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How to Settle a Class Action in the 7th Circuit

From the Experts

David S. Almeida and Mark S. Eisen

As most in-house counsel know, the federal district courts within the U.S. Court of Appeals for the Seventh Circuit—encompassing Illinois, Wisconsin and Indiana—have become a hotbed of class action litigation. Over the last few years, hundreds of companies have faced multi-million dollar consumer fraud and privacy class action litigation in this region, particularly under statutes with high damages provisions. And as most in-house counsel know, a significant number of these cases eventually end in settlement.

What most in-house counsel may not know, however, is that over the last year, the Seventh Circuit has issued four opinions significantly affecting the way class actions will be settled in the circuit. And given the Seventh Circuit's stature, district courts in other circuits are beginning to take notice as well. This article highlights those opinions, and sets forth the key points that must be taken into account when attempting to settle consumer class actions in the Seventh Circuit--and may prove useful elsewhere.

Class Action Settlements in the Seventh Circuit pre-2014.

It was once common in the Seventh Circuit (and is still common elsewhere) to settle class action lawsuits with a claims-made reversionary fund, where the defendant creates a fund of money that is available to pay all claims, fees and other costs. Whatever money is left over at the end of the claims period (minus the other costs) reverts to the defendant.

Claims-made reversionary structures are popular because the plaintiff's attorney fees are calculated as a percentage of the fund of money available to the class, while the defendant still gets to retain whatever money is not paid out through claims and other costs. Generally speaking, parties also include in the value of such a settlement (for the purpose of calculating attorney fees) the notice and administration costs (i.e., the costs incurred in notifying the class members of a settlement), injunctive relief (i.e., changes in policy to ensure that violations do not reoccur) and cy pres relief (i.e., money distributed to charity rather than class members).

The Seventh Circuit Changes the Landscape.

Over the last year, the Seventh Circuit issued four opinions concerning consumer class action settlements—Eubank v. Pella Corporation, Redman v. RadioShack Corporation, Pearson v. NBTY Inc.and In re Southwest Airlines Voucher Litigation. Each impacts the landscape of class action settlements in the circuit.

Eubank v. Pella

In Pella, the plaintiffs brought a class action over allegedly defective windows. After nearly seven years of litigation, the district court granted final approval of the class settlement, over strong objection, valuing class relief at $90 million and approving an $11 million attorney fee award. The Seventh Circuit vacated the settlement, finding two issues especially troubling. First, the claims process was structured to depress claims. Among the many issues, the claim form was needlessly complicated and made obtaining relief difficult. Second, the attorney fees award was based on an "inflated" value of relief to the class, for which there was no independent valuation. The court calculated the actual value to the class at closer to $8.5 million, and indicated that a fee equal to 56 percent of the settlement (56 percent = $8.5m + $11m / $11m) is excessive.

Redman v. RadioShack

Radioshack involved a class action lawsuit pursuant to FACTA—a federal law restricting the number of credit card digits that can appear on a receipt. The settlement provided a $10 coupon to each claimant. All told, the settlement was valued at $4.1 million ($830,000 in claims + $1 million in attorney fees + $2.2 million in administrative costs). In reversing the district court, the circuit focused predominantly on the requested $1 million in attorney fees, making two key holdings: (i) notice and administration costs are not to be included in calculating the benefit to the class, and (ii) the ratio to evaluate the reasonableness of a fee award is the ratio of the fee to the fee plus what the class members actually received. In applying that equation to the settlement, the court found the ratio—55 percent ($1 million + $830,000 / $1 million), after erasing notice costs—unreasonable, and all the more so because no attempt was made by the parties to determine the actual value of the coupons. The solution, the court recommended, would be to increase the amount of the settlement received by the class at the expense of the counsel fee. To hammer this point home, Judge Richard Posner, writing for the court, noted "the reasonableness of a fee cannot be assessed in isolation from what it buys," (i.e., "no one would think a $1 million attorneys' fee appropriate compensation for obtaining $10,000 for the clients").

