10-3618(L), 10-3651(XAP), 10-3652(XAP), joined 10-3798

IN THE

United States Court of Appeals

FOR THE THIRD CIRCUIT

Docket No. 10-3618(L)

JOHN M. DEWEY; PATRICK DEMARTINO; PATRICIA ROMEO; LYNDA GALLO; RONALD B. MARRANS; EDWARD O. GRIFFIN,
on behalf of themselves and all others similarly situated,

v.

VOLKSWAGEN AKTIENGESELLSCHAFT; VOLKSWAGEN BETEILIGUNGS GESELLSCHAFT M.B.H.; VOLKSWAGEN GROUP OF AMERICA, INC. (formerly known as VOLKSWAGEN OF AMERICA, INC.); AUDI AG; VOLKSWAGEN GROUP OF AMERICA, INC., d/b/a AUDI OF AMERICA, INC.; AUDI OF AMERICA, LLC; VOLKSWAGEN DE MEXICO, S.A. DE C.V.

(D.N.J. 07-cv-02249)

(Additional Caption On the Reverse)

On Appeal from the United States District Court for the District of New Jersey

Fourth-Stage Reply and Response for Appellants/Cross-Appellees Joshua West, Lester Brickman, Darren McKinney, and Michael Sullivan

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JACQUELINE DELGUERICO; LYNDA GALLO; FRANCIS NOWICKI; KENNETH BAYER,
individually and on behalf of all others similarly situated,

v.

VOLKSWAGEN AMERICA, INC.; VOLKSWAGEN GROUP OF AMERICA, INC.;
VOLKSWAGEN OF AMERICA, INC., d/b/a AUDI OF AMERICA, INC.;
VOLKSWAGEN AG; AUDI AG; VOLKSWAGEN DE MEXICO, S.A. DE C.V.;
ABC ENTITIES 1-20,

(D.N.J. 07-cv-02361)

LESTER BRICKMAN, DARREN MCKINNEY, MICHAEL SULLIVAN, JOSHUA WEST,

Appellants.

Docket No. 10-3651(XAP)

JOHN M. DEWEY; PATRICK DEMARTINO; PATRICIA ROMEO;
RONALD B. MARRANS; EDWARD O. GRIFFIN,
on behalf of themselves and all others similarly situated,

v.

VOLKSWAGEN AKTIENGESELLSCHAFT; VOLKSWAGEN BETEILIGUNGS
GESELLSCHAFT M.B.H.; VOLKSWAGEN GROUP OF AMERICA, INC.
(formerly known as VOLKSWAGEN OF AMERICA, INC.); AUDI AG;
VOLKSWAGEN GROUP OF AMERICA, INC., d/b/a AUDI OF AMERICA, INC.;
AUDI OF AMERICA, LLC.; VOLKSWAGEN DE MEXICO, S.A. DE C.V.,

(D.N.J. 07-cv-02249)

JACQUELINE DELGUERICO; LYNDA GALLO; FRANCIS NOWICKI; KENNETH BAYER;
individually and on behalf of all others similarly situated,

v.

VOLKSWAGEN OF AMERICA, INC.; VOLKSWAGEN GROUP OF AMERICA, INC.;
VOLKSWAGEN OF AMERICA, INC., d/b/a AUDI OF AMERICA, INC.;
VOLKSWAGEN AG; AUDI AG; VOLKSWAGEN DE MEXICO, S.A. DE C.V.;
ABC ENTITIES 1-20,

(D.N.J. 07-cv-02361)

VOLKSWAGEN GROUP OF AMERICA, INC. s/h/a VOLKSWAGEN OF AMERICA, INC.,
VOLKSWAGEN AG, VOLKSWAGEN DE MEXICO, S.A. DE C.V.,
AUDI OF AMERICA, LLC, AUDI AG, and
VOLKSWAGEN BETEILIGUNGS GESELLSCHAFT M.B.H.,

Appellants.

(Additional Caption On the Following Pages)

Docket No. 10-3652(XAP)

JOHN M. DEWEY; PATRICK DEMARTINO; PATRICIA ROMEO;
RONALD B. MARRANS; EDWARD O. GRIFFIN,
on behalf of themselves and all others similarly situated,

v.

