IN THE UNITED STATES DISTRICT COURT FOR THE WESTERN DISTRICT OF NORTH CAROLINA CHARLOTTE DIVISION CIVIL ACTION NO. 3:16-CV-00861-GCM

ROBERT C. BARCHIESI and LEJLA HADZIC, Individually and in a representative capacity on behalf of a class of all persons similarly situated, et al. Plaintiffs, vs. CHARLOTTE SCHOOL OF LAW, LLC, INFILAW HOLDING, LLC, and INFILAW CORPORATION, Defendants.	)	**BARCHIESI PLAINITFFS' MEMORANDUM OF LAW IN SUPPORT OF OBJECTIONS TO APPROVAL OF CLASS ACTION SETTLEMENT**

Plaintiffs/objectors Robert Barchiesi and Lejla Hadzic (hereinafter, the "Barchiesi Plaintiffs"), along with objectors Rebecca Applebaum, Graham Barnes, Nathan Bunch, Bridget Campbell, Jessica Hall, Ericka Lee, Hattie Macon, Nishi Patel, Alexandria Petty, Leroy Richardson, Julieta Smith, Christopher Tabaka, Stacy Townsend, Vonda Johnson, Kaytlin Ruzicka, Thomas Ruddy, Erin Bauman, Aeriel Carter, Alecia King, Brendon Davis, Keona Eaton, Caroline Aprahamain, Bryant Lavendar, and Jason Merritt (hereinafter collectively referred to as the "Barchiesi Objectors"), by and through undersigned counsel, hereby submit this Memorandum of Law in Support of their Objection to approval of the class action settlement pending before the Court.

INTRODUCTION

The Settling Parties ask this Court to approve a mandatory, non opt-out settlement for a multitude of unliquidated tort claims, based upon the contention that the Defendants have a "limited fund" from which to satisfy these claims. As demonstrated herein, such contentions are

all but extinct under the jurisprudence that has emanated from the United States Supreme Court over the last 20 years.

FACTUAL AND PROCEDURAL BACKGROUND

This action was initiated by the Barchiesi Plaintiffs on 22 December, 2016. The Barchiesi Plaintiffs seek to represent two classes of similarly situated plaintiffs who attended the Charlotte School of Law ("CSL") during the summer and fall semesters of 2016. [D.E. 78, pp. 39-40]. Each of the Barchiesi Objectors attended CSL between the summer and fall semesters of 2016. [D.E. 110, 111, 117-129, 134-136, 140, 144,164].

The Barchiesi Plaintiffs alleged, and Defendants admitted, that CSL had been notified by its accreditor, the American Bar Association ("ABA") on 3 February 2016, that CSL was "not in compliance" with ABA accreditation Standards 301(a), 501(a), 501(b), and Interpretation 501-1. [D.E. 6, ¶ 30; D.E. 66, 67, ¶ 30]. The Barchiesi Plaintiffs alleged, and Defendants admitted, that the ABA issued a decision in July of 2016 that CSL was out of compliance with the same Standards and that the noncompliance was "substantial" and "persistent." [D.E. 6, ¶ 37; D.E. 66, 67, ¶ 37]. The Barchiesi Plaintiffs alleged, and Defendants admitted, that on 14 November 2016, CSL disclosed to its students <u>for the first time</u> that it was out of compliance with the aforementioned ABA Standards, after being ordered to do so for the second time by the ABA. [D.E. 6, ¶¶ 44, 46; D.E. 66, 67, ¶¶ 44, 46]. Defendants further admitted that CSL had sent a letter to the ABA on October 4, 2016 which included a "study" that addressed "the negative effect upon CSL admissions of a disclosure" of CSL's noncompliance with the ABA Standards. [D.E. 66, 67, ¶ 50]. Defendants further admitted that as late as 21 December 2016, CSL continued to promote on its website that ". . . Charlotte School of Law **<u>is</u>** in full compliance with the ABA Standards for Approval of Law Schools." [D.E. 66, 67, ¶¶ 61 (emphasis added)].

On 17 August, 2017 the Court entered its Order on the Defendants' Motion to Dismiss, denying the Motion as to the Barchiesi Plaintiff's claim for Unfair and Deceptive Trade Practices, and on 14 September, 2017, the Defendants filed their Answer. Prior to the opening of merits discovery, on 11 September 2017, Defendants filed their Motion to Consolidate Merits Discovery. On 13 October 2017, the Court ordered two other pending actions, the Krebs and Levy actions, to be consolidated in the instant action for purposes of discovery. (Krebs and Levy are hereinafter referred to as the "Settling Plaintiffs"). The Settling Plaintiffs sought to represent classes of students who last attended CSL as early as September of 2014. (D.E. 78, p. 40).

Beginning 13 December 2017 the consolidated Plaintiffs engaged in written merits discovery with the Defendants. At no point in time in this action has a single witness been deposed on the merits of this case, the proposed settlement thereof, or the Defendants' ability to pay a judgment, now or in the future.

From 19 April to 20 April 2018, counsel for the parties participated in a mediation of this matter with a private mediator proposed by the Defendants. The mediation concluded with a Memorandum of Understanding ("MOU") that required, *inter alia*, the Defendants to produce additional documentation for review by the Plaintiffs in the context of potential settlement.

