OUTSIDE PERSPECTIVES

Increased Judicial Scrutiny Of Class Action Settlements

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GONE ARE THE DAYS DEFENDANTS COULD settle claims quietly with compliant class counsel and hope to avoid judicial scrutiny of whether the settlement is actually in the best interest of the class. Federal courts, in particular, are casting a more critical eye on class action settlements that appear to be more the product of cooperation between the defendant and class counsel than the result of vigorous negotiation between litigation adversaries. Companies looking to achieve a global resolution of the claims made against them in class action cases should take note of the increased attention by courts on the bona fides of the proposed settlement and potential disqualifying conflicts of class representatives or their counsel that might lead to judicial rejection of a proposed class action settlement.

The increasing scrutiny paid by courts to class action settlements is well illustrated by a recent decision by the U.S. District Court of South Carolina. In a January 21, 2011 ruling in a case captioned *Hege v. Aegon USA, LLC, et al.*, Judge G. Ross Anderson, Jr. refused to give full faith and credit to a class action settlement approved by a state court judge in Arkansas, thereby essentially carving out South Carolina residents from a settlement of claims made against Transamerica Life Insurance Company with respect to its supplemental cancer insurance policies. The case involved allegations that Transamerica had underpaid insurance claims by changing its interpretation of the meaning of the "actual charges" for which it would provide reimbursement under the policies.

Faced with several lawsuits challenging its practices in both state and federal court, Transamerica approached the plaintiffs' attorneys to discuss potential settlement of the actions. After a mediation failed and the judge in one of the federal cases denied a motion for class certification, settlement negotiations resumed between Transamerica and the law firm representing the class for which class certification had been denied. The negotiations resulted in a proposed national class action settlement and an agreement that Transamerica would not challenge a $3.5 million attorney's fee award sought by the law firm. The law firm then filed a new class action in the Circuit Court of Pulaski County, Arkansas seeking judicial approval of the settlement and promptly moved jointly with Transamerica to stay all proceedings in the remaining lawsuits pending the court's approval of the settlement. Three days after the proposed settlement agreement was filed, the court granted preliminary approval of the settlement and directed that a class action notice issue to over 250,000 class members nationwide advising them of the settlement. Ultimately, the court approved the settlement and entered a final order and judgment after rejecting a number of objections to the settlement and denying motions to intervene. The final order approved by the court contained a broad release of any claims class members could assert against Transamerica related to its "actual charges" policies and payments and an award of the agreed-upon class action attorney's fees of $3.5 million.

In light of the approval of the nationwide class action settlement, Transamerica moved for summary judgment on similar claims asserted against it in an action by a South Carolina class member who had not opted out of the prior settlement. Under the Full Faith and Credit Act, all properly authenticated state court judicial proceedings "shall have the same full faith and credit in every court within the United States . . . as they have by law or usage in the courts of such State . . . from which they are taken." 28 U.S.C. § 1738. Judge Anderson initially held that for the final order and judgment in the Arkansas state court to "acquire the presumption of full faith and credit" and foreclose the class member's collateral attack on the settlement, the state court must have complied with the Due Process Clause. According to Supreme Court precedent, class action judgments bind class members where "the interests of those not joined are of the same class as the interests of those who were, and where it is considered that the latter fairly represent the former in the prosecution of the litigation."

Applying this standard, Judge Anderson concluded that the judgment entered by the Arkansas court did not satisfy the Due Process Clause and should not be given full faith and credit because of a variety of troubling circumstances surrounding the nationwide class settlement. First, the court found that the class action notice approved by the Arkansas court was materially misleading to class members. The notice suggested that class members would benefit from not opting out of the class because (1) there were no additional benefits to be had by pressing forward with the litigation and (2) the continuation of the litigation would only lead to future increases in their insurance premiums. Judge Anderson ruled that, under South Carolina law, class members could have recovered additional benefits not provided by the settlement if the litigation had continued and that the promise of no future premium increases was essentially illusory since nothing in the settlement prohibited Transamerica from passing on such increases to participating class members.

The court also rejected the argument that class counsel had adequately represented the class' best interests. Judge Anderson held that class counsel's negotiation of its fees in advance of filing the lawsuit created an intractable conflict of interest between counsel and the class it sought to represent. Transamerica's agreement not to contest the $3.5 million fee amounted to a "clear sailing" understanding between the Transamerica and class counsel which prevented the fee request from being tested in the adversary process and incentivized class counsel to bargain away value belonging to the class in return for the understanding from Transamerica.

The court went on to find that, by agreeing to its fee upfront, class counsel had no motivation to litigate its case in an adversarial manner. To the contrary, class counsel focused all of its efforts on opposing all objections to the pre-packaged settlement and exhibited "outright hostility" to class members seeking a more lucrative outcome to the litigation. Class counsel vigorously opposed motions filed by two class members to intervene in the case and repeatedly took the position that the proposed settlement would result in 100% of what the class members were owed by Transamerica. Judge Anderson concluded that this conduct amounted to "ample evidence that Class Counsel placed their own interests above those of the class they purported to represent."

Finally, the court ruled that the Arkansas lawsuit itself was not the type of contested litigation entitled to full faith and credit since the outcome of the litigation was predestined before it was even filed. Citing numerous statements in the state court record, Judge Anderson concluded that the Arkansas lawsuit was filed for settlement purposes only and not to contest anything. According to the court, the "only discernable effort" made by class counsel was to initiate the lawsuit, which of course they had to do in order to earn their negotiated fee award. The court held that the Arkansas litigation "was not contested in good faith" and therefore should not be afforded full faith and credit in South Carolina.

The *Hege* decision represents a stark reminder that class action settlements, while potentially beneficial to settling defendants, need to be carefully considered and crafted in order to be enforceable. Companies that want to "buy" global peace via class action settlements have to assure themselves that the class action lawyers with whom they are negotiating are actually asserting the best interests of the class through the active prosecution of litigation, cannot be accused of selling out the class to serve their own personal interests, and have been candid with the court and other class members about the merits of the decision to settle and to forego at least some of the relief to which the class might otherwise be entitled. Hopefully, companies will take note of this and similar decisions, take their lessons to heart and avoid the kind of unwanted judicial scrutiny that Transamerica had to face.

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