

THE REVIEW OF  
**SECURITIES & COMMODITIES  
REGULATION**

AN ANALYSIS OF CURRENT LAWS AND REGULATIONS  
AFFECTING THE SECURITIES AND FUTURES INDUSTRIES

Vol. 52 No. 16 September 25, 2019

## LEGAL ETHICS CONSIDERATIONS IN CLASS ACTION LITIGATION

*In this article, the authors discuss ethical issues surrounding communication with absent class members, settlements, and litigation funding.*

By Neal R. Marder and Kelly Handschumacher \*

Class actions implicate myriad ethical considerations. Some involve the rules of professional conduct as applied to the circumstances of class litigation. Other ethical considerations arise when courts decide whether to approve a class settlement as fair, reasonable, and adequate. This article will look closely at a few key areas that involve ethics issues in class action litigation: defendants' communications with absent class members, settlements, and litigation funding.

### COMMUNICATIONS WITH ABSENT CLASS MEMBERS

The scope of permissible communications between defendants and absent class members changes based on whether the class is certified. The permissible scope is large before class certification, and relatively limited thereafter. The operative professional rule is Rule 4.2 of the Model Rules of Professional Conduct, which is similar to Rules 4.2(a) of the California and New York Rules of Professional Conduct. Model Rule 4.2 provides: "In representing a client, a lawyer shall not communicate about the subject of the representation with a person the lawyer knows to be represented by another lawyer in the matter, unless the lawyer has the consent of the other lawyer or is authorized to do so by law or a court order." The question for applying Rule 4.2 in a class action is whether absent class members are

represented by class counsel such that defendants' counsel cannot communicate with class members about the litigation without class counsel's consent.

#### **Pre-certification**

Courts generally hold that before a class is certified, putative class members are not yet represented by plaintiffs' counsel.<sup>1</sup> Thus, defendants generally may communicate with putative class members pre-certification.<sup>2</sup> However, courts may restrict communications with putative class members in certain circumstances: where the defendants' communications are deceptive, coercive, or otherwise improper.<sup>3</sup> For example, in *Quezada v. Schneider Logistics Transloading & Distribution*,<sup>4</sup> the court held that the defendant's communications with its employees who

---

<sup>1</sup> See, e.g., *Parks v. Eastwood Ins. Servs., Inc.*, 235 F. Supp. 2d 1082, 1084 (C.D. Cal. 2002) (listing authority).

<sup>2</sup> *Casey v. Home Depot*, No. EDCV142069JGBSPX, 2016 WL 7479347, at \*8 (C.D. Cal. Sept. 15, 2016) (citing *Maddock v. KB Homes, Inc.*, 248 F.R.D. 229, 236 (C.D. Cal. 2007)).

<sup>3</sup> *Id.*

<sup>4</sup> 2013 WL 1296761 (C.D. Cal. Mar. 25, 2013).

---

\* NEAL R. MARDER is a partner and KELLY HANDSCHUMACHER is an associate at Akin Gump Strauss Hauer & Feld LLP. Their e-mail addresses are nmarder@akingump.com and khandschumacher@akingump.com.

were putative class members were impermissibly deceptive and coercive. In finding that the communications were deceptive, the court considered that defendant's attorneys conducting the interviews failed to notify the employees that the purpose of the interviews was to gather evidence to be used against them in a lawsuit, the attorneys did not tell the employees that the document each was asked to sign at the close of the interview was a sworn declaration, and the attorneys incorrectly told the employees that the interviews were for an internal investigation. In finding the communications deceptive, the court considered that the defendant had summoned employees to attend the interviews over a loudspeaker or had employees' supervisors order them to attend, and defendant did not provide employees the option not to attend the interviews. Having found the interviews to be improper communications, the court disregarded the 106 putative class member declarations that resulted from the interviews, prohibited the defendant from further communication with class members about the litigation absent court permission, and issued a curative notice to inform putative class members that their declarations would not be considered by the court.