On 23 April, 2018, this Court entered an Order staying this matter for 60 days while settlement discussions continued.

On or about 15 May 2018, media outlets reported that the Defendants had hired Kirkland & Ellis, LLP[1] and was filing a series of lawsuits against the American Bar Association, which had not previously been disclosed to any of the Plaintiffs. A series of communications between

[1] "One of America's top lawyers" according to an article published by the Charlotte Observer. https://www.charlotteobserver.com/news/local/article211258674.html, attached as Exhibit 1.

all Plaintiffs and Defendants as to the funding and allocation of any proceeds from said litigation as part of any settlement ensued.

After reviewing information provided by the Defendants, and conducting a searching legal analysis, the undersigned counsel for the Barchiesi Plaintiffs determined that the "limited fund," non-opt out settlement, on the terms proposed by the Defendants, could not be confirmed under legal standards set forth by the United States Supreme Court in Ortiz v. Fibreboard Corp., 527 U.S. 815 (1999). After raising this concern, counsel for the Barchiesi Plaintiffs were excluded from further negotiations amongst the Defendants and Settling Plaintiffs.

The Court entered Orders extending the stay in this matter on 20 June 2018, and 22 August, 2018.

On 11 September 2018, the Defendants and Settling Plaintiffs jointly moved for preliminary approval of a proposed limited fund, non opt-out class-action settlement in this matter (Defendants and Settling Plaintiffs are hereinafter collectively referred to as the "Settling Parties"). Under the settlement, the Defendants would contribute $150,000.00, plus the remains of a "wasting" insurance policy in the amount of $2,500,00.00, and would be permitted to continue operations and have priority of all funds recovered in the ABA litigation. The proposed class has been expanded to include students who finished attending CSL as early as September of 2013. (D.E. 98-3, p. 32). In lieu of conducting any adversarial discovery on the Defendants' allegation of a "limited fund," the Settling Plaintiffs choose to rely exclusively upon an Affidavit provided by the Defendants' Chief Financial Officer, supported by Defendants' "pro forma" unaudited financial statements, in determining the existence and extent of the alleged "limited fund." Defendants have not produced any information to verify the depletion of over

$7,500,000.00 in insurance coverage on attorneys' fees, nor to verify that Defendants could not contribute more than $150,000.00 to settle all outstanding claims.

On 12 September 2018, the Court entered an Order granting preliminary approval of the proposed settlement, and set a deadline of 26 November, 2018 for class members to file objections. The Barchiesi Plaintiffs filed a Motion to Lift Stay and Permit Limited Discovery on 9 October 2018, which has not been ruled upon. As a result thereof, and the Defendants' and Settling Plaintiffs' refusal to engage in discovery on the merits of the proposed Settlement, no discovery has been conducted on the subject by and of the plaintiffs.

On or about 21 November 2018, Edward P. Bowers, a former United States Bankruptcy Trustee and current forensic accountant with the Certified Public Accounting firm Middleswarth, Bowers & Co., LLP, issued a report after review of the financial documentation produced by the Defendants, and concluded, *inter alia*, that "[t]he Defendants have not provided sufficient information to prove that there exists a limited fund in the amount claimed by the Defendants, or that the whole of any limited fund is being contributed to the settlement." [D.E. 174-1, p. 6].

Each of the Barchiesi Objectors have filed detailed objections with the Court in substantial conformity with the requirements set forth in the Order Granting Preliminary Approval of Class Settlement and Preliminary Settlement Class Certification.

ARGUMENT

I. THE REQUIREMENTS FOR A LIMITED FUND SETTLEMENT HAVE NOT BEEN MET

Defendants and Settling Plaintiffs propose a "limited fund" settlement of all claims of the class members pursuant to Rule 23(b)(1)(B). [D.E. 98-3, p. 6]. The claims of the class members,

including the settling plaintiffs, unquestionably sound in tort. [D.E. 78, pp. 43-51 (stating causes of action for Unfair and Deceptive Trade Practices, Fraud, and Negligent Misrepresentation)].

"Certification under subsection (b)(1)(B) . . . must be carefully scrutinized and sparingly utilized." In re Telectronics Pacing Systems, Inc., 221 F.3d 870, 881 (6th Cir. 2000). The principal authority on "limited fund" class action settlements pursuant to Rule 23(b)(1)(B) is the United States Supreme Court's decision in Ortiz v. Fibreboard Corp., 527 U.S. 815 (1999). In Ortiz, the Supreme Court expressed "serious constitutional concerns that come with any attempt to aggregate individual tort claims on a limited fund rationale." Id at 845. The Court noted that "certification of a mandatory class followed by settlement of its action for money damages obviously implicates the Seventh Amendment jury trial rights of absent class members" and "implicate[s] the due process 'principle of general application in Anglo-American jurisprudence that one is not bound by a Judgment *in personam* in litigation in which he is not designated as a party or to which he has not been made a party by service of process.'" Id. at 846. Against the backdrop of these fundamental rights, the Supreme Court cited the Rules Enabling Act's "mandate that 'rules of procedure shall not abridge, enlarge or modify any substantive right.'" Id. at 845. "The Advisory Committee did not envision mandatory class actions in cases like this one, and both the Rules Enabling Act and the policy of avoiding serious constitutional issues counsel against leniency in recognizing mandatory limited fund actions in circumstances markedly different from the traditional paradigm." Id. at 864-65.