VOLKSWAGEN AKTIENGESELLSCHAFT; VOLKSWAGEN BETEILIGUNGS
GESELLSCHAFT M.B.H.; VOLKSWAGEN GROUP OF AMERICA, INC.
(formerly known as VOLKSWAGEN OF AMERICA, INC.); AUDI AG;
VOLKSWAGEN GROUP OF AMERICA, INC., d/b/a AUDI OF AMERICA, INC.;
AUDI OF AMERICA, LLC.; VOLKSWAGEN DE MEXICO, S.A. DE C.V.,

(D.N.J. 07-cv-02249)

JACQUELINE DELGUERICO; LYNDA GALLO; FRANCIS NOWICKI;
EDWARD O. GRIFFIN; KENNETH BAYER;
individually and on behalf of all others similarly situated,

v.

VOLKSWAGEN AMERICA, INC.; VOLKSWAGEN GROUP OF AMERICA, INC.;
VOLKSWAGEN OF AMERICA, INC., d/b/a AUDI OF AMERICA, INC.;
VOLKSWAGEN AG; AUDI AG; VOLKSWAGEN DE MEXICO, S.A. DE C.V.;
ABC ENTITIES 1-20,

(D.N.J. 07-cv-02361)

JOHN M. DEWEY, PATRICK DEMARTINO, PATRICIA ROMEO,
RONALD B. MARANS, EDWARD O. GRIFFIN,
JACQUELINE DELGUERICO, LYNDA GALLO, FRANCIS NOWICKI, KENNETH BAYER,

Appellants.

Docket No. 10-3798

JOHN M. DEWEY; PATRICK DEMARTINO; PATRICIA ROMEO;
RONALD B. MARRANS; EDWARD O. GRIFFIN;
on behalf of themselves and all others similarly situated,

v.

VOLKSWAGEN AKTIENGESELLSCHAFT; VOLKSWAGEN BETEILIGUNGS GESELLSCHAFT M.B.H.; VOLKSWAGEN GROUP OF AMERICA, INC. (formerly known as VOLKSWAGEN OF AMERICA, INC.); AUDI AG; VOLKSWAGEN GROUP OF AMERICA, INC., d/b/a AUDI OF AMERICA, INC.; AUDI OF AMERICA, LLC; VOLKSWAGEN DE MEXICO, S.A. DE C.V.,

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VOLKSWAGEN AMERICA, INC.; VOLKSWAGEN GROUP OF AMERICA, INC.; VOLKSWAGEN OF AMERICA, INC., d/b/a AUDI OF AMERICA, INC.; VOLKSWAGEN AG; AUDI AG; VOLKSWAGEN DE MEXICO, S.A. DE C.V.; ABC ENTITIES 1-20,

(D.N.J. 07-cv-02361)

DANIEL SIBLEY, DAVID STEVENS,

Appellants.

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Introduction

West's opening brief identified several independent grounds for reversal of this unfair settlement that arbitrarily excluded over a million class members from reimbursement, even though their claims were indistinguishable from favored "Subclasses" that were eligible for full compensation. While the appellees engage in a variety of attacks on West's counsel relating to issues that have nothing to do with this appeal, they do not dispute that:

- no class representatives belonged to the unreimbursed and uncertified "Subclass 7" (West Br. 30–33);
- though the district court's sole reason for justifying exclusion of "Subclass 7" members from reimbursement was the difference in claim rates, several model years of vehicles in "Subclass 7" had higher claim rates than vehicles in the favored "Subclasses" (West Br. 33–35);
- there is no record evidence that the legal claims "Subclass 7" are qualitatively worse than the claims of favored "Subclasses" (West Br. 35–36);
- to the extent that the parties are claiming that "Subclass 7" does have qualitatively different claims from other "Subclasses," *Wal-Mart v. Dukes* precludes class certification of the single settlement class—indeed, neither appellee brief mentions *Wal-Mart* (West Br. 35–36);
- the district court applied the wrong standard for evaluating Rule 23(a)(4) adequacy by requiring a showing that an intraclass conflict was "apparent, imminent and on an issue at the very heart of the suit." (West Br. 36–38);
- the flawed methodology of the sole expert witness testifying to the improbable multi-million-dollar valuation of an "educational letter" would

lead to the absurd result that an advertisement for an iPad is worth as much as the iPad itself, or that his expert report omitted any discussion of the offsetting costs of this relief to the class (West Br. 44–46); or

- there was no order requiring objectors who filed a notice of appearance to give additional advance notice of the interest in cross-examining expert witnesses at a fairness hearing (West Br. 46–47).

