLEMENT REJECTION REVEALS
MIXED IMPACT OF CLASS ACTION LAW**

by
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INTRODUCTION

Many commentators on both sides of the plaintiff/defendant divide have characterized the Class Action Fairness Act of 2005 (CAFA) as an unmitigated boon for corporate defendants. Their view rests on the fact that CAFA confers federal court jurisdiction over most class actions having multi-state implications, which minimizes the ability of pro-plaintiff state courts that had developed into “magnets” for class action filings to exert undue influence over targeted companies and industries.

But CAFA became law in large part due to widespread condemnation of class action settlements that released large numbers of class member claims in exchange for dubiously valuable “coupons” to class members and exorbitant fee awards to plaintiff’s lawyers. This combination raised the question: if a class action lawsuit is so weak that plaintiff’s lawyers settle it without obtaining significant money for class members, why should they receive a multi-million-dollar fee award?

After studying the question, Congress concluded that many borderline-frivolous class actions were being brought on behalf of uninjured consumers in state courts where elected judges prevented defendants from obtaining dismissal

of meritless cases. Yet because counsel for both sides recognized the weakness of the case, they agreed to coupon settlements, coupled with substantial fee awards, to end the lawsuit before a trial that posed a risk of embarrassment for plaintiff's counsel, and a risk of a huge judgment for defense counsel. By sending these cases to federal courts under expanded diversity jurisdiction, Congress anticipated that lifetime-tenured federal judges applying well-developed class action law would dismiss the plainly frivolous class actions, focusing their efforts on those actions that more plausibly merited *en masse* consideration. This in turn would eliminate the need for the lawyers to enter into face-saving/risk-avoiding coupon settlements.

In addition to sending more class actions to federal courts where coupon settlements of dubious cases would not be necessary, Congress also included in CAFA several provisions designed to discourage class action litigants from entering into coupon settlements in the first place. These provisions include a directive requiring explicit court review of coupon settlements; a requirement that attorneys' fee petitions seeking a percentage of a coupon settlement's "benefit to the class" be evaluated based on the coupon's redemption rate, rather than the face value of the coupons multiplied by the number of class members; and a requirement that the attorneys general of all U.S. states and territories be informed of proposed federal court class settlements, and be given an opportunity to object to such settlements in protection of the public interest.

The combination of enhanced federal jurisdiction and greater scrutiny of coupon settlements makes CAFA a mixed blessing for class action defendants. To be sure, it allows them to remove many class actions to federal courts that arguably are better situated to consider the merits of those cases in a dispassionate manner. But it also makes it more difficult for defendants to settle federal court class actions brought on behalf of persons who suffered no real personal or economic injury by providing low-cost coupon benefits to class members that reflect the negligible value of their claims.

This “no-cheap-settlements” prong of CAFA was exercised with great force in the October 11, 2007 decision by U.S. District Court Judge Cecilia M. Altonaga of the Southern District of Florida, which denied approval of a proposed nationwide class settlement in *Figueroa v. Sharper Image Corp.*, No. 05-21251. The case concerned claims that Sharper Image Corp. falsely advertised its Ionic Breeze® air purifier as able to clean and purify air when it allegedly does not purify air and instead emits harmful levels of ozone. In rejecting a proposed class action coupon settlement in *Figueroa*, Judge Altonaga made several rulings that have potentially broad applicability to defendants seeking to settle weak class actions on terms they deem acceptable to them.

First, she held that courts in the post-CAFA era are required to scrutinize class settlements in which coupons are the predominant form of relief under a heightened standard to ensure that they are “fair, adequate, and reasonable”

compromises reached through arms-length negotiations. **Second**, she decided that if the proposed class claims seem factually and legally plausible, a proposed settlement that gives class members little monetary value should be viewed skeptically, and that the settling parties' assertions that the defendant cannot or will not pay more in settlement due to its precarious financial condition should have little weight in assessing the settlement's fairness. **Third**, she attached great weight to the fact that a large number of state attorneys' general repeatedly and forcefully objected to the proposed settlement, invoking to an unprecedented degree their new CAFA-created role as "public advocate objectors."

Judge Altonaga's rejection of the *Figueroa* settlement was in large part based on its peculiar substance and procedure. The parties had hastily pulled together the initial settlement shortly before an already-certified class action in another court went to trial under circumstances where the *Figueroa* plaintiff appeared at serious risk of having its lawsuit derailed. Also, the settling parties repeatedly sought to "sweeten" the settlement in various minor ways in response to seriatim criticisms. These two factors together tainted this proposed settlement both procedurally and substantively in a way that ultimately led to its rejection.