The Supreme Court "counseled against 'adventurous application of Rule 23(b)(1)(B)' . . . stressing that a limited construction of the Rule, 'staying close to the historical model . . . avoids serious constitutional concerns raised by the mandatory class resolution of individual legal claims[.]" In re Katrina Canal Breaches Litigation, 628 F.3d 185, 192 (5th Cir. 2010) (citing

Ortiz at 842, 845). "The Court described this 'historical model' of a limited fund as a 'fund with a definitely ascertained limit, all of which would be distributed to satisfy all those with **liquidated** claims based on a common theory of liability, by an equitable, pro rata distribution." Id. at 193. (emphasis added). The Court noted that "classic" examples of the historical model include "claimants to trust assets, a bank account, insurance proceeds, company assets *in a liquidation sale*, [and] proceeds of a ship sale in a maritime accident suit[.]" Id. at 834-35 (citing 1 Newberg § 4.09, at 4–33) (emphasis added); *See also* Telectronics at 877 ("As emphasized in *Ortiz*, the limited fund concept in subsection (b)(1)(B) contemplates a fixed fund in the traditional sense: a fixed resource, such as a mineral deposit, or a fixed amount of money, such as a trust.").

> From its discussion of the historical model, the Court identified three "presumptively necessary" characteristics of a traditional limited fund. Those characteristics are:
>
> (1) the totals of the aggregated liquidated claims and the fund available for satisfying them, set definitively at their maximums, demonstrate the inadequacy of the fund to pay all claims,
>
> (2) the whole of the inadequate fund is to be devoted to the overwhelming claims, and
>
> (3) the claimants identified by a common theory of recovery are treated equitably among themselves.

In re Katrina at 192-93 (quoting Ortiz at 838-39, 841-42).

Ortiz cast doubt on whether a "limited fund" mandatory settlement could *ever* be used in the context of unliquidated tort claims. Ortiz at 864-865 ("Assuming, *arguendo*, that a mandatory, limited fund rationale could under some circumstances be applied to a settlement class of tort claimants"); *see also* Jefferson v. Ingersoll Int'l Inc., 195 F.3d 894, 897 (7th Cir. 1999) ("Earlier this year the Supreme Court stressed that proper interpretation of Rule 23,

principles of sound judicial management, and constitutional considerations (due process and jury trial), all lead to the conclusion that in actions for money damages class members are entitled to personal notice and an opportunity to opt out."). Since Ortiz, the vast majority of courts reviewing 23(b)(1)(B) settlements involving unliquidated tort claims have rejected them *See e.g.*, Telectronics (reversing certification of mandatory settlement class in defective pacemaker personal injury mass tort litigation); Zinser v. Accufix Research Inst., Inc., 253 F.3d 1180 (9th Cir. 2001) (same); In re Simon II Litigation, 407 F.3d 125, 137 (2d Cir. 2005) (reversing certification of mandatory settlement class of cigarette smokers); Elizabeth M. v. Motenez, 458 F.3d 779, 786 n.3 (8th Cir. 2006) ("The district court erred in also certifying the non-opt-out class under Rule 23(b)(1)(B) without considering the impact that adjudication of the broad prayer for declaratory relief might have on class members' damage claims."); In re Katrina (decertifying mandatory settlement class of plaintiffs injured in connection with hurricanes).

While the Barchiesi Objectors contend their claims, as unliquidated tort claims, are not subject to mandatory class treatment under Rule 23(b)(1)(B) for the reasons set forth in Ortiz and its progeny, the Settling Parties have nevertheless failed to meet the three "presumptively necessary" characteristics of a traditional limited fund identified in Ortiz.

A. The Proponents Have Failed to Prove the Requisites of a "Limited Fund"

First, the Settling Parties' attempt to estimate the maximum of all claims, aggregated, falls woefully short of the heightened scrutiny the Court must undertake in the required analysis of a mandatory class settlement, and ignores the admonitions of Ortiz: "[T]he first such hurdle being a computation of the total claims. It is simply not a matter of adding up the liquidated amounts, as in the models of limited fund actions." Ortiz at 850. Simply put, without parsing out the damages of each meritorious claimant, there is only speculation as to what the total

maximum aggregated amount of the unliquidated claims are—this problem confounds not only the question of whether the claims exceed a limited fund, if one exists, but also any attempt at an equitable pro rata distribution based upon the value of each claim as contemplated in the historical model.

Here, there are students who attended CSL both before and after the first finding that CSL was officially out of compliance with ABA Standards. Many of the class members were able to graduate, pass the bar, and obtain gainful employment; others transferred with a substantial amount of their earned credits intact. The question of damages is thus not as simple or broad as merely identifying the total tuition paid during the relevant period as Defendants have suggested. [D.E. 98-7, ¶ 6].

More importantly, the Settling Parties have failed to *prove* the existence of a truly "limited fund" and its upper maximum as contemplated in the historical model.