Any of these by themselves is sufficient to require reversal. But even where the appellees do contest West's arguments, they resort to extra-record claims, misstatements of the facts, and flawed legal analyses. The plaintiffs, perhaps recognizing that the settlement as written is untenable, go even farther and argue that the settlement is fair because it provides relief that the district court and their own expert said it doesn't.

The settlement requires reversal. The Court should take the additional opportunity to clarify existing precedent by adopting Section 3.05 of the *ALI Principles*, which the appellees do not dispute is consistent with existing precedent and is good public policy.

The plaintiffs and defendants each raise a variety of erroneous legal arguments on cross-appeal; to the extent this Court reaches these arguments, West requests that the Court adopt West's reasoning for evaluating them.

I. Two Separate Intra-Class Conflicts Preclude Settlement Approval.

The settlement is unfair because of two separate independent intra-class conflicts that impermissibly prejudice the rights of unrepresented (and uncertified) "Subclasses" of class members, in particular "Subclass 7," a million-vehicle "Subclass"

with thousands of damaged vehicles that were not entitled to the same reimbursement that favored "Subclasses" received.[1]

Neither set of appellees refute West's argument that there is an inherent conflict between class members with potential future claims and those who have already experienced water damage. Furthermore, appellees have not shown that the categorization of class members that resulted in the exclusion of monetary benefits to one uncertified "Subclass" in the single settlement class was based on a legitimate—or even a permissible—factor. Nor have they shown that this group was represented by a named plaintiff that would advance their interests adequately. This structural flaw of lack of adequate representation as well as the inherent conflict between class members renders the settlement legally improper.

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[1] Defendants insinuate that the "Subclass 7" designation to refer to the uncertified subclass of disfavored car-owners is an invention of the appellants. Def. Br. 28. This is false: it comes from plaintiffs' own expert report and the district court's decision identifying, but failing to certify or determine adequate representation for, "Subclass 7." JA127–28. It is the defendants who attempt to confuse the record by inventing an entirely new nomenclature on appeal by referring to "subgroup (a)" (the favored "Subclasses" 1 through 6) and "subgroup (b)" (the disfavored "Subclass 7") that appears nowhere in the record below. Def. Br. 6.

"JA" refers to the Joint Appendix. "SA" refers to the Supplemental Appendix. "Dkt." refers to the docket in the lead *Dewey* case, No. 07-cv-2249 (D.N.J.) (JA165–211). "West Br." is West's opening brief; "Def. Br." is defendants' second-stage brief; "Pl. Br." is plaintiffs' third-stage brief.

A. The Settlement Fails to Comply with the Requirements of *Amchem* That All Class Members Are Represented.

1. The settlement creates an intra-class conflict in violation of *Amchem* and *Sullivan v. DB Investments* by failing to reimburse members in "Subclass 7" who have suffered damage when similarly situated class members with identical injuries are reimbursed.

The district court found that, under the terms of the settlement, class members in "Subclass 7" do not receive compensation for any damages they might have suffered, while members of favored "Subclasses" receive up to $8 million for identical damages. JA131, 133. There is no dispute that none of the named plaintiffs is a member of this uncertified "Subclass 7." This disparity in interests, given the limited settlement fund, combined with the arbitrary disparity in relief is an independent demonstration of the inadequacy of the representatives. *Amchem Products, Inc. v. Windsor*, 521 U.S. 591 (1997).