I. BACKGROUND

To understand Judge Altonaga’s rejection of the *Figueroa* settlement, one must review the roots of that litigation—which began far away from her courtroom. The February 2002 issue of *Consumer Reports* compared the speed at which sixteen different air cleaners reduced air pollutants. Sharper Image’s Ionic Breeze Quadra (IBQ) finish last. The article said it produced “almost no measurable reduction in airborne particles.” Sharper Image complained about the results. So *Consumer Reports* had an independent expert review its test procedures and run the tests again. This second study, published in the October 2003 issue of the magazine, ranked the IBQ next-to-last. The magazine again stated that the IBQ was “not effective.”

In January 2004, Sharper Image sued Consumers Union, the publisher of *Consumer Reports*, alleging that the critical statements it had made about its air purifier were false. The federal district court in which the case was filed dismissed Sharper Image’s case. After a thorough review of Consumer Union’s testing methodology, the court found that Sharper Image had “not shown a reasonable probability of proving [that] any of Consumers Union’s challenged statements are false by reason of the results of Consumers Union own testing.”

In the meantime, adverse publicity about Sharper Image’s air purifier led to the filing of multiple overlapping class actions. Three lawsuits were filed in California state court (which were consolidated via California’s “mini-MDL”

procedure), and a fourth action was filed in Florida state court. All of the suits alleged that the company's air purifiers failed to perform as advertised and that they exposed consumers to hazardous levels of ozone. *Figueroa* was the fifth lawsuit, filed in May 2005 in the U.S. District Court for the Southern District of Florida and assigned to Judge Altonaga.

Sharper Image filed a Motion to Stay, Abate, Dismiss or Transfer *Figueroa* on the grounds that it was merely a "copy cat" of the cases already pending in California and Florida. In response, the *Figueroa* plaintiffs filed an amended complaint adding Zenion Industries, the inventor of Sharper Image's ionic air purifiers, as a co-defendant, thus differentiating *Figueroa* from the other cases, and mooted Sharper Image's stay motion. Newly-added *Figueroa* defendant Zenion moved to dismiss plaintiff's claims against it. After limited discovery, the Florida court ultimately dismissed Zenion in August, 2006. The way was now clear for Sharper Image to kill the *Figueroa* case by staying it in deference to the California cases (which had already been certified for class treatment) and the previously filed Florida state court action. It was in this setting – in which Sharper Image faced an imminent class action trial in California, but had the power to terminate *Figueroa* at any time – in which settlement discussions in *Figueroa* began.

II. THE PROPOSED SETTLEMENT

On the eve of a scheduled November, 2006 certification hearing in *Figueroa*, the parties informed the court that they had reached an agreement in principle on a settlement that would resolve the plaintiff's class claims on a nationwide basis. They said, however, that they needed time to work out certain details (including attorneys' fees). The court agreed to postpone the certification hearing to let the parties finalize a proposed settlement.

In January, 2007 the parties presented a completed agreement to the court and filed a joint motion for preliminary approval of the settlement and conditional certification of the settlement class. The agreement provided class members with a \$19 merchandise credit, redeemable for one year, for use at Sharper Image retail stores on Sharper Image branded products. Only one credit would be given to each household no matter how many ionic air purifiers they had purchased. The agreement also allowed class members to purchase, over a six-month period, an "Ozone Guard" attachment for their purifier at the manufacturer's cost of \$7. Sharper Image also agreed to make certain modifications to its advertisements for the purifiers. The court required the parties to make a few clarifications to the agreement, but once these were made, it preliminarily approved the settlement and launched the class notice and settlement approval process.

The proposed settlement came under fire almost immediately. Plaintiffs' counsel in the competing California and Florida cases (who were not included in

the settlement negotiations and would have recovered nothing in their cases if the *Figueroa* settlement was approved) objected on multiple grounds. They objected to the \$19 value of the certificates (considering that the ionic air purifiers were typically purchased for over \$300), the fact that the certificates could only be used on Sharper Image products, the limitation of one certificate per household, the unavailability of Ozone Guard attachment for all purifiers, and the charge imposed on class members for the Ozone Guard attachments.

