You'll Get Nothing and Like It!

CAFA's Efforts to Provide Real and Substantial Relief to Class Members by Scrutinizing Coupon Settlements

by James J. Ferrelli and Christopher L. Soriano

In years past, class action settlements—particularly those in state courts around the country—received little scrutiny. The common thinking was that if class counsel, whose job is to represent the interests of the class members, and the defendant could agree on a solution, courts were happy to allow the parties to resolve the disputes on their own terms and fashion their own remedy. One of the most common remedies was the coupon settlement, in which injured class members received coupons from the defendants who allegedly injured them. Often, the coupons required the purchase of additional products in order for the class member to receive a benefit. Typically, the cash in these settlements would end up as attorneys' fees to class counsel.

The problem with this method is that it frequently provided little, if any, relief to injured class members. In order to get the benefit of the settlement, the class member would have to purchase another product from the defendant or a related company, thus rewarding the defendant for its alleged wrongdoing to the plaintiff class. Some egregious circumstances arose, such as the 'net loss' settlement, in which a class member ended up obligated to pay attorneys' fees to class counsel that exceeded the class member's recovery. These situations created the perception—demonstrably true in some cases—that class actions were being abused as a mechanism to create a windfall of fees for class action attorneys while providing little or no real benefit or justice to the parties or society at large.

All of these issues led Congress, in 2005, to enact the Class Action Fairness Act (CAFA). In addition to expanding federal court jurisdiction in order to allow more class actions to be heard in federal court, CAFA included provisions that required greater scrutiny of coupon settlements and net loss settlements. CAFA also required notification to the United States attorney general and the attorney general of any state in which a class member lived, in order to allow those officials to review the proposed settlement and seek to intervene if they believe it appropriate.

This article reviews the problems with coupon settlements that led to CAFA, CAFA's provisions relating to coupon settlements, and how the courts have implemented these provisions.

The Identified Problem—Coupon Settlements: "Papa Says He Knows That I Don't Have Any Money"

In recommending to the Senate that CAFA be enacted, the Senate Judiciary Committee issued a report discussing the need for CAFA and its purposes.[1] The committee observed that state courts were "readily approving class action settlements that offer little—if any—meaningful recovery to the class members and simply transfer money from corporations to class counsel."[2] The committee identified class action settlements approved in state courts where the class members each received $8.76, while class counsel received $8.5 million.[3] Some class members were charged an $80 expense fee, resulting in the class members losing money as a result of the settlement.

At the heart of the committee's concern was the "coupon settlement," which the committee described as a settlement where the class member receives nothing more than a promotional coupon that could only be used to purchase more products from the defendants.[4] The committee was particularly concerned with settlements containing promotions that resulted in a benefit to the defendant and attorneys' fees for the plaintiffs' attorneys, but provided little meaningful recovery for the class members.

In one example of a problematic case noted by the committee, a defendant toy store held a 30 percent off sale for a week in order to settle a deceptive pricing class action. All of the cash in the settlement went into attorneys' fees. Another case concerning deceptively sized beer mugs was settled for 50,000 $1 coupons, while all of the cash went to attorneys' fees. In another example, consumers received $1 off rentals from a video store, while plaintiff class attorneys received a fee award of over $9 million. A study predicted that only 20 percent of the class members who received coupons would actually use them.

CAFA's Proposed Solution to Bogus Coupon Settlements

CAFA purported to address issues arising from insufficient recovery for class members by enacting the colloquially known Consumer Class Action Bill of Rights; 28 U.S.C. Section 1712(a) deals with contingent fees in class actions based on coupons. If a portion of the fee award to class counsel is based on the value of the settlement, then the value of the coupons is to be computed based on the number of coupons actually redeemed, not merely the number of coupons issued. In light of the 20 percent response rate discussed above, this provision establishes a disincentive to using illusory coupon settlements as part of a settlement containing a contingent fee for attorneys.

In other class actions involving coupons, if the attorneys' fees are not based on the coupons, they must be based on the amount of time class counsel reasonably expended on the case, subject to court approval.[5] The court may, in its discretion, receive expert testimony on the actual value to the class members of the coupons redeemed in order to arrive at a fee award.[6] In a settlement where the class members are to be awarded coupons, the court may approve the settlement only after a hearing to determine whether it is fair, reasonable and adequate.[7] The court is required to make written findings, supported by an appropriate evidentiary record, that the settlement is fair, reasonable and adequate.[8]

CAFA also prohibits the approval of a net loss settlement—one in which any class member is obligated to pay class counsel an amount in excess of that class member's recovery—unless the court finds, in writing, that the nonmonetary benefits to the class member substantially outweigh the monetary loss.[9]

Another manner of scrutiny that CAFA establishes is review by federal and state officials. CAFA provides that within 10 days of the filing of a proposed settlement with the court, the defendant must provide notice to an "appropriate state official"—typically the state's attorney general—in any state in which a class member resides.[10] The defendant must also notify the U.S. attorney general.[11] The defendant must provide a copy of the complaint, any scheduled hearing, the notice to class members, the proposed settlement, and other relevant documents. A court may not grant final approval to a proposed settlement until 90 days after service of this notice. If notice is not provided, a class member may refuse to be bound by the settlement agreement.

