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September 27, 2018

S.D.N.Y. rules "objector extortion" in class settlement context can and should be sanctioned, and further curtailed by requiring an appellate bond

by Jay Bogan

Takeaway: Where a class settlement is reached, objectors may be lurking, oftentimes to extort personal payments. Earlier this year, the Seventh Circuit termed this practice "objector blackmail." Judge Rakoff of the Southern District of New York recently took direct action against these tactics, sanctioning an objector's attorney in an opinion replete with references to legal "extortion." Moreover, unless rejected by Congress, an amendment to Federal Rule 23, requiring judicial approval of "side deals" with objectors (and thereby involving district courts in potentially abusive efforts by objectors), will go into effect at the end of 2018. In the meantime, settling parties and district courts have additional tools to address what Judge Rakoff termed "objector extortion."

In June 2018, in the securities class action *In re: Petrobas Securities Litigation*, Judge Rakoff approved a $3 billion settlement. In approving the settlement, he overruled objections to the settlement filed by an objector (Mr. Bueno), who was represented by an attorney (Mr. Furman), as well as objections prepared by an attorney (Mr. Gielata) on behalf of his parents (two other named objectors). Judge Rakoff did not at that time address the claims advanced by the class plaintiffs that the objectors were seeking to extort personal payments, but he did "expressly retain[] jurisdiction to address, even after entry of final judgment, any past or future objector efforts at extortion." *In re: Petrobas Securities Litigation*, No. 14-cv-9662 (JSR), 2018 WL 4521211, at *2 (S.D.N.Y. Sep. 21, 2018).

When the objectors appealed the district court's judgment, the class plaintiffs moved for sanctions, arguing that the objectors "filed their objections and subsequent appeals as part of an 'extortionist agenda' to extract a monetary settlement in exchange for dismissing their appeals." 2018 WL 4521211, at *3. Judge Rakoff granted the motion in substantial part, imposing sanctions in the amount of $10,000 against Mr. Furman, and requiring the objectors to post appeals bonds (for Mr. Bueno, a bond in the amount of $5,000, and for the Gielatas, a bond in the amount of $50,000).

Judge Rakoff began his analysis by describing the role of objectors in class action litigation. On the one hand, "[i]t is well settled that objectors have a valuable and important role to play in preventing collusive or otherwise unfavorable settlements." *Id*. at *1 (quoting *White v. Auerbach*, 500 F.2d 822, 828 (2d Cir. 1974)). On the other hand, "it has become obvious that some objectors seek to pervert the process by filing frivolous objections and appeals, not for the purpose of improving the settlement for the class, but of extorting personal payments in exchange for voluntarily dismissing their appeals." *Id*. The Seventh Circuit, the district court noted, recently

referred to these efforts as "objector blackmail." *Id*. (quoting *Pearson v. Target Corp.*, 893 F.3d 980, 982 (7th Cir. 2018)).

Judge Rakoff focused on two sources of authority to sanction objectors and their counsel: the district court's inherent power and the "vexatious litigation" statute, 28 U.S.C. § 1927. "Sanctions are justified pursuant to the court's inherent power where there is a 'specific finding' of bad faith and 'clear evidence that the conduct at issue is (1) entirely without color and (2) motivated by improper purposes.'" *Id*. at *3 (quoting *Wolters Kluwer Fin. Servs., Inc. v. Scivantage*, 564 F.3d 110, 114 (2d Cir. 2009)). Section 1927 provides that an attorney may be sanctioned "who so multiplies the proceedings in any case unreasonably and vexatiously," thereby inflicting on the other parties "excess costs, expenses and attorney's fees reasonably incurred because of such conduct." *Id*. (quoting 28 U.S.C. § 1927). Similar to "inherent power" sanctions, Section 1927 sanctions require "a clear showing of bad faith on the part of an attorney," which "may be inferred only if actions are so completely without merit as to require the conclusion that they must have been undertaken for some improper purpose such as delay." *Id*. (quoting *Salovaara v. Eckert*, 222 F.3d 19, 35 (2d Cir. 2000)).

Regarding Mr. Furman (counsel for objector Mr. Bueno), the court found that his objections to the class action settlement had no colorable basis. Among other things, the court found that Mr. Furman had prepared a "kitchen-sink brief" replete with meritless objections and citations to "entirely inapposite" authorities. *Id*. at *4. The only objection he raised that was even "conceivably colorable" applied to the issue of *cy pres* distributions, but even that argument was not supported by any cited case law, and it failed to take into account that the court expressly deferred ruling on the issue of *cy pres* distributions, because it was not clear that the settlement would result in any such distributions. The district court observed that the *cy pres* distribution issue was the *only* objection that Furman raised on appeal to the Second Circuit. The court stated, "and since the essence of Class Plaintiffs' motion is that Furman's notice of appeal was filed for purely extortionate purposes, it is worth noting how totally frivolous that appeal is." *Id*. at *5 (noting, among other things, that there is no Second Circuit authority requiring a district court to identify a *cy pres* recipient prior to approving a class settlement).

The court then addressed the issue of bad faith, noting that Furman "made repeated misrepresentations of both the facts and the law" in his filings with the court. *Id*. at *6. "The only likely motive for this misconduct," the court said, "is Furman's attempt to extort a payment from the Class Plaintiffs in order that they may avoid costly delay, in other words, extortion." *Id*. In support of this finding, the court cited to "Furman's established history, detailed in Class Plaintiffs' submissions, of filing appeals on behalf of objectors and then voluntarily dismissing them in exchange for payments." *Id*.

Lastly, as to Mr. Furman, the court found that sanctions were appropriate and that sanctions in the amount of $10,000 were appropriate "for now," leaving the class plaintiffs with the option of seeking further sanctions later, depending on what transpired on appeal.

Regarding the Gielatas, the court declined to sanction them, finding some "colorable basis" to their objections,

and declining to make a "bad faith" ruling against them similar to the one made against Mr. Furman (although "some of the Gielatas' behavior in this case and other cases casts more doubt on their bona fides"). *Id*. at *8.

On the class plaintiffs' separate motion for appellate bonds, Federal Rule of Appellate Procedure 7 provides that, "[i]n a civil case, the district court may require an appellant to file a bond or provide other security in any form and amount necessary to ensure payment of costs on appeal." *Id*. at *10 (quoting Fed. R. App. P. 7). Whether a bond is ordered is judged on the following factors: "(1) the appellant's financial ability to post a bond, (2) the risk that the appellant would not pay appellee's costs if the appeal loses, (3) the merits of the appeal, and (4) whether the appellant has shown any bad faith or vexatious conduct." *Id*. (quoting *Stillman v. Inservice Am., Inc.*, 838 F.Supp.2d 138, 140 (S.D.N.Y. 2011)). "Most critical" to the court's analysis was that, "while the Gielatas' appeal is slightly more colorable than Bueno's frivolous appeal, both appeals lack merit and both appellants have exhibited some bad faith conduct, albeit worse in Bueno's case than in the case of the Gielatas." As noted above, the objectors were required to post appeals bonds ($5,000 for Mr. Bueno and $50,000 for the Gielatas), and the appeals bonds served as another form of sanctions against the objectors for their litigation misconduct.