Appellees fail to grasp the core issue: identically-situated class members in the same settlement class are treated differently for no justifiable reason. The disparate and inadequate relief in the settlement is not justified by *In re Pet Foods* and other precedent cited by appellees. In *In re Pet Food Products Liability Litigation,* 629 F.3d 333 (3d Cir. 2010), some class members had damages solely from purchasing contaminated pet food, while others had both claims for purchases and for injury or death of their pets. The court held there was no conflict between the two groups because the class representatives had purchase claims (as well as injury claims), and because "class members with only Purchase Claims *do not receive less value for identical*

claims asserted by other class members." 629 F.3d at 345–346 (emphasis added). In other words, whether they had a purchase claim only, or both a purchase claim and an injury claim, the purchase claims were all treated the same. The legal claims were the same, based on the contamination of the pet food; the amount of the economic loss was different.

In contrast, the settlement's denial of compensation to "Subclass 7" is not based on the extent of injury to class members, as in *In re Insurance Brokerage Antitrust Litigation,* 579 F.3d 241, 272 (3d Cir. 2009), or the value of their legal claims, *In re Community Bank of Northern Virginia,* 622 F.3d 275 (3d Cir. 2010). The appellees have not presented any evidence that the legal claims of "Subclass 7" members are any qualitatively different from those of the other categories, the district court did not make any findings that the "Subclass 7" members had qualitatively different legal claims, and the court below held that the claims were sufficiently similar for class treatment. JA78–79 (common questions of law and fact).

Contrary to defendants' straw-man argument, West does not dispute that non-pecuniary benefits can be part of a settlement. Def. Br. 34. If every class member received the educational letter and nothing more, there would be no class conflict (though the settlement would be problematic for other reasons). But the case here is that, while everyone received the educational letter, only members of the favored and represented uncertified "Subclasses" received monetary compensation for identical damages from identical injury.

The recently decided *Sullivan v. DB Investments*, No. 08–2785, 2011 U.S.App. LEXIS 25185 (3d Cir. Dec. 20, 2011) (*en banc*), is on point. "We can find no support in our case law for differentiating within a class based on the strength or weakness of the theories of recovery." *Id.* at *139. Yet that is exactly what the parties and the district court did here. *Sullivan* did not hold that a single class could receive wildly different compensation for the same injury: indeed, it held the opposite—that it was permissible to award the same relief to a single class where the quality of class members' claims differed. Worse, the appellees and the district court did not even *attempt* to differentiate "based on the strength or weakness of the theories of recovery"—instead the district court approved differential relief without engaging in "the type of fact-intensive merits… analyses" that would be the "only" basis to authorize such differential treatment. *Id. Accord Mirfasihi v. Fleet Mortgage Corp.,* 356 F.3d 781, 786 (7th Cir. 2004) (Posner, J.) (where different claims treated differently, court must undertake independent analysis of fairness of settlement relative to each type of claim on the merits).

Plaintiffs make the unremarkable argument that differing amounts of damages between plaintiffs does not demonstrate a conflict. Pl. Br. 35–36. This begs the question. The fact that one class member might have a damaged Transmission Control Module and another has damaged carpets is not the issue; this is not a challenge to the categories of reimbursement. The issue is that some class members with damage do not receive any compensation whatsoever, while other class members with the same type of damage in the same certified class do. West Br. 37.

The asserted difference that supposedly justifies the differing relief is that the frequency of warranty claims is less for "Subclass 7." See Pl. Br. 15–16; Def. Br. 31; JA101. This, of course, as the appellees do not and cannot dispute, is not entirely true. West Br. 23; JA1188–89. But even if it were, the *frequency* of damage within a group is entirely different from the *quality* of the damage any one member may suffer; the parties cite no precedent otherwise. There may be fewer people with damage in "Subclass 7."[2] But the members of the disfavored "Subclass 7" who have suffered

[2] As part of their attempt to introduce new facts into the appellate record that were not before the district court, defendants undermine even this slim reed for differentiating between the favored "Subclasses" and the disfavored "Subclass 7." *Compare* Def. Br. 13 (favored "Subclasses" or "subgroup" had 0.49% claim rate of damage (citing impermissible post-appeal evidence)) *with* Def. Br. 13 (rationalizing exclusion of "Subclass 7" because it had "average claim rate" of 0.3%). Defendants make much of their claim that "approximately 99.7% of ["Subclass 7"] has no record of any water ingress issues," Def. Br. 13, but that hardly justifies adverse treatment of "Subclass 7"; 99.5% of the favored "Subclasses" did not make claims for reimbursement. Def. Br. 13.

