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### **Third Circuit Sends Mixed Messages on Class Action Settlements**

The Third Circuit has issued three decisions, within a three-month span, about class action settlements. The three cases send different signals about the trial court's role in reviewing class action settlements.

In June 2010, the Third Circuit reversed a trial court for too actively scrutinizing a class-wide settlement. In July, the Third Circuit did the opposite – but later agreed to rehear its decision en banc. Finally, in September, the Third Circuit reversed a trial court's approval of a settlement agreement for errors in the class certification analysis. In the first case, the Third Circuit appears to elevate the sanctity of contract (a negotiated settlement agreement) above the court's duty to scrutinize class settlements. In the second and third cases, the Third Circuit found that the trial court was too deferential to the contractual terms of the settlement. The cumulative effect of these cases leaves practitioners wondering what role the trial court should play in analyzing negotiated class-wide settlements.

Here is what happened. On June 15, 2010, the Third Circuit decided *Ehrheart v. Verizon Wireless*. In that class action, plaintiffs alleged statutory claims under the Fair and Accurate Credit Transaction Act (FACTA). After plaintiffs and Verizon negotiated a class settlement, it was preliminarily approved by the trial court. Then, before the settlement hearing and final court approval, Congress amended FACTA in a manner that eliminated the class's claim for relief.

Ruling that the class claims were extinguished by the amendment to FACTA, the District Court vacated its order giving preliminary approval to the settlement.

On appeal, the Third Circuit (2-1 split) ruled that, although class members no longer had viable legal claims, that did not prevent the court from certifying a class and approving a negotiated settlement. In so holding, the Third Circuit emphasized the importance of a negotiated settlement. The Court reasoned that the purpose of judicial review under Rule 23 is to ensure that absent class members are fairly treated by the settlement. The trial court stands in a quasi-fiduciary role to unrepresented class members; but that “tightly focused role” does not empower the trial court to protect the defendant, *i.e.*, the party seeking relief from the settlement here. The Third Circuit held that changes in the law prior to final approval and entry of judgment did not moot the negotiated settlement. The court reasoned that a settlement reflects a deliberate decision of both parties to opt for certainty over risk and that courts should “not relieve a party of that decision because hindsight reveals that its decision was, given later changes in the law, probably wrong.” The Third Circuit’s opinion is significant because it gives decisive weight to the parties’ agreement to settle, even when an act of Congress eliminates the plaintiffs’ claims before the settlement is final and final judgment is entered.

Thirty days later, a different panel of the Third Circuit was much less respectful of a negotiated settlement. In *Sullivan, et al. v. De Beers*, the Third Circuit reversed the trial court’s approval of a \$295 million settlement of an antitrust class action against De Beers. The Third Circuit found that the trial court had been overly deferential to the parties’ contract to settle and had not exercised sufficient scrutiny of the stipulated class and settlement terms.

Sending a message that might be seen as the opposite of *Verizon*, the Third Circuit in *De Beers* said that where plaintiffs have no claim there cannot be a class and, therefore, there cannot be a class-wide settlement. The decision thus nullified the settlement agreement negotiated by

the parties. As part of that settlement, De Beers had agreed not to contest certification of a nation-wide class of indirect purchasers who were asserting state antitrust, consumer protection, and unjust enrichment laws claims. Objectors to the settlement challenged certification of that class, arguing that state laws across the nation varied so much that common questions of law or fact did not predominate and that a nation-wide class of indirect purchasers was improper under Rule 23.

The District Court overruled the objections and approved the negotiated settlement. The Third Circuit reversed because some states do not grant antitrust standing to indirect purchasers and, as a result, some members of the class lacked the substantive right to make indirect purchaser claims. This lack of standing created an obstacle to class certification that could not be “wished away by the promise of easier litigation management.” In other words, the negotiated class-wide settlement had to be set aside when it was premised on claims which some class members could not legally assert. This, of course, was a message distinct from that sent by the Third Circuit 30 days earlier in *Ehrheart* – where the elimination of standing was no bar to approving a negotiated settlement.

