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A Lesson For Objectors In Class Action Settlements

Law360, New York (January 27, 2014, 5:31 PM ET) -- Class members who object to proposed settlements and pursue rival lawsuits may wish to review a recent federal court ruling approving the settlement of allegations that Hydroxatone deceived consumers nationwide by offering beauty products with risk-free trial offers and auto-shipment programs that, in fact, consisted of customer-service practices which failed to credit product returns or to cancel membership in the programs as requested by dissatisfied customers. Sabol v. Hydroxatone, No. 11-4586 (D.N.J. Nov. 26, 2013).

The court concluded that the objector's claims were included in the Sabol settlement agreement and characterized her objection as "at least in part, the continuation by other means of a struggle among counsel for control of the litigation."

Objector Lisa Margolis, whose husband initially acted as her counsel and at one point sought to serve as class counsel in the Sabol action, had filed her putative class action a few weeks before the Sabol matter commenced. The latter action "progressed more rapidly," with settlement discussions beginning less than a year after filing. Margolis apparently refused to participate in the Sabol negotiations, and, instead, revised the alleged facts in her dispute and unsuccessfully sought to consolidate her case with Sabol's, while seeking various forms of discovery and otherwise trying to delay the settlement, according to the court.

Her original complaint alleged that she had spoken with a live operator/agent in making her product purchase; an amended complaint alleged that she had participated in the program by means of an interactive voice response ("IVR") system, although evidence in the record showed that her purchase was made through a vendor that used live operators only. Margolis argued that her IVR class was not covered by the settlement, but the court found otherwise, ruling that both IVR and live class members came within its ambit, particularly given that Sabol's claim was based on use of the IVR system.

Margolis also added defendants, including Hydroxatone's CEO and a company that provided marketing consulting services to Hydroxatone, in an apparent effort to further distinguish her action from Sabol's. She objected to the amount of the settlement, contending that it was disproportionate to and failed to account for some $300 million in IVR product sales and that it failed to tap available insurance funds.

Under the settlement, the defendants, without conceding any liability, have agreed to change how they market their products, pay $3 million into a common settlement fund and provide up to an additional $4 million in noncash benefits consisting of a selection of products. Each class member is eligible for awards between $40 and $100 or replacement products. The agreement also provides class counsel with one-third of the cash fund to reimburse their expenses and fees; any remaining funds will be paid to cy pres recipient the Electronic Frontier Foundation.

Setting the context for its fairness ruling, the court noted that the complaint was in essence a matter of customer dissatisfaction with a product that many "seemingly were happy with ... and content to keep," involved few claims — 1.4 percent of the total potential class — and even fewer objections, only two.

The court also noted that Margolis' objection was "of a special nature" given her status as a class member and "the sole named plaintiff in a rival putative class action." And the court emphasized that the "highly regarded and experienced" retired judge who presided over the parties' mediation declared that its terms were "fair, adequate, reasonable and in the best interest of the plaintiffs and the proposed class."

While the court thoughtfully presented and analyzed each of Margolis' specific objections, it was clearly not inclined to give short shrift to the work of an esteemed mediator.

Among other matters, the court found that Margolis' $300 million calculation "is manufactured from thin air ... [and] is not a damages figure at all." It also determined that funds to satisfy a settlement of this size were "not a realistic possibility," noting that the defendants had experienced "very significant losses over the last 24-36 months." In this regard, the court concluded, "[t]he financial data before the court are more than adequate to merit my deference to one of the premises of the parties' settlement, which was that it was fruitless to try to wring more money from these defendants."

As to the settlement's release of entities named as defendants by Margolis but not sued by the Sabol plaintiffs, the court stated that she had "not provided a persuasive reason for excluding" them from the settlement. According to the court, Margolis "has not made any showing that [the CEO] would be personally liable for claims related to the corporate defendants' practices," and "available facts suggest that the parties made a permissible decision that it was not worth holding up a settlement to pursue an additional recovery from marketing architects ... which would have a contractual right to be indemnified by defendants if sued separately."

The court further observed that the marketing consultant, which was involved in the IVR system's set up, could not have been sued by Margolis in any event, because she "was not herself an IVR purchaser, and would lack standing to pursue the rights of IVR customers personally or as a class representative."

Whether an additional $13 million in insurance coverage would be available to satisfy the class members' claims, the court noted that most of the involved carriers had disclaimed coverage and that Margolis' expert report on the issue "does not really state that the other policies cover these claims." The expert's submissions, the court said, "suggest that reimbursement might be obtained from these other insurers through negotiation, arbitration, or litigation," but do not indicate how costly or time-consuming it would be to pursue policies held by nonparties. Applying Third Circuit precedent, which "does not demand that significant resources be spent in separate litigation to unearth other sources of recovery," the court found the "parties' decision to forgo such protracted litigation ... understandable."

The court dismissed Margolis' attempt to distinguish the two class actions to support her claim that the release was overbroad, stating that both were "based on Hydroxatone's marketing campaign and 'risk-free' trial offer. Customers who made their purchases through an IVR system are not excluded from the Sabol action class; they are included, and claims related to those purchases are contemplated and provided for in the" settlement agreement.

Seeing no reason to "dissent from" the mediator's opinion that the agreement was "the product of

advocacy and negotiation and conducted at arms-length in good faith," the court further rejected Margolis' argument that the settlement unfairly distinguished between two groups of claimants — those who returned their products for refunds and canceled membership in the auto-shipment program and those who "are dissatisfied now." The former are eligible for cash or product benefits; the latter are not eligible for a cash benefit. As the court noted, nothing on the face of the distinction between the groups "suggests unfairness, and there has been literally no objection from any Group 2 claimant."

In response to Margolis' reliance on a consent order in a "risk-free trial" case involving the Federal Trade Commission to support her contention that the settlement will not deter deceptive conduct, the court said that the other case "has no precedential authority here," "final approval of the proposed settlement before me does not hinge on what was negotiated in a different case on different facts," and the standard of review does not "require me to fashion the best possible settlement." Unfortunately for Margolis, the defendants apparently ceased the practice to which she objected, "rendering injunctive relief inappropriate at present."

The takeaways for objectors can be summarized as follows: (1) carefully assess the strength of your objections before filing, (2) seize the opportunity offered to participate in ongoing negotiations, (3) don't plead what you may not be able to prove and (4) consider the restrictions imposed on courts by general legal principles favoring settlement.

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