That counsel in competing class actions objected to the *Figueroa* settlement was hardly surprising. When a defendant is subjected to multiple class actions over the same issue, it becomes difficult to obtain a global resolution through settlement. There are many different plaintiffs' lawyers groups having exorbitant expectations about the value of their claims and the size of the fee award they should receive. Paying all of them to settle their overlapping cases costs too much. So the company negotiates the broadest possible class settlement with one group of lawyers, and then defends that settlement against all efforts to kill it by the other lawyers who have been frozen out. The settling parties hope that the presiding judge will view the settlement as a reasonable compromise of the claims asserted, and will reject the objections levied against it as attacks by self-interested lawyers who espouse an inflated view of the value of the case, and who fail to acknowledge the reality that any settlement must abandon the chance of winning eventual full recovery to obtain the certainty of immediate partial recovery.

While objections from jilted plaintiffs' lawyers are to be expected, *en masse* objections to class action settlements from state attorneys general have been (at least previously) unusual. CAFA required that attorneys general be notified of all proposed class settlements that affect their constituents, so that they could object to settlements they believe to be unfair. In the almost three years since CAFA went into effect, few class actions settled under CAFA have seen state attorneys general invoke this power. Typically, settling defendants mail the proposed settlement agreement and the accompanying preliminary approval order to all attorneys general, a few respond with a form letter acknowledging receipt, and the group is never heard from again. In *Figueroa*, however, an unheard-of 35 state attorneys general attacked the settlement as a classic "coupon settlement" that CAFA was meant to outlaw. They criticized it for not providing meaningful compensation to class members, failing to disgorge ill-gotten gains from Sharper Image, and forcing class members to engage in future business with the defendant.

In response to this robust criticism, the *Figueroa* parties changed and resubmitted the settlement agreement twice before the hearing on final approval, in the process adopting many of the objectors' suggestions for improvement. As a result, while the agreement submitted to the court in July 2007 for final approval was still based upon \$19 credits – Sharper Image contended that a cash payout was unfeasible – it was markedly sweetened beyond the one initially put forth six months earlier. Among the new features were the elimination of the restriction of

one \$19 credit per household. The credits were now fully transferable, the credits could be used on any Sharper Image product, and class members had a longer time period to use the credits. In addition, Sharper Image agreed to provide Ozone Guards free of charge to any class members who had purchased units without one. Nevertheless, despite these enhancements to the settlements, the interveners and six of the Attorneys General still maintained their objections to the settlement.

III. THE COURT'S RULING

The district court decided that CAFA required it to subject the proposed agreement to “a greater level of scrutiny” because store credits of \$19 constituted the principal form of compensation to class members and thus the agreement was a “coupon settlement.” But CAFA does not require a higher level of scrutiny for coupon settlements. It requires courts to review coupon settlements (like any other class settlements) to ensure that they are “fair, reasonable, and adequate for class members.” This is the same standard that, as the district court acknowledged, is “already provided in FED. R. CIV. P. 23(e)(i)(c) and governing case law.” Nevertheless, Judge Altonaga concluded there is a “statutory directive to imply the application of a greater level of scrutiny to the existing criticism than pre-CAFA,” because of “Congress’ objectives and concerns regarding the fairness *vel non* of coupon settlements in particular.”

Another notable aspect of the district court’s review of the *Figueroa* settlement was its parameters for judging a “fair, adequate, and reasonable

settlement.” In arguing the merits of the settlement to the court, the parties had focused on the settlement’s empirical benefits – that is, the advantages the settlement presented over continued litigation. Repeatedly emphasizing Sharper Image’s precarious financial situation (including imminent risk of bankruptcy, which would likely preclude class members from ever recovering money from the company), the parties asserted that a non-cash settlement was the best one achievable from the defendant. Sharper Image also belittled the plaintiffs’ chance of success, pointing out that its experts would poke holes in the plaintiffs’ theories. The parties argued that this settlement would give class members a quick and ascertainable recovery in contrast to the uncertain, and certainly far-off, gain that they might achieve at trial.

The district court took another approach to evaluating the settlement’s fairness. In reviewing the settlement, it looked at whether the settlement was the best possible result that could have been achieved for class members – and not simply whether it was empirically “adequate.” Consequently, in reviewing the procedural and substantive fairness of the settlement, the court did not simply consider whether the process by which the settlement was reached and the terms of the settlement were fair, but whether they could have been better.