> [T]he settling parties must present not only their agreement, but evidence on which the district court may ascertain the limit and the insufficiency of the fund, with support in findings of fact following a proceeding in which the evidence is subject to challenge, see *In re Bendectin Products Liability Litigation*, 749 F.2d 300, 306 (C.A.6 1984) ("[T]he district court, as a matter of law, must have a fact-finding inquiry on this question and allow the opponents of class certification to present evidence that a limited fund does not exist")[.]

Ortiz at 850. "[C]ourts have refused to certify a class under subsection (b)(1)(B) unless **all potential sources of recovery** are shown to have limited funds. In re Telectronics Pacing Sys., Inc., 221 F.3d 870, 878 (6th Cir. 2000) (emphasis added) (citing Hum v. Dericks, 162 F.R.D. 628 (D.Hawai'i 1995); In re Dennis Greenman Sec. Litig., 829 F.2d 1539 (11th Cir.1987)).

The first failure comes in the form of the insurance proceeds available to the class. Other than Defendants being "notified" that one policy has been depleted and "advised" of the balance of the remaining policy, the Settling Parties have failed to offer direct admissible evidence

proving the exhaustion of the insurance policies, such as verified itemized breakdowns of the "spent" proceeds available from each insurer. While Ortiz involved litigation between the defendants and their insurers as to the extent of available coverage, there has been no showing here that that the Defendants have made the slightest effort to argue for additional potential coverage. This appears problematic, given the AIG policy at issue was in effect from July of 2016 through July of 2018, yet claims have been asserted as far back as 2013. [D.E. 98-7, p. 17]. *See* Ortiz at 857 (noting changes in insurance policies over the course of relevant class period affected the value of competing claims). It is also noteworthy that, on its face, the AIG policy proclaims the $5,000,000 "limit of liability" to be "annual" with an "aggregate limit" of $8,000,000.00. [D.E. 98-7, p. 100]. Given the apparent assertion that students who graduated as far back as 2013 were injured, it would appear the "annual" limit of the $5,000,000 may not apply.[2] It is also intriguing that while Defendants assert only $2,047,517.90 of the "Chubb" policy "remains," Chubb is nonetheless contributing $2,500,000 to the settlement. [D.E. 98-7, ¶ 12; D.E. 100-9, ¶ 8]. These facts, seemingly ignored by the Settling Parties, certainly beg for intense scrutiny by the Court as to whether there is the potential for additional insurance coverage available to the class (or any subclass).[3]

The second and more obvious failure is the lack of any objective proof that the Defendants are truly limited to a "fund" of $150,000.00, the amount of their personal contribution to the settlement. The "nice round number" certainly appears to be the product of agreement, and not some definite amount sitting in a bank account waiting for distribution. The

[2] It is hard to imagine that a series of omissions and misrepresentations occurring over the span of three years, affecting different students in different years, could constitute one "occurrence" or "claim" under any policy of insurance.

[3] This point also reinforces the benefits to creditors, such as the class members, in a bankruptcy proceeding, where a trustee would be entitled to investigate and pursue litigation on behalf of the debtor for the benefit of the class.

Affidavit of the Defendants' CFO, Scott Thompson, does not even attempt to specify why the Defendants are "limited" to this figure, but instead makes the summary conclusion that "in order to fund the Additional Contribution, Infilaw Corporation will have to forgo paying certain currently due vendor obligations, and therefore this sum is set at its maximum." Such a conclusory, bare bones allegation certainly cannot satisfy the stringent standards set forth in Ortiz.

The issue is only complicated by the fact that the Defendants will not be "liquidated" as contemplated in the historical model, but will remain a going concern with millions of dollars in annual revenues. The Ortiz Court favorably noted the district court's valuation of the defendant therein, which was to remain a going concern after settlement, based upon testimony from multiple experts in attempting to calculate the upper maximum of the "limited fund." Ortiz at 850-51 ("the District Court and the Fifth Circuit concluded that Fibreboard had a then-current sale value of $235 million that could be devoted to the limited fund. While that estimate may have been conservative, at least the District Court heard evidence and made an independent finding at some point in the proceedings."). No such showing of market value has even been attempted in this case. This shortcoming is amplified by the Defendants' initiation, and maintenance, of three lawsuits against the ABA and other defendants seeking substantial monetary damages and injunctive relief that would restore CSL's accreditation.—all of which suggest a company planning to continue operations in the future, and the potential for positive outcomes, both of which would conceivably affect the sale value of the business which could be devoted to the class. By completely failing to address this issue, it is impossible for the Court to determine the "limit" of any fund with the exacting detail required by Ortiz.

Finally, the report of Ed Bowers, a well-qualified forensic accountant, establishes that the information produced by the Defendants to date does not suffice to prove that Defendants are in fact subject to a personal "limited fund" of $150,000.00. [D.E. 174-1, pp. 2-3, 9]. This evidence, from a witness as established and thorough as Bowers, should be enough for the Court to require, in the very least, additional discovery on the assets, liabilities, and sale value of the Defendant.

In summary, the Settling Parties have failed to prove both the aggregate total of the liquidated claims, and the funds available to satisfy them, set definitively at their maximums, in order to establish the inadequacy of the "fund."

B. The Proponents Have Failed to Prove the Whole of the Inadequate Fund is to be Devoted to the Overwhelming Claims

There can be no question that the "whole of the inadequate fund," if such a thing even existed in this case, is not being devoted to the overwhelming claims.