Pearson v. NBTY

In NBTY—a class action alleging false labeling of glucosamine pills—the district court approved a $5.63 million settlement, which included nearly $2 million in attorney fees, $1.5 million in administration costs, $1.13 million to cy pres and $865,284 to the class. The court first took aim at attorney fees, finding the settlement was improperly valued at $20.2 million, where the class actually received less than $900,000. The court further found the cy pres award to be worthless to the class, and questioned why that money did not go to the class. Using the Radioshack ratio, the court calculated attorney fees to be 69 percent and concluded that was "outlandish." The court suggested the proper ratio "should not exceed a third or at most half of the total amount of money going to class members and their counsel." Second, the court was critical of the claims process, which it found "discourage[ed] the filing of claims." Specifically, the claims form required claimants to document the date and place at which the product was purchased, included a warning that false claims might be subject to prosecution and required claimants to certify claims under penalty of perjury—all this to receive $3 to $5 per bottle of pills purchased.

In re Southwest Airlines Voucher Litigation

Southwest—which stemmed from Southwest's alleged failure to honor certain drink vouchers—is the only settlement of quartet to receive the Seventh Circuit's imprimatur. The settlement was simple: Southwest reissued vouchers to each claiming class member on a one-for-one basis. Plaintiffs' counsel was awarded $1.6 million, reduced from the $3 million originally requested. Notably, the circuit declined to apply the Radioshack ratio the fee award or otherwise value class relief, which can be attributed directly to the relief awarded and the ease of the claims process. In short, the circuit determined replacement coupons, which were all class members were entitled to, provided "essentially complete relief" and was "the model of an adequate settlement," and that the claims process—a simple verification—was "easy." Indeed, the relief and claims process caused the court to overlook generally troublesome settlement features, like a clear-sailing and kicker clauses, which drew the ire of the court in Pella, Radioshack and NBTY.

Structuring the New Deal

Going forward, in order to settle cases in the Seventh Circuit, in-house counsel must be acutely aware of three central issues: (i) the complexity of class notice, (ii) the value of class relief, and (iii) the ratio of requested attorney fees to class relief.

First, class notice will need to be as robust and simple as possible. As the court alluded to in both Pella and NBTY, a complicated notice procedure is likely to depress the claims rate—or at the least, be seen as an attempt by the parties to depress the claims rate. This is especially so in circumstances like in NBTY, where the amount of money per claim is exceedingly small. Conversely, as became evident in Southwest, a simple claims procedure can go so far as to make up for otherwise troublesome settlement features.

Second, the parties should provide the court a detailed valuation of the benefit the settlement provides the class (which generally cannot include notice and administrative costs and cy pres payments). In many instances, this will be aided by utilizing independent experts. Further, in-house counsel should consider using alternative settlement arrangements, like so-called "all-in" non-reversionary funds, that ensure a minimum level of benefit to the class and will be distributed regardless of the claims-rate. All-in funds are typically lower in overall fund size as compared to a reversionary fund, since no money is reverting. Alternatively, offering complete relief to each claimant (recognizing that claims-rates are generally very low in consumer class actions) may help insulate a claims-made reversionary settlement.

Third, and finally, in-house counsel must be cognizant of the ratio of requested attorney fees to the value of class relief. At the end of the day, to fit within the Seventh Circuit's ratio, either relief to the class will have to go up, or the award to class counsel will have to go down. In order to ensure the latter, in-house counsel should consider settling on the limited issue of relief to the class and require plaintiffs' counsel to petition the court for a fee request, while retaining the option to oppose any fee application. Additionally, from the onset, in-house counsel should remind plaintiffs' counsel of Posner's advice in Radioshack: "some cases should not be brought, because the litigation costs will exceed the stakes."

David S. Almeida is a partner in Sheppard Mullin's Chicago office and specializes in defending consumer class actions, including data privacy, statutory privacy, consumer fraud and false labeling. He also frequently counsels clients in data privacy compliance policies. Mark S. Eisen is an associate in the same office and focuses on defending companies against consumer class actions, including data privacy, statutory privacy and consumer fraud. He, too, frequently provides data privacy compliance counseling.