

Drafting Blow-Up Provisions in Class Action Settlement Agreements

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Today's Topics

Relevant Rule 23 Settlement Requirements

Fed. R. Civ. P. 23(e) requires court approval of all class action settlements, which may be granted only after a fairness hearing and a determination that the settlement taken as a whole is fair, reasonable and adequate.

Recent amendments require parties moving for preliminary approval to demonstrate (1) the proposed settlement will likely be granted and (2) the court will likely certify the class for purposes of settlement.

Settlement approval requirements

Settlement Approval Under Rule 23(e)(1)—Standardizes the final approval criteria *across circuits*:

- whether “**class representatives and class counsel have adequately represented the class**”;
- whether the settlement was “**negotiated at arm’s length**”;
- whether the **relief provided for the class is adequate** (taking into account such factors as costs and risks of trial and appeal, the effectiveness of the proposed distribution, and attorneys’ fees);
- whether “**class members are treated equitably relative to each other.**”

Settlement approval requirements

Class Member Objections Under Rule 23(e)(5)—New requirements for objections:

- **“The objection must state whether it applies only to the objector, to a specific subset of the class, or to the entire class, and also state with specificity the grounds for the objection.”**
- These amendments may deter “serial objectors” with ulterior and personal financial motives from delaying settlement approval and distribution to class members.

Blow-Up Provisions In Settlements

- *What is a blow-up provision?*
- *Why have one?*
- *Relevant considerations*

What is a blow-up provision?

- A “blow-up” provision in a settlement agreement allows a defendant **to terminate or renegotiate a proposed class settlement** when economic exposure from opt-outs (exclusion requests) reaches an unacceptable level, rendering the proposed settlement no longer economically desirable.
- Such provisions are structured to give defendants **the option to terminate a preliminarily-approved class settlement agreement** if a specified threshold number of opt-outs is reached.



Why have one?

- A blow-up provision tied directly to the dollar amount of potential exposure allows a defendant to make a reasoned decision as to whether to proceed to final approval of a settlement when it will face follow-on litigation that undermines finality and increases the cost of overall resolution.
- Studies have shown that **the larger the proposed settlement, the more likely the settlement will have opt-outs**. Such cases proceed on an individual basis and the plaintiffs who bring them can exercise considerable leverage over a defendant.

Relevant considerations

- Relief provided in the settlement relative to the claims that could be asserted (*e.g.*, has the opportunity for repair or replacement been provided?)
- If relief is being provided in the form of a common fund, what is the value of the settled claims relative to the amount of the fund?
- What will be the timing of the distribution of the proposed relief relative to when the blow-up provision can be exercised?
- Can the value of the claims of the opt-outs be assessed with accuracy?

Drafting Pitfalls

- *Not tying the blow-up provision to potential dollar amount of opt-out exposure*
- *Not identifying and understanding claim value*
- *Not creating an effective blow-up provision allowing for renegotiation or termination*



*Relating the
blow-up
provision to the
value of the
opt-out
exposure*

Potential value of opt-out exposure cannot be known with certainty because opt-out plaintiffs may make different allegations and assert different claims, but:

- Consider setting the provision at **a specified dollar value of potential claims** so that determining whether it has been triggered is easier
- Consider negotiating **very specific remedies in the alternative to termination** so that the settlement can possibly be saved



*Understanding
the value of the
claims of
individual
settlement class
members*

- Calculating the value of potential claims can be difficult where different proposed settlement class members are differently situated
- It is critical for a defendant to have information sufficient to reasonably estimate the value of the claims of individual settlement class members so that a reasonable opt-out threshold and mechanism can be negotiated
- Recognized loss sometimes can be calculated by an expert based on allegations asserted in the pleading

Creating an effective blow-up provision

Blow-up provisions are frequently confidential, but a number of different structures have been observed:

- Total number of opt outs exceeds some number
- A specific number of named plaintiffs opt out of the settlement
- Dollar value of potential claims
- In securities class actions, the percentage of shares purchased by class members, the percentage of shares traded, or the percentage of shares outstanding

Ambiguity is *unhelpful*.

All is likely subject to *reasonableness* test.

Creating an effective blow-up provision

Potential pitfalls:

- Creating a structure in which the amount of damage per proposed class member is variable and cannot be known
- Creating a structure that sets the trigger for the blow-up provision too high, making it unlikely to trigger even after high exposure
- Creating a structure that is ambiguous thereby making it unclear as to whether the blow-up provision has in fact been triggered
- Failing to provide for parameters for renegotiation in the event the blow-up provision is triggered but the settlement still remains desirable

Confidentiality of Opt-Out Thresholds

Courts recognize that publicizing the threshold could result in the failure of the settlements to become effective and could result in settlement proceeds being unfairly channeled away from the proposed settlement class members to parties and attorneys who do not deserve them.

*Courts are
receptive but
frequently want
to review in
camera*

- In the context of class-action settlements, opt-out thresholds, which permit defendant to terminate or renegotiate settlement if number of settlement class members exceeds a particular threshold, are usually not disclosed and kept confidential to discourage organized or “mass” opt outs. *New York State Teachers’ Retirement Sys. v. Gen. Motors Co.*, 315 F.R.D. 226, 240 (E. D. Mich. 2016) (overruling objection to confidential Supplemental Agreement specifying opt-out threshold and provisions for renegotiation or termination of settlement if threshold met; no *in camera* review).
- The existence of a termination option triggered by the number of class members who opt out of the Settlement does not by itself render the Settlement unfair. *Hefler v. Wells Fargo & Co. et al.*, Case No. 16-05479-JST, 2018 WL 6619983 *1, *7 (N. D. Cal. Dec. 18, 2018) (“Court previously reviewed the supplemental agreement under seal and concluded that the termination provision is fair and reasonable.”).

Key Takeaways

1. Would client would go forward with the settlement if there were a certain number of opt-outs or value of claims?
2. Define by number of opt-outs, dollar value, claims, shares, etc.?
3. Confidentiality—consider filing opt-out “blow up” threshold under seal to deter objectors / mass opt-outs
4. Next steps—what happens if blow-up triggered?

Today's Presenters



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