And, in any event, the parties do not dispute that the classification of individual models into the favored "Subclasses" or the disfavored "Subclass 7" occurred regardless of an individual model's claim rate: several "Subclass 7" models have claim rates above 0.49% (including "preceding and succeeding model years" of the 2001 Audi A8 (Def. Br. 32)), while several favored "Subclass" models have claim rates below 0.3%. West Br. 23, 34–35 (*quoting* JA1188–89). It is also factually incorrect that the "average" "Subclass 7" claim rate was "only" 0.3%. As defendants now admit, they invented that fictional "average" by omitting vehicles in "Subclass 7" that had high claim rates. JA1189; Def. Br. 32–33. (Defendants' argument that this self-serving computation was an acceptable methodology because of individualized issues with particular vehicles (*id.*) is inconsistent with any claim that there was commonality and predominance.) If one manually performs the math on "Subclass 7" without defendants' artificial gerrymandering, the average claim rate was 0.42%, almost

injury have suffered the same injury caused by the same defect as members of the other groups. Any distinction in frequency within a group does not demonstrate any difference in kind of injury to class members, and thus, in compensation. As West noted in his opening brief, if one "Subclass" really had three times the frequency of damages claims, permitting both "Subclasses" access to the Reimbursement Fund would just mean that that the "Subclass" with a higher frequency of claims would receive three times as much from the Reimbursement Fund *per capita*; simply excluding the disfavored "Subclass" from the Reimbursement Fund arbitrarily penalizes them. West Br. 33–34. The appellees fail to respond to this dispositive argument that the district court committed reversible error.

The division of the settlement fund may have been based on compromise, which is certainly an inherent aspect of negotiation. Perhaps it would have been impossible to negotiate full compensation to every plaintiff in the class; West is not arguing that the parties were required to. But compromise cannot mean providing one set of plaintiffs in the class with full compensation, and a different set of identically (and sometimes better) situated plaintiffs with no compensation—especially when the disfavored "Subclass" is neither certified nor represented. If a defendant is only willing to pay two thirds of the claims in compromise, it is not a permissible "compromise" to create two uncertified "Subclasses" where people with last names beginning with the letters "A" through "P" collect in full, while "Q" through "Z" waive their claims

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indistinguishable from the 0.49% claim rate in favored "Subclasses" actually observed in the settlement claims process. *Compare* JA1189 *with* Def. Br. 13.

and get nothing. The similarly arbitrary exclusion of "Subclass 7" is not permissible. For this reason alone, the settlement approval was an error of law, an abuse of discretion, and cannot stand.

2. The unified class approved by the lower court made no distinction between class members with present claims and those with future claims, and is therefore unacceptable under *Amchem.*

There is a second intraclass conflict that independently requires reversal of the settlement approval. Neither set of appellees directly addresses the core issue in *Amchem*: when there is a limited settlement fund, class members with solely possible future claims must have a class representative who stands in their shoes and represents their interests. "Indeed, the key to *Amchem* appears to be the careful inquiry into adequacy of representation." *Pet Food,* 629 F.3d at 342 (quoting *In re Prudential Ins. Co.*, 148 F.3d 283, 308 (3d Cir. 1998)). Adequacy of representation is a threshold inquiry that must be satisfied regardless of the settlement terms. *Amchem,* 521 U.S. at 613.[3]

The class members who have experienced water damage have a strong interest in maximizing their recovery now, but those who have not experienced water damage have a conflicting interest in ensuring that there are funds in the future to cover their potential losses. Contrary to the parties' arguments that there is no conflict, the fact

[3] Plaintiffs' discussion of *Amchem* attempts to paint it as a case about commonality and notice. The decision, however, was primarily focused on the predominance of class-wide issues, 521 U.S. at 622–625, and the adequacy of representation, *id.* at 625–628.

that named plaintiffs have the possibility of future damages does not make them adequate representatives, because their immediate interest in maximizing current recovery for known past damages is clearly more significant than the possibility of lack of compensation for speculative future damages. Their incentive is to sacrifice their possible future claim in exchange for present payments.