For example, in its consideration of the procedural fairness of the proposed settlement, the court honed in on the disparity of the parties’ bargaining position during settlement negotiations. The court found it important that settlement

negotiations had occurred only after Sharper Image's co-defendant Zenion had been dismissed from the case and thus "with the specter of a stay of this case a constant companion." In other words, even though the court found "no evidence of fraud or collusion," it presumed that the settlement was not the product of arms-length negotiations because "Plaintiffs counsel necessarily negotiated from a position of weakness."

As support for this conclusion, the court pointed to the fact that plaintiffs' counsel lowered its settlement demand from an estimated \$279.96 coupon per class member to \$28.50 per class member in two weeks. (Of course, this drop could have been as much the result of initial posturing by plaintiffs' counsel as intimidation by Sharper Image's counsel.) Likewise, the court did not view Sharper Image's repeated agreement to "improve" the settlement in response to objectors' comments in a positive light. Instead, the court felt that Sharper Image's concessions validated the criticisms of the objectors and showed that the original settlement was "not the product of informed, arms-length negotiations between effective Class Counsel and the Defendant."

The district court also found the settlement to be substantively unfair. Relying largely on the dismissal of Sharper Image's lawsuit against Consumers Union (and hence, the rejection of its attacks on Consumer Union's criticisms of the air purifier product), the court found plaintiffs "to have a strong likelihood of succeeding at trial on some of their causes of action which rely on the

ineffectiveness of the product.” Relying on this conclusion and noting that many of the plaintiffs’ claims sought disgorgement of the purchase price of their purifiers, which were advertised for sale in the \$300 price range, the court found the \$19 offered to each class member to be insufficient.

By focusing so much on the range and possibility of recovery, the court gave less importance to other key points – such as the possibility of the defendant going bankrupt before relief could be awarded, and the time value of a certain monetary award in the present versus the prospect of a larger monetary award years later after a verdict and appeals. In the end, however, the court concluded, especially due to the objections of the attorneys general, that “the small risk of receiving nothing is worth taking.” Although unstated, the court’s conclusion may have been based on the fact that the California class action was already certified and nearing trial – meaning that the strength or weakness of the claims likely would be tested in short order if the *Figueroa* settlement (and Judge Altonaga’s related stay of all competing litigation) was terminated.

In many ways, the precedential value of *Figueroa* is limited because it is so tied to the circumstances of this case. Clearly, there were many things about this settlement that would have troubled many judges. That the parties presented the very kind of “coupon” settlement that CAFA sought to combat – one that placed very little of value in class members’ pockets in exchange for their release of claims – made this a tough sell at the outset.

That the parties apparently negotiated the settlement hastily to fend off an imminent class trial in another jurisdiction, and then repeatedly tinkered with the settlement in response to criticisms, undermined the court's confidence that the settling parties had carefully thought through the settlement terms. That the *Figueroa* plaintiffs appeared to hold a much weaker negotiating hand than plaintiffs' lawyers who controlled other cases increased the court's concerns. That the substantive allegations about the device's defectiveness had already been litigated in another forum, with Sharper Image losing, tended to discredit the settling parties' assertion that the proposed class claims were weak. That the settlement's detractors included not just competing lawyers with a personal financial stake in killing the settlement, but a large majority of states' attorney general apparently acting in the public interest, legitimized the objections that Judge Altonaga received.

In short, it is not terribly surprising that the *Figueroa* settlement received strong objections and, ultimately, judicial rejection. Yet the rejection of the *Figueroa* settlement raises broader questions that will continue to trouble companies that are targeted with class actions and that wish, for varying reasons, to settle rather than litigate them. These questions are detailed below.

A. How does a class action defendant obtain approval of a low-value settlement in a case where class members deserve little monetary benefit because they have not been injured?

In a perfect world, trial judges would quickly dismiss class actions that are legally and/or factually far-fetched. The reality is they often do not. Perhaps the trial judges believe that any high-profile case filed as a class action must rest on factually and legally plausible claims -- especially if the case involves allegations that have received intense media coverage critical of the defendant. Perhaps the trial court judges worry that an early dismissal – before extensive discovery – will be reversed on appeal.