First, the Settling Parties have failed to make an adequate allocation to the class for the value of Defendants' business, which conceivably has some market value given its stream of revenues and continued existence as a "for profit" business. The Settling Parties made an express agreement on the provision of sale proceeds in the event the Defendants sold one or both of their law schools on or before April 20, 2019, but only provided that 10% of the sale proceeds, after exceeding the value of all secured debts and obligations to creditors with priority interests. Ortiz suggests that the Court must determine the value of the Defendants' business and allocate that value to the class. *See* Ortiz at 850 (citing In re Temple, 851 F.2d 1269, 1272 (C.A. 11 1988) ("Without a finding as to the net worth of the defendant, it is difficult to see how the fact of a limited fund could have been established given that all of the defendant's assets are potentially available to suitors."); Id. at 850-51 (citing with approval the lower courts' finding that

"Fibreboard had a then-current sale value of $235 million that could be devoted to the limited fund."); Id. at 860 ("With Fibreboard retaining nearly all its net worth, it hardly appears that such a regime "is the best that can be provided for class members."). Because the Defendants have provided insufficient information to make this determination, because no qualified expert has offered an opinion on the market value and/or net worth of the Defendants, and because the "draft/unaudited" financials they have produced at least disclose the potential for positive market value, the Settling Parties have failed to prove that the "whole" of the inadequate fund has been allocated to the overwhelming claims.

Second, the face of the Settlement Agreement betrays that funds obtained from the ABA litigation, being prosecuted and funded by Defendants with money they claim they don't have, would first go to the Defendants as follows: (a) to satisfy all of their outstanding debts and liabilities *as of the date the payment is received*;[4] (b) any costs, expenses, attorneys' fees, settlement payments owed, or final money judgments, in any then-pending litigation or government investigation owed or incurred as of the date an ABA Litigation Payment is received, and (c) the sum of $6.5 million. [D.E. 100-9, ¶ 10.4]. Only *after* providing the Defendants all of the aforementioned benefits would the first penny go to the class. This allocation gives the Defendants priority against the proceeds of the litigation that is above the class members—a clear contradiction of the mandate in Ortiz at 839 (Noting that in the historical model, "[i]t went without saying that the defendant or estate or constructive trustee with the inadequate assets had no opportunity to benefit himself or claimants of lower priority by holding back on the amount distributed to the class. The limited fund cases thus ensured that the class as

[4] The plain meaning of this language indicates debts and liabilities which Defendants may incur after the settlement date will *ipso facto* take priority over the claims of the class, regardless of the nature of their nature.

a whole was given the best deal; they did not give a defendant a better deal than *seriatim* litigation would have produced.”).

Finally, it cannot be ignored that Defendants have purportedly wasted approximately 75% of the original amount of the alleged “limited funds” available through insurance. [D.E. 98-7, ¶¶ 9-12]. Given Defendants have selectively “wasted” this amount on a variety of matters that benefit themselves, while on notice of the class claims against them, it is hard to fathom that Defendants can equitably obtain the rare benefit of a 23(b)(1)(B) class settlement by electing to surrender the paltry remains of the policies at this late stage. *See* Ortiz at 854 (“It is a fair question how far a natural class may be depleted by prior dispositions of claims and still qualify as a mandatory limited fund class[.]”).

Accordingly, the Settling Parties have objectively failed to prove that the whole of the alleged inadequate fund is being devoted to the overwhelming claims at issue.

C. The Proponents Have Failed To Treat the Claimants Equitably Among Themselves

In examining the equitable treatment of class members in the context of a mandatory 23(b)(1)(B) settlement, “There are two issues, the inclusiveness of the class and the fairness of distributions to those within it.” Ortiz at 854.

1. The proposed class is both over-inclusive and under-inclusive

The Ortiz court focused its analysis of the “inclusiveness” prong on the settlement’s failure to include a large number of similar claimants who appeared to fare better than those covered by the settlement. Id. at 854-55. Here, the opposite problem is presented: the Settling Parties have sought to include a multitude of claims against the limited fund that appear to have little, if any, merit; specifically the claimants whose attendance at CSL pre-dated the main

actionable issue in the case, to wit, the Defendants' failure to disclose the February and July, 2016 official ABA findings that CSL was out of compliance with accreditation standards. Students who attended between 2013 and the Fall of 2015, including those who voluntarily transferred or graduated during that time, were clearly never in attendance at any time in which CSL had been officially found out of compliance, and could not have been damaged by such a failure to disclose. Indeed, the Settling Parties have expressly acknowledged in the Settlement Agreement that students in attendance before the ABA's February 3, 2016 decision first finding noncompliance do not have meritorious claims. [D.E. 100-9, p. 22 (Tier IV explanation: "Appropriately included in fourth tier relief category because CSL attendance preceded February 2016 ABA decision first suggesting non-compliance with relevant ABA Standards; **all other alleged misrepresentation are non-actionable educational malpractice.**" (emphasis added)).