On their face, CAFA's provisions certainly seem to address those cases in which a class action settlement involving the distribution of coupons to class members provides only an illusory benefit to the entire class, or in which the class as a whole obtains no benefit from the settlement. But how have these provisions played out in the courts?

Radio Shack's Coupon Plan

A recent decision from the U.S. Court of Appeals for the Seventh Circuit demonstrates the enhanced scrutiny that coupon settlements receive under CAFA.[12] Radio Shack attempted to settle a class action under the Fair and Accurate Credit Transaction Act (FACTA), which allows statutory damages where a retailer prints a full expiration date of a credit card on a retail receipt. The settlement agreement proposed that each class member who registered for benefits would receive a coupon for $10, to be used in Radio Shack, with a six-month expiration date. If a customer purchased a product for less than $10, they would not receive change. A customer could "stack" up to three coupons, but since each class member could only receive one coupon the class member would have to obtain additional coupons elsewhere.

The court noted that it was unlikely any customer would buy a product worth less than $10, because the customer would forfeit the remaining balance. Therefore, the court concluded that the only realistic way for a class member to receive a benefit would be through spending additional money on a product, which would be a significant benefit to Radio Shack. This was troubling to the court.[13]

The value of the benefit to the class relative to the counsel fee was also troubling. The court also found that, at best, the total amount of coupons would be $830,000, while class counsel was seeking an award of $1 million.[14] But the court concluded that the $830,000 number was inflated because some recipients would lose the coupon, forget about it, not have it with them when shopping, or let it expire. As a result, the court determined the benefits to the class, versus the benefit to class counsel, were so disproportionate it required reversing the district court's order granting final approval to the settlement.

A Failing Grade for Classmates.com

Similarly, a recent case from the Western District of Washington demonstrates how the lack of class-wide participation in a coupon program, and the requirement that class members spend money to obtain class benefits from a coupon program, can combine to undermine a class settlement. The social networking site Classmates.com allowed anyone to sign up for free. However, as a marketing device the site would then notify them that while other customers had viewed their profile in order to learn their identities a premium membership would have to be purchased.[15] Excited to reconnect with former classmates, these users were often disappointed to find that, in fact, no one had viewed their profile.[16] Accordingly, plaintiffs asserted that defendant Classmates.com had engaged in a fraudulent scheme to drive up business.

In a negotiated settlement, class members were offered either a $2

coupon to use toward purchasing a membership or those who had purchased a membership were offered the option to claim $3 in cash instead of the $2 coupon.[17] Only 33,000 out of 8.5 million potential class members asked for the coupon and 17,000 asked for the cash; the remainder did not participate.[18] The court quickly rejected the coupon, finding it was being offered primarily to class members who never spent money on a membership and, as a result, in order to obtain any benefit those class members would have to spend money.[19] The court concluded the coupon "was a benefit to Classmates alone," and was, therefore, unfair and unreasonable to the class.[20]

West Publishing's Coupon Plan Goes South

In a case that will surely hit home with many lawyers, a California federal court rejected a coupon settlement in an antitrust case brought against West Publishing, the producer of the Bar/Bri bar review course. The plaintiffs in this case alleged that defendant West and its competitor, defendant Kaplan, had conspired to artificially inflate the cost of bar review courses. One aspect of the proposed settlement was a certificate that would entitle the class member to a credit toward a future class offered by Kaplan.[21] But Kaplan was no longer in the bar preparation class business and, even if it were, the class members were mostly students who had already taken a bar exam.[22] So why would they want to take an exam preparation course in some other field when they were already members of the greatest profession in the world?

