Unusual Settlement Structure Leads to Approval of Fee Award Nearly Double the Payout

by Thomas E.L. Dewey

Public policy generally prohibits class action settlements in which the attorney fee awards dwarf the amount awarded to the class. But as a recent case in the U.S. District Court for the Southern District of New York illustrates, such a settlement may be approved if it is structured so that class counsel's award does not come at the class's expense.

In *Hart v. BHH*, No. 15-cv-4804, 2020 WL 5645984, at *2 (S.D.N.Y. Sept. 22, 2020), Judge Pauley approved over $4.6 million in fees and expenses for class counsel, even though the total payments to class members were expected to top out at less than $2.5 million. However, the court balked at the inclusion of a "quick-pay" provision in an earlier draft of the settlement, which would have allowed class counsel to collect its fees before the class members were paid, and did not allow the parties to submit attorney fees to a separate arbitration.

Background

The two named plaintiffs filed suit in in June 2015, alleging that "ultrasonic pest repeller" devices they had purchased from BHH LLC (branded Bell + Howell) were "ineffective and worthless." The complaint included claims under the federal Magnuson-Moss Warranty Act, multiple California consumer protection laws, and the implied warranty of merchantability. In May 2016, the court dismissed the federal statutory claim, but allowed the state law claims to proceed. An amended complaint then added a claim for fraud, citing representations made on the devices' packaging and via the Home Shopping Network that they would rid homes of "ants, spiders, mice, roaches, rats and other pests."

In July 2017, the court certified three classes of plaintiffs who had purchased the devices—a nationwide fraud class, a California-only class, and a multi-state breach of warranty class. Each party then offered experts on the efficacy of the devices. Judge Pauley began his Sept. 5, 2018, opinion on summary judgment with images from one of the expert reports, noting, "As the photographs show, mice can apparently relax comfortably under a Repeller and even appear to be so drawn in by its siren song that one would scale a wall just to snooze on it." Having thus found a disputed issue of fact regarding the efficacy of the devices, the court set jury trial for Sept. 9, 2019.

On July 16, 2019, the parties informed the court that they had reached a settlement, and on Sept. 3, 2019, the plaintiffs moved for preliminary approval of the agreement.

'Quick-Pay' Attorney Fees Provision Scuttles Preliminary Approval

The most notable feature of the proposed agreement in *Hart* was its so-called "quick-pay" provision, under which the plaintiff's attorneys would be paid their fees within 10 days of final settlement approval. Plaintiff contended the provision was necessary to discourage "the filing of baseless objections (and appeals), which can delay payment of class relief." Analyzing that provision in a July 17, 2020, opinion, the court wrote that it "strains credulity" that such a measure would deter baseless objections. The court assured the litigants that such objections could be better discouraged by the threat of Rule 11 sanctions.

The court also found that, having reached a proposed agreement, the two parties had little incentive to pour any more resources into the case if valid objectors came forward. The court noted that "money is the best way to keep lawyers engaged."

Although plaintiffs' counsel cited seven previous SDNY orders in which similar provisions had been granted preliminary approval, the court pointed out that none of those previous orders contained "an iota of analysis on 'quick-pay' provisions." Thus, in the first detailed analysis of such a provision in the Southern District, the court held that paying counsel "prior to compensating the class conflicts with Rule 23(e)'s mandate for fairness, reasonableness, and adequacy."

Also as part of the preliminary agreement, the parties proposed to engage an arbitrator to determine the amount of attorney fees to be awarded to plaintiffs' counsel. The court ruled that such an arrangement was contrary to law, as it would usurp the court's discretion and eviscerate its duty to "act as a fiduciary who must serve as a guardian of the rights of absent class members."

The court thus denied preliminary approval of the settlement. The plaintiffs quickly submitted a revised proposed settlement which no longer included the quick-pay provision or arbitration of attorney fees. The court reviewed the revised settlement on Feb. 12, 2020, and granted preliminary approval, setting a hearing on final approval for September 2020.