Including these students as class members entitled to obtain substantial benefits under the "tiered" point system only serves to allow those with unmeritorious claims to consume the already meager remains of the alleged "limited fund" available to those harmed the most. Certainly, the Court must be as vigilant against over-inclusiveness that will harm the true victims with actionable claims against a "limited fund," as it is against under-inclusiveness that will harm absentee victims without a representative, particularly in the growing climate of mass-tort litigation, in which lawyers may seek to simply sign up as many potential clients as possible, regardless of the merits of their case, to leverage a seat at the settlement table and a share of substantial fees. *See* Ortiz at 852 (noting that assumptions of unhindered counsel cannot be indulged "in any class action settlement with the potential for gigantic fees.").

Alternatively, if unmeritorious claims must be included under the inclusiveness requirement, or as a practical matter to avoid defeat of the settlement's purpose, a *de minimus*

nominal payment, such as $10.00, may be made to eliminate such a threat without unnecessarily cannibalizing a significant portion of the settlement fund.

On the other hand, the proposed class lacks inclusion of other claims against the alleged "limited fund," which is a marked departure from the historical model. While Defendants assert "numerous other pending and contingent obligations" including its landlord dispute, qui tam lawsuits, credit obligations, and liability to the Department of Education, there is no attempt to force those parties to accept a piece of the alleged "limited fund," nor any explanation how Defendants intend to satisfy those claims. This suggests that either (1) the class will be the recipient of preferential transfers from Defendants, or (2) the fund is not as limited as purported, and Defendants have simply elected to apportion $150,000.00 plus the remains of one insurance policy to establish a limited fund to resolve the instant class claims, while reserving other assets to resolve the claims of the other liabilities. Under the historical model of the "limited fund" mandatory settlement, the Court took control over the fund and distributed it pro rata to all claimants to prevent absentee creditors from losing the opportunity to recover against the fund. Ortiz at 836-37 (citing Hazard, Gedid & Sowle 1915 (purpose of mandatory class action is to prevent creditors who are parties from recovering the fund to the detriment of absentee creditors who would otherwise recover nothing)). It is thus hard to fathom how this settlement fits the historical model (as mandated by Ortiz) yet purports to exclude a sizeable number of claimants to the alleged "limited fund" from the settlement. The Barchiesi Objectors contend this proposition is clear evidence that the Defendants have additional funds at their disposal with which they intend to pay some or all of the other outstanding claims.

2. The settlement fails to ensure equitable treatment among class members

The terms of the Settlement Agreement establish that the Settling Parties recognize, at a minimum, that there are vast disparities in the viability and/or quality of claims included within the settlement class; the "tiered point system" suggesting some class members will receive at least 25 times the amount other class members will receive. [D.E. 100-9, pp. 19-22]. Clearly then, there are intra-class conflicts borne out of the competition between the different "tiers" of claimants as to the alleged limited fund.

This "disparate treatment" of different class members runs afoul of the parameters set forth in Ortiz to ensure equitable treatment among class members, namely, the requirement of competing subclasses with independent counsel. Ortiz at 855 ("[E]ven ostensible parity between settling nonclass plaintiffs and class members would be insufficient to overcome the failure to provide the structural protection of independent representation as for subclasses within conflicting interests."). The Ortiz court pointed again to the historical models of mandatory class settlements:

> On the second element of equity within the class, the fairness of the distribution of the fund among class members, the settlement certification is likewise deficient. Fair treatment in the older cases was characteristically assured by straightforward pro rata distribution of the limited fund. See *supra*, at 2312. While equity in such a simple sense is unattainable in a settlement covering present claims not specifically proven and claims not even due to arise, if at all, until some future time, at the least such a settlement must seek equity by providing for procedures to resolve the difficult issues of treating such differently situated claimants with fairness as among themselves.

Id at 855-56. The Court went on to state, "Assuming, *arguendo*, that a mandatory, limited fund rationale could under some circumstances be applied to a settlement class of tort claimants, it would be essential that . . . **intraclass conflicts [be] addressed by recognizing independently represented subclasses**." Id. at 864-65 (emphasis added).

In this case, counsel for the class have purported to represent all class members together, irrespective of the intraclass conflicts and without subdivision into any formal subclasses. Notably, none of the related class action complaints purported to make claims on behalf of students who attended prior to the fall of 2014, [D.E. 78, ¶ 105 ("Defendants knew as early as September 2014 that its ABA accreditation was in jeopardy.")],[5] but have nevertheless agreed to include claimants from 2013 in the class and resolve their claims in absentia at a fraction of what other claimants are entitled to recover. [D.E. 100-9, p. 22]. The temporal distinction between claims requiring subclasses with separate counsel was recognized in Ortiz and its progeny. Id at 857, In re Cmty. Bank of N. Virginia Mortg. Lending Practices Litig., 795 F.3d 380, 394 (3d Cir. 2015) ("If the District Court determines that any subclass's equitable tolling arguments fail, it may well be necessary to appoint separate counsel to represent newly divergent interests."); *See also* In re Literary Works in Elec. Databases Copyright Litig., 654 F.3d 242, 252 (2d Cir. 2011) (Holding even intense, protracted, adversarial mediation, with some structural assurance of fair and adequate representation, failed to satisfy requirements set down by Supreme Court).