Applying CAFA's enhanced scrutiny to the coupon aspect of the settlement, the court categorically rejected the settlement.[23] The court noted that the value to the class "was most troubling" to the court and that "because of the nature of the services for which they may be redeemed and the career choices of the class members," the coupons were essentially valueless to the class members.[24] The court observed an expert had testified that the coupon redemption rate would be approximately one percent.[25] The expectation was that the class members would resell their coupons on a secondary market in order to obtain value for them.[26] The court concluded that the vast majority of class members would obtain no value from the coupons. Moreover, the court was troubled that the coupons had the effect of encouraging further business with the defendants, rather than disgorging their ill-gotten gains. In short, the court rejected the settlement as not fair, reasonable or adequate under Rule 23.[27] As a postscript, the parties later reached a new settlement that provided for cash payments to class members rather than coupons.[28]

39 Lawyers Agree on Something: DirectBuy's "Thank You Sir, May I Have Another" Settlement is No Good

The notice to federal and state authorities provision of CAFA has also influenced judicial decisions regarding whether to certify class actions. In one case, the attorneys general of 37 states plus Puerto Rico and the District of Columbia filed an *amicus* brief objecting to the approval of a class settlement that called for an in-kind form of relief.[29]

The settlement agreement sought to resolve claims of misrepresentation and fraud against DirectBuy, a service that purported to offer its members products at manufacturer's rather than retail prices.[30] However, membership in Direct Buy required an initial fee of several thousand dollars, plus an approximate $200 renewal fee.[31] The proposed benefit to the class was a minimum of two free months of membership, and up to four free months of membership if a customer purchased a two-year renewal.[32] The attorneys general argued that this settlement provided little or no value to class members, and the court agreed. The court noted the dollar value of the settlement did not represent its actual cost to DirectBuy, and resulted in a benefit to DirectBuy in the form of retention of members.[33]

The court rejected the settlement as unfair and inadequate.[34]

Conclusion

The use of coupons may once have been an effective and efficient way to settle a class action. However, providing benefits by distributing coupons to class members was and remains a practice with the potential to create settlements providing little value to class members but huge attorneys fee awards and a disproportionate business benefit to class action defendants.

CAFA, however, has changed the landscape of class action settlements in which coupons are used to provide a remedy to class members. Post-CAFA cases demonstrate that federal courts are not hesitant to reject coupon settlements, especially where the value of those coupons is disproportionate to the amount of attorneys' fees awarded to class counsel. This is particularly true in situations where the class member is required to spend additional money with the defendant in order to receive the benefit of the coupon.

While CAFA has not completely abrogated the use of coupons in class action settlements, the takeaway from the still-evolving case law under CAFA is that courts reviewing class action settlements involving the distribution of coupons to the class will, under CAFA, look closely at the actual benefits provided across the class by the coupon program. Therefore, as part of settlement negotiations, prudent counsel for both plaintiffs and defendants in class actions should perform a careful analysis of the actual and likely impact of coupons on both the plaintiff class and the defendants, and be

prepared to demonstrate to the court that the coupons will provide a real and substantial benefit across the class, as opposed to an illusory or hypothetical benefit, or a benefit to only a small portion of the class. Careful review and analysis of this issue should begin early in the settlement process and continue throughout the process, so judicial rejection of proposed class settlements may be avoided. ⚖

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ENDNOTES

1. Sen. Rep. 109-14, Feb. 28, 2005.
2. *Id.* at 4.
3. *Id.* at 14.
4. *Id.* at 16.
5. 28 U.S.C. § 1712(b).
6. 28 U.S.C. § 1712(d).
7. 28 U.S.C. § 1712(e).
8. *Id.*
9. 28 U.S.C. § 1713.
10. 28 U.S.C. § 1715(b).
11. A limited exception to this arises when the defendant is a federally supervised bank, in which case notice must be provided to the appropriate federal regulator rather than the attorney general.
12. *Redman v. RadioShack Corporation*, 769 F.3d 622 (7th Cir. 2014).
13. *Id.* at 628-30.
14. *Id.*
15. *In re Classmates.com Consolidated Litig.*, No. C-09-45 (W.D. Was. Feb. 23, 2011)(slip op. at 2-3).
16. *Id.*
17. *Id.* at 3.
18. *Id.* at 4-5.
19. *Id.* at 6.
20. *Id.*
21. Transcript of Oral Decision, *Stetson v. West Publishing Corp.,* No. 08-810-R (C.D. Cal. June 20, 2011) at 13.
22. *Id.*
23. *Id.* at 14.
24. *Id.* at 13.
25. *Id.* at 13-14
26. *Id.*
27. *Id.* at 14.
28. Stipulation and Settlement Agreement, March 18, 2013.
29. *Wilson v. DirectBuy, Inc.*, No. 09-cv-590 (D. Conn. May 16, 2011) (slip op.).
30. *Id.* at 2-3.
31. *Id.*
32. *Id.*
33. *Id.* at 13-14.
34. *Id.* at 32.