Perhaps sensing the confusion inadvertently sown by these two decisions, on August 27, 2010, the Third Circuit vacated its order in *De Beers* and set the matter down for a rehearing en banc (the hearing has not been scheduled yet). By vacating its order, the Third Circuit appears to have recognized that its opinions in *Verizon* and *De Beers* may send conflicting messages. Interestingly, however, *De Beers* is the case that seems more true to the tenets of Rule 23, which requires courts to act in a quasi-fiduciary capacity to ascertain that negotiated classes and settlements are not the result of improper collusion. The conventional tenets of Rule 23 suggest that *Verizon*, not *De Beers*, is the outlier decision. The Third Circuit’s subsequent decision in *Community Bank* underscores this observation.

On September 22, 2010, the Third Circuit decided *In re Community Bank of Northern Virginia*, in which it reversed – for the second time – a trial court’s approval of a \$46.7 million class action settlement. *Community Bank* involves an alleged predatory lending scheme. Objectors to the settlement argued that the named plaintiffs and class counsel did not adequately represent all class members because they had failed to assert federal claims belonging to some, but not all, members of the class. The named plaintiffs were time-barred, but many absent class members were not. These claims would be waived under the terms of the settlement agreement, which the trial court approved.

Upon appeal by class members objecting to the settlement, the Third Circuit vacated the trial court’s order certifying the class and approving the settlement agreement. The Third Circuit held that the trial court erred by applying improper legal standards to review the viability of claims being asserted by objectors. The court also discussed divisions within the proposed class and the decision by class counsel not to assert the objectors’ claims. The Third Circuit remanded with directions to the trial court to determine whether subclasses should be created and whether class counsel were adequate representatives of the class.

These three decisions and the varied philosophies they embody leave practitioners uncertain as to the effectiveness of negotiated class-wide settlements. Can defendants stipulate to and settle with broad and questionable classes to gain sweeping protection from future claims? Does the judicial interest in settlement override other interests in assessing classes and negotiated settlements? Is the trial court expected to examine vigorously the bona fides of stipulated classes and negotiated settlements? Should courts insist on compliance with all Rule 23 standards, even if it means overturning an agreed upon, class-wide settlement?

The fact that *De Beers* is set for rehearing en banc does not by itself resolve any confusion regarding these recent decisions. In some ways, it adds to it. For among the trio of

recent class action decisions, *Verizon* is the case which may have been the best candidate for a rehearing. In that case, unlike in *DeBeers* and *Community Bank*, the panel put unusual emphasis on the importance of settlement and the sanctity of contractual resolutions. Reviewed in light of *DeBeers* and *Community Bank*, *Verizon* seems to overweight the significance of a negotiated resolution when measured against the need for a rigorous judicial review of class settlements.

What is clear from these cases is that there may be a split within the Third Circuit about the trial court's role in reviewing fully negotiated class resolutions. The Third Circuit appears to be – except for *Verizon* – ready to overturn negotiated classes and class settlements where they are not in strict compliance with Rules 23. The already slow process for obtaining a class-wide settlement may become even more sluggish if the parties overreach or if the trial court missteps in its Rule 23 analysis, as is painfully obvious from the Third Circuit's decision in *Community Bank*.

Over time, the Third Circuit's decision in *Verizon* – approving a class settlement after the class lost all viable claims – may be seen as an anomaly. This, of course, depends on the Third Circuit's decision in its rehearing of *De Beers* and whether it decides to champion the settlement (as it did in *Verizon*) or remand for further review of the Rule 23 factors (as the panels did in *DeBeers* and *Community Bank*). In any event, we can expect the rehearing to provide more guidance about the balance between Rule 23's strict requirements and the public's interest in negotiated settlements. Practitioners who handle class actions should pay close attention.

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