The resort to a "claims made" settlement process also poses the risk of inequitable treatment. Namely, class members who were personally represented by counsel before settlement will be virtually guaranteed to have notice of the settlement and submit timely claims, while absentees will, statistically and historically speaking, be far less likely to receive Notice and submit a claim. *See e.g.* Claims-Made Class Action Settlements, Judicature, Duke University,

[5] It must be stressed that this assertion appears to be a misreading of the facts. The ABA first indicated it had "reason to believe" CSL "had not demonstrated compliance" with ABA Standards 301(a), 501(a), 501(b), and interpretation 501-1 on February 24, 2015. However, the ABA did not make a decision that CSL was out of compliance with said standards until February 3, 2016, after further investigation. [D.E. 78, ¶¶ 44-49].

Volume 99, No. 3, Winter 2015[6], p. 82 ("[C]laims rates are relative low – usually under 10 percent and frequently less than 1 percent."). The result will be that those who either don't receive notice, or otherwise fail to timely submit a properly completed claim form, will be deprived of their constitutional rights of Due Process and trial by jury, and receive nothing in return. *See* Jefferson, 195 F.3d at 897 ("[C]onstitutional consideration (due process and jury trial), all lead to the conclusion that in actions for money damages class members are entitled to personal notice and an opportunity to opt out.""). By operation of the Settlement Agreement, the claimants will then divide the residual of the limited fund—meaning, represented claimants (including unmeritorious claimants) stand to have a windfall at the expense of meritorious class members who either don't receive notice or fail to submit a properly completed claim form. More equitable treatment would be direct allocation and disbursement of each class members' share of the alleged "limited fund."

Additionally, as set forth above, the Settling Parties have acknowledged that claims based upon attendance pre-dating February of 2016 are "not actionable," and therefore said claimants should not be equitably be entitled to a share of the limited fund with the meritorious claimants, or at most, should only be afforded a *de minimus* nominal payment of an amount such as $10.00.

Accordingly, because there was a failure to create formal subclasses of the competing claims before settlement, with independent representation, and because the disparate relief of different subclasses in some aspects appear to be based on nothing more than a ransom to unmeritorious claims, the Settlement Agreement fails to meet the requirement of "fair and equitable treatment" among class members.

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[6] Available at https://judicialstudies.duke.edu/sites/default/files/centers/judicialstudies/judicature/judicature-vol99-no3_point-counter.pdf

II. THE SETTLEMENT IS NOT FAIR, ADEQUATE, OR REASONABLE

Rule 23(e)(2) requires the Court to approve a binding class action settlement only if the settlement is "fair, adequate, and reasonable" considering the factors listed therein. As shown below, the Settlement is not fair, adequate, or reasonable.

First, the class representatives and class counsel have not adequately represented the class. In addition to the failure to divide the class into subclasses with separate representation, and provide equitable treatment, as required by Ortiz, class counsel in this case have failed to conduct due diligence into the basis for the alleged limited fund. As previously stated, class counsel have not conducted a single deposition on the merits of the case or the settlement, including the Defendants' allegation that they are "limited" to contributing $150,000.00 to the settlement. In a stark contradiction to the notion of "due diligence," class counsel simply accepted the Defendants' assertions of poverty at mediation, accepted the first amount proposed by the Defendants, and agreed verification of the Defendants' financial condition would be assured through an affidavit from one of Defendants' officers, which attached "draft unaudited" and/or "pro forma" financial statements. Stated differently, class counsel failed to make even a passing attempt to scrutinize the veracity of the figures offered or push for additional documentation. Notably, the Defendants have not produced critical audited financial statements or even a filed tax return—which would conceivably be the bare minimum expected before compromising thousands of class claims for a pittance. It is troubling that class counsel purport to have expended $35,773.82 in prosecuting this action, [D.E. 145, ¶ 2], but declined to spend a fraction thereof to retain a forensic accountant to review the Defendants' submissions and scrutinize the existence of a true "limited fund." As the report of Edward Bowers makes clear,

there is simply not enough objective evidence in the Defendants' submissions to prove the existence of a limited fund as alleged.

Second, while the negotiations appeared to be "at arm's length," there were certainly elements that bore a collusive tone. For example, undersigned counsel attended the mediation in April of 2018, and witnessed the Defendants propose the tiered point system almost identical to the one being utilized in the opening session on the first day. Given the lack of due diligence by class counsel, their adoption of the Defendants' position on its inability to pay, and the virtually un-negotiated sum the Defendants agreed to pay, coupled with the sizeable fee class counsel seeks to be awarded to close the case, and the entirely one-sided provisions dealing with disbursement of any proceeds from Defendants' suits against the ABA, there at least appeared to be a lack of diligent, zealous adversarial negotiation, resulting in an excellent deal for the Defendants (discharging thousands of claims without resort to bankruptcy for the sum of $150,000, and thereafter being free to conduct business unhindered going forward).

Next, the relief to be afforded to the class is not adequate. Given the facts of the case concerning Defendants' liability have largely been established, and even admitted by the Defendants, *See* page 2, *supra*, the costs and risks of trial should be minimal, relatively speaking. While delay is a factor to be considered, the Court cannot look to exigency as justification for departing from rigorous adherence to the requirements of a mandatory class. *See* Ortiz at 862 (rejecting the proposition that the Court can lower the structural requirements of Rule 23(a) to justify mandatory class treatment on a limited fund theory merely because "the clock is about to strike midnight.").