Refunds for Class Members Found Fair

In its Sept. 22, 2020, opinion granting final approval of the settlement, the court devoted significant consideration to the structure of the awards to the class, which were styled as refunds for purchases of repeller devices. By providing proof of purchase that included the price paid for each unit, a class member could receive a full refund for up to six units. Without proof of the price paid, the amount of each refund was set at $15, which the parties chose as the best estimate of the purchase price. Finally, class members who could not provide any proof of purchase could still receive $15 each for up to two units

purchased.

As of August 24, class members had filed 82,503 claims for payment, and a total payout of $2,118,505 had been approved by the class administrator. And crucially, no objections to the settlement had been received from notified class members. The administrator expected a final payout between $2.1 million and $2.5 million. BHH had agreed in the settlement to a total potential liability of over $57 million.

In evaluating the fairness of the settlement, the court noted that if the case had proceeded to a jury trial, class members might have received considerably less than full refunds—especially because plaintiffs "faced substantial risk in proving loss causation." The court found the settlement to be procedurally and substantively fair, and moved on to considering the fees to be awarded to class counsel.

Attorney Fees Exceed Amount Awarded to Class Members

The agreement allowed class counsel to seek up to $6.5 million in attorney fees and expenses—an amount almost triple the expected payout to class members. That would typically pose a problem for a reviewing judge, who must "carefully scrutinize lead counsel's application for attorneys' fees to ensure that the interests of the class members are not subordinated to the interests of … class counsel." *Hart* at 10, *citing Maywalt v. Parker & Parsley Petroleum Co.*, 67 F.3d 1072, 1078 (2d Cir. 1995). But as the court explained, "This case provides one unique feature absent from most class-action settlements: rather than the class members sharing from a settlement pool, the recovery to the class will be claims based. As a result, attorneys' fees will not reduce the class recovery." Hart at 10.

For such claim-based settlements, the court explained that its "fiduciary role in overseeing the award is greatly reduced, because there is no conflict of interest between attorneys and class members." *Id. citing McBean v. City of New York*, 233 F.R.D. 377, 392 (S.D.N.Y.2006). The opinion also noted that the attorney fees were negotiated after the parties had reached an agreement on class recovery, which "tends to eliminate any danger of the amount of attorneys' fees affecting the amount of the class recovery." *Hart* at 11, citing *In re Sony SXRD Rear Projection Television Class Action Litig.*, 2008 WL 1956267, at *15 (S.D.N.Y. May 1, 2008).

Performing the Second Circuit's preferred fee analysis from *Goldberger v. Integrated Res.*, as checked by the lodestar method, the court awarded $3,976,762.50 in legal fees and $700,227.57 in litigation expenses. It rejected plaintiffs' argument that unclaimed funds should be used as the denominator to calculate the fee percentage, since in this instance, the unclaimed funds would revert to BHH instead of being distributed via cy pres, and therefore the unclaimed funds did not provide an actual benefit to the class. That was significant, because by plaintiffs' calculation, nearly 90 percent of the agreed $57 million

settlement was expected to go undistributed.

Even so, the final fee award was substantially greater than the total award to the class. The court considered this carefully. "On one hand, allowing lawyers' recovery to dwarf the settlement is against public policy," the court wrote. *Hart* at 21. "On the other hand, Class Counsel should be rewarded for concentrating their time, effort, and resources in successfully representing the class on a contingent basis. And, most importantly, the fee will be paid directly by Defendants and will not come at the class' expense." The court ordered that the attorney fees may be paid when at least 75% of the settlement has been distributed. The court also awarded each class representative a $5,000 incentive award.

Practice Tips

The Hart case is as a helpful illustration of the restrictions on attorney fee provisions in class action settlements. Though courts will be skeptical of attorney fee provisions that approach or exceed the total benefit to class members, such skepticism may be overcome if the settlement is structured so that increasing class counsel's payout does not decrease the benefit to the class. Additionally, the Hart court's reasoned disapproval of a quick-pay attorney fee provision may portend greater scrutiny of such provisions in future cases in the Southern District and elsewhere.

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