Regardless, if the trial court does not quickly dismiss the dubious case, defendant companies face the cost, disruption, and risk associated with a long-shot class action. Not all companies are willing to roll the dice and litigate. So they decide to settle if reasonable terms can be negotiated. Plaintiffs who bring such cases often understand that their cases are weak, and so are willing to negotiate a modest settlement. But the message of CAFA is that “frivolous class actions should not be filed and should not be settled.” CAFA put more of those cases into federal court in the hopes that federal court judges would quickly dispose of them. Yet, if, for whatever reason, the federal court does not do so, it forces the parties to enter into a “cheap” class settlement (possibly involving non-monetary coupon benefits). This leaves the parties in the difficult position of trying to justify the modest benefits of their class settlement in a case as to which the both sides ascribe

modest value. The rub is that the proposed settlement is submitted to the district court against a legislative background of CAFA, which strongly encourages federal district courts to disapprove any and all “coupon” settlements.

To obtain approval of this kind of settlement, the settling parties must convince the court of two points: (1) the case was weak, and (2) the benefits are rich when compared to the likely prospects of the case. Although the *Figueroa* plaintiffs failed to make this case, it can be made through an appropriate analysis of the strengths and weaknesses of plaintiff’s lawsuit and a well-supported description of the value of the proposed settlement.

B. How does a class action defendant obtain “global peace” at a reasonable price when it is subject to multiple overlapping lawsuits?

Where, as often happens, multiple teams of plaintiffs’ lawyers file copycat class actions in many different courts, it becomes harder to obtain “global peace” through settlement. The huge number of plaintiffs’ lawyers with inflated expectations makes it too costly for the defendant to negotiate a settlement that satisfies all of them. Yet defendants who negotiate with just one set of lawyers who manifest a willingness to be reasonable, and “freeze-out” the others, will face a harder time getting the resulting settlement approved. Employing the “reverse auction” epithet, financially motivated objectors invariably attack the settlement as inadequate because it does not pay every class member 100% of what the objecting

lawyer ambitiously seeks in the competing class action.

Such objectors have many weapons to employ that may interfere with the prompt evaluation and implementation of the settlement, thereby depriving the defendant of the litigation peace it is trying to obtain through the settlement process. The *Figueroa* decision will embolden plaintiffs' lawyers to adhere to unrealistically high valuations of their class actions by giving them greater confidence that they can derail more modest settlements that defendants negotiate with other lawyers who perhaps have a more realistic view of the weaknesses of the claims asserted.

Still, it is not impossible to settle a class action in one court where parallel class actions are pending in others – even where the plaintiffs' lawyers in those other cases strenuously object to the proposed settlement because they are not parties to it, and are not receiving fees from it. The key is to convince the reviewing court that the proposed settlement is fair on its own terms, and that the lawyers objecting to it are motivated primarily by their anger at being cut out of the fee recovery obtained by those lawyers who negotiated the settlement. This case can be made if the settling parties are confident of the fairness of their settlement, and prepared to expose the self-interested nature of the objectors.

C. What role will state attorneys general play in class action settlements?

Figueroa is the first time that state attorneys general have collectively mounted a vigorous CAFA-enabled attack on a class settlement. The success of that attack ensures that it will not be the last. Increasingly, state attorneys general are becoming more activist – employing their power to file or participate in litigation as a way to assert influence in public policy debates, often by joining forces with private lawyers in the plaintiffs’ class action bar. In coming years, state attorneys general likely will object to more proposed settlements (either individually or in coordination with other attorneys general) that involve high-profile controversies. This will occur especially where there are private lawyers seeking to prevent approval of the settlement who are motivated to facilitate the attorneys’ generals’ formulation and submission of written objections.

Still, if the proposed settlement is objectively defensible, federal courts can be counted on to approve it notwithstanding objections from a handful of state attorneys general. District court judges evaluating the fairness of proposed settlements will not be unduly swayed by state attorney general objections if their objective evaluation of the proposed settlement leads them to conclude that the proposed settlement represents a fair compromise resolution of the putative class action.

CONCLUSION

While CAFA surely benefited class action defendants more than plaintiffs by transferring more cases to federal courts that offer more fairness and predictability in the adjudication of class actions, it is not a “free-pass” for targets of class action lawsuits.

The *quid pro quo* of giving class action defendants greater access to federal courts is that CAFA expects defendants to vigorously litigate, not settle via coupon settlements, frivolous class actions. The message of *Figueroa* is that class action defendants in federal court who try to escape all litigation risk by proposing low-value coupon benefits in exchange for global releases of claims (especially where competing lawyers and attorneys’ general are involved in the controversy) will have a difficult time persuading the federal courts to approve such settlements.