If the Defendants are in as dire financial straits as they contend, the appropriate avenue is bankruptcy. *See* In re Telectronics Pacing Sys., Inc., 221 F.3d 870, 880 (6th Cir. 2000)

("Presumably *all* companies have limited funds at some point—there is always the possibility that a large mass tort action or other litigation will put a company into bankruptcy. Should that eventuality threaten, we have a comprehensive bankruptcy scheme in this country for just such an occurrence. Simply demonstrating that there is a possibility, even a likelihood, that bankruptcy might at some point occur cannot be the basis for finding that there is a 'limited fund' in an ongoing corporate concern. The district court cannot discharge the debt in advance of the occurrence, thereby usurping the bankruptcy scheme through settlement, even it believes such an avenue to be in the best interests of most of the plaintiffs."). "Moreover, bankruptcy would require vigorous examination of administrative expenses, including attorneys' fees, and would provide for a creditors' committee that would examine all claims and could object to any claim it found excessive." Id.; *See also* [D.E. 174-1, p. 9 ("In comparison, had the defendants filed for bankruptcy, the required disclosures in the schedules to the petition and the statement of financial affairs would be far more detailed.")]. It should also be concerning that Defendants, through this process, will effectively liquidate a substantial number of unliquidated claims to certain liabilities that are trivial compared to what the meritorious claimants could hope to achieve at trial, and were Defendants to immediately file bankruptcy, this settlement could prove detrimental to the class as against other unsecured creditors by minimizing their share of unencumbered assets.

It should also be noted that the Settlement Agreement preserves claims against parent companies (the "Sterling Entities") "that have a direct ownership interest in and direct operation control over CSL, and any member or officer of the foregoing acting on behalf of the foregoing." While claims under a theory of direct control and supervision are not compromised, settling the claims against the Defendants with no admission of liability would certainly complicate any

attempts to obtain recovery that are premised upon indirect liability of parent entities due to the Defendants' inability to satisfy a judgment.

Nor is the proposed method of distributing relief to the class effective. There can be no question that Defendants know each and every class member, given they attended Defendants' institution between 2013 and 2017, and Defendants undoubtedly carefully documented information for each student. Nor can there be any doubt that Defendants know when each class member attended CSL. The Settling Parties represent that they have the means to provide adequate notice to the class, estimated to be approximately 2,500 former students, primarily through direct mail and email [D.E. 98-1, pp. 12-14; D.E. 98-6, ¶¶ 18-22]. However, the Settlement Agreement resorts to using a "claims made" process, whereby each potential claimant will have to respond to the Notice by completing and returning a detailed questionnaire concerning their history of attendance at CSL. [D.E. 98-3, p. 54]. Typically, a "claims made" process is utilized when the identity and location of numerous class members is difficult to ascertain. *See, e.g.* Claims-Made Class Action Settlements ("Claims made settlements are typically utilized in retail consumer claims class actions when defendants do not have records of the identities of purchasers or the number or amount of their purchases. Hence, some affirmative action by class members is required to distribute settlement proceeds."). It stands to reason that if the Settling Parties know the identity, contact information, and attendance information for each class member, the settlement fund could be distributed without resorting to requiring class members to submit claims forms and answering questionnaires that pose a greater likelihood of creating burdens to relief for meritorious claimants than providing them the relief afforded.

The terms of the proposed award of attorneys' fees are also problematic. Class counsel has submitted a single Declaration, by one out of state lawyer, on behalf of at least six different

law firms, attesting to the investment of time and expense by each. [D.E. 145-3]. Given the Settling Plaintiffs' counsel seek to consume in excess of $433,000.00 in attorneys' fees and expenses, of an alleged "limited fund" of only $2,650,000 to be divided amongst approximately 2,500 claimants, it would seem a greater degree of scrutiny on the basis for the fee should be undertaken, particularly considering the case did not involve a single deposition on the merits, no adversarial discovery on the merits of the settlement, nor any substantive motions practice beyond motions to dismiss. Nor was any class certified prior to settlement.

Finally, as previously set forth herein, the Settlement fails to treat class members equitably relative to each other.

Accordingly, the proposed Settlement is not fair, adequate, or reasonable within the meaning of Rule 23(e)(2), and should not be approved in its current form.

CONCLUSION

For the reasons stated herein, and as otherwise set forth in the Notices of Objection filed by the Barchiesi Objectors, the Court should deny certification of the settlement class and deny approval of the Settlement Agreement.

Respectfully submitted this 26th day of November, 2018.

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CERTIFICATE OF SERVICE

I hereby certify that on November 26, 2018, I electronically filed the foregoing **PLAINTIFFS' MEMORANDUM IN SUPPORT OF MOTION TO LIFT STAY AND PERMIT LIMITED DISCOVERY** with the Clerk of the Court using the CM/ECF system which will send notification of such filing to the following: Johnny M. Loper, Esq.; Debbie W. Harden, Esq.; Sarah Motley Stone, Esq.; David E. Mills, Esq.; Michael D. Hays, Esq., Noah Abrams, Douglas Abrams, Timothy Baily, D. Blake Carter, Jr., and Taylor M. Norman.

By: /s/ *Kyle J. Nutt*