In another example, *Zamboni v. Pepe W. 48th St. LLC*,<sup>5</sup> the court held that although defendants were entitled to obtain information relevant to the litigation by interviewing their putative class member employees, it was inherently coercive for defendants to have solicited a statement from each employee that he did not have a claim for unpaid wages. Because these communications were improper, the court extended the opt-in period for the Fair Labor Standards Act class action and ordered defendants to issue notice advising their employees that they have not waived any of their rights under the FLSA.

### **Post-certification**

After a class is certified, defendants' communications to class members are much more restricted. This is because courts hold that members of a certified class are represented by class counsel.<sup>6</sup> One grey area, however,

is whether the attorney-client relationship between class counsel and the class forms upon the court issuing an order granting class certification or upon the close of the class notice period (i.e., when the time for class members to opt out of the class has lapsed).<sup>7</sup> This uncertainty may affect the scope of permissible communications during the months between the class certification order and the close of the notice period.

Of course, even after a class is certified, defendants may talk to class members about issues not related to the litigation. For example, a defendant employer could continue to communicate about work with class member employees, and a defendant business could continue to communicate about business transactions with class member customers.

Plaintiffs' counsel does not represent individuals who opt out of the class during the notice period. Thus, defendants may communicate directly with opt-outs, which could be helpful in gathering further information or evidence to defend the case. For example, a defendant could contact a customer who opted out of a class for an interview about the customer's experience as it pertains to the merits of the litigation.

## **SETTLEMENT**

### **Prohibition On Restricting The Practice Of Law**

Ethical issues also arise in the class settlement context. One issue is whether settlements can prohibit class counsel from bringing another similar case against the defendant. When drafting an individual plaintiff

---

<sup>5</sup> 2013 WL 978935 (S.D.N.Y. Mar. 12, 2013).

<sup>6</sup> *Newberg on Class Actions 5th (Trial Practice Series)*, section 9:9, 2019-1 update.

---

<sup>7</sup> Compare *Impervious Paint Indus., Inc. v. Ashland Oil*, 508 F. Supp. 720, 723 (W.D. Ky. 1981) (defendants' counsel must treat class members as represented by counsel during the class notice period) and *Tedesco v. Mishkin*, 629 F. Supp. 1474, 1483 (S.D. N.Y. 1986) (impermissible for defendant attorney representing himself to communicate with class members after the court orally certified the class) with *In re Katrina Canal Breaches Consol. Litigation*, 2008 WL 4401970 (E.D. La. 2008) (quoting *ABA Comm. on Ethics & Prof'l Responsibility*, Formal Op. 07-445, at 3 (2007) ("putative class members are not represented parties for purposes of the Model Rules prior to certification of the class and the expiration of the opt-out period"))).

---

settlement in a putative class action, defendants often wish they could include language in the settlement agreement that would prevent plaintiffs' counsel from turning around and suing defendants again for the same claim with a different client. However, Rule 5.6 of the Model Rules of Professional Conduct, which is similar to Rules 5.6 of the California and New York Rules of Professional Conduct, prohibits such language in settlement agreements because it would be a restriction on plaintiffs' counsel's right to practice law. Model Rule 5.6 provides: "A lawyer shall not participate in offering or making . . . an agreement in which a restriction on the lawyer's right to practice is part of the settlement of a client controversy." Thus, instead of restricting plaintiffs' counsel's ability to bring future claims, defendants should assess the circumstances that make it more or less likely that plaintiffs' counsel will sue them again for the same issue with a new plaintiff, and factor that possibility into the settlement consideration.

### **Courts' Considerations In Approving Class Settlements**

Ethics considerations also arise in courts' approval of class settlements. Before approving a class settlement, courts must find under Federal Rule of Civil Procedure 23(e)(2) that the settlement is "fair, reasonable, and adequate." The 2018 amendments to Rule 23(e)(2) further specify that a court, in making this finding, must consider whether the class representatives and class counsel have adequately represented the class; the proposal was negotiated at arm's length; the proposal treats the class members equitably relative to each other; and the relief provided for the class is adequate, taking into account: (i) the costs, risks, and delay of trial and appeal; (ii) the effectiveness of any proposed method of distributing relief to the class; (iii) the terms of any proposed award of attorney's fees, including timing of payment; and (iv) any agreement required to be identified under Rule 23(e)(3).

In determining whether the proposed settlement is fair and adequate, courts have considered specific elements of a settlement, including whether unclaimed settlement funds would revert back to the defendant, and whether the settlement consideration consists of coupons or other non-monetary consideration. Courts may view the settlement as collusive where plaintiffs' counsel's fees are based on a settlement amount not actually received by the class, such as where plaintiffs' counsel's fees are

a percentage of a total settlement fund whose unclaimed funds would revert to the defendant.<sup>8</sup>

Courts may also consider the timing of payments to the class versus to class counsel. For example, in *Jones v. Singing River Health Servs. Found.*,<sup>9</sup> the Fifth Circuit disapproved of a settlement in which class members would receive payments over 35 years, with significant risk regarding the defendant's ability to make future payments, while class counsel would be paid their \$6.5 million in fees immediately. The court commented, "That counsel assured themselves a multimillion-dollar bird in hand, while leaving the class members two in the bush, is disturbing."<sup>10</sup> Where a class settlement involves structured payments over time, a court may require that class counsel receive its fees in installments over time instead of immediately.<sup>11</sup>

### **LITIGATION FUNDING**

Litigation funding is increasingly common in class actions and raises additional ethics issues. A key concern is whether litigation funders may be able to control aspects of the litigation while wanting to settle at a different price, or litigate at a different cost, than what is in the best interests of the class. The rules of professional conduct intersect with this concern in requiring that counsel maintain independent judgment and not harm their clients from conflicts of interest. Specifically, Rule 2.1 of the Model Rules of Professional Conduct, like Rules 2.1 of the California and New York Rules of Professional Conduct, provides: "In representing a client, a lawyer shall exercise independent professional judgment and render candid advice." And Rule 1.7 of the Model Rules of Professional Conduct, similar to Rules 1.7 of the California and New York Rules of Professional Conduct, provides in relevant part that, absent a client's informed, written consent and a lawyer's reasonable belief that she will be able to provide competent and diligent representation, "a lawyer shall not represent a client if . . . there is a significant risk that the representation of one or more clients will be materially limited by the lawyer's responsibilities to . . . a third person or by a personal interest of the lawyer."

---

<sup>8</sup> *Stewart v. USA Tank Sales & Erection Co.*, No. 12-05136-CV-SW-DGK, 2014 WL 836212, at \*6 (W.D. Mo. Mar. 4, 2014).

<sup>9</sup> 865 F.3d 285, 298 (5th Cir. 2017).

<sup>10</sup> *Jones v. Singing River Health Servs. Found.*, 865 F.3d 285, 298 (5th Cir. 2017).

<sup>11</sup> *See, e.g., In re Ready-Mixed Concrete Antitrust Litig.*, No. 1:05-CV-00979-SEB, 2010 WL 3282591, at \*4 (S.D. Ind. Aug. 17, 2010).

---

Thus, class counsel obtaining litigation funding must make sure that their judgment remains independent and that the litigation funding does not conflict with the class's interests, or that any such conflicts are properly addressed.

Litigation funding also implicates rules prohibiting lawyers from sharing fees with non-lawyers. For example, New York City Bar Association Ethics Opinion 2018-5 interprets Rule 5.4 of the New York Rules of Professional Conduct to prohibit lawyers from entering into litigation funding agreements in which lawyers would pay back loans through a percentage of their fees collected in specific matters. Similarly, Comment 2 to Rule 5.4 of the California Rules of

Professional Conduct notes that “compensation to a non-lawyer third-party may not be determined as a percentage or share of the lawyer’s or law firm’s overall revenues, or tied to fees in particular cases or legal matters.” In other words, counsel cannot promise a percentage of their fees to litigation funders.

## **CONCLUSION**

Ethics issues in class actions are developing over time. Counsel should stay up to date on evolving ethics issues, including the rules of professional conduct applicable in their jurisdiction and court decisions, rules of civil procedure, and local rules regarding ethical considerations in class action settlements. ■