Named plaintiffs with multiple claims cannot adequately represent class members with only one of those claims. *In re Literary Works in Electronic Databases Copyright Litig.,* 654 F.3d 242 (2d Cir. 2011). In *Literary Works*, the district court had approved a class action settlement where the class was divided into three groups based on the viability of their copyright claims (determined by the date the copyrights were registered). The payments to the third group were lower than the other two groups and would be the first reduced if the fund was insufficient to cover all claims. The class representatives held varying combinations of all three claims, but none held only claims in the third group. The Second Circuit held that this impermissible intra-class conflict made it an abuse of discretion to find adequate representation, because holders of all three claims do not have the requisite incentive to bargain for the best result for those with only the third, least valuable, type of claim. 654 F.3d at 249–56. Only the creation of subclasses would cure the defect. Here, the district court acknowledged the existence of "lay" "Subclasses," but did not certify them or ensure that the individual uncertified "Subclasses" had adequate representation.

As in *Literary Works,* the named plaintiffs here had both the favored present and disfavored future claims and are therefore inadequate representatives for class

members with only future claims. Certainly class members with potential future damage claims would want the reimbursement fund to be large enough to cover their future losses. The "Revised Maintenance Program" may or may not be sufficient to address possible future claims, as Defendants contend it does. But without a separately-represented plaintiff to argue on behalf of owners with no current damages, there is no way to know if this is the best bargain for those owners. *Pet Foods* is not to the contrary; indeed, the reason this Court held *Pet Foods* did not have an *Amchem* problem was because "all class members here have present claims" and there was no potential subclass that would accrue claims in the future. 629 F.3d at 344.

Defendants assert that there is no conflict because "the entire class had but one goal—to avoid future water related damages by obtaining proper information, and to maximize the recovery for those with past damages." Def. Br. 27–28. The proposition is self-refuting: it lists two goals.

Moreover, the parties' argument that future damage is unlikely is not a reason to ignore this fatal flaw in the settlement. If the informational relief makes future damage so improbable that this Court need not address the fact that the settlement forces class members to waive future claims for damage, then the refusal to adequately fund for the possibility of future damage is entirely arbitrary. After all, if defendants' premise is true, there would be no cost to the defendants for abiding by *Amchem* and not improperly freezing out future-damages claimants. The Court should not accept the speculation of the parties that this will be a non-issue as a reason to disregard the

settlement infirmity: if Volkswagen really believed it was a non-issue, why would they structure the settlement to protect themselves from liability?

Indeed, *Literary Works* also addressed this issue. The settling parties argued that a contingent provision in the settlement that capped recovery for Category C should not be held against the adequacy of representation because it was "unlikely to be triggered." 654 F.3d at 253. The Second Circuit "disagree[s]. Those negotiating the Settlement identified a risk and placed that risk on a single category of claims… We can discern no reason, and [settling parties] offer none, why this burden should have been placed exclusively on Category C, rather than shared equitably among all three categories of claim. That only one category was targeted for this penalty without credible justification strongly suggests a lack of adequate representation for those class members who hold only claims in this category." *Id.* at 253–54.

On its face, the settlement violates *Amchem* by impermissibly prejudicing future claims without separate representation. The intra-class conflict prohibits certification.

B. Defendants' Argument for Distinguishing "Subclass 7" from the Rest of the Single Settlement Class Continues to Be Arbitrary, and Would Require Class Decertification for Lack of Commonality.

Defendants claim that, notwithstanding the overwhelming statistical evidence (West Br. 33–35), the segregation of disfavored vehicles in "Subclass 7" was not arbitrary. Def. Br. 33. Defendants justify the difference in relief between "Subclass 7" and the favored "Subclasses" by arguing that the "platforms" were different between the "Subclasses." Def. Br. 12, 33. This argument fails for four reasons.

First, it is factually false. There are A4, A5, B5, and B6 platform vehicles in the favored "Subclasses"; there are A4, A5, B5, and B6 platform vehicles in the disfavored "Subclass 7." Def. Br. 6–7; JA 314–15, 317–19.

Second, even the "platform" explanation does not provide a prediction for whether vehicles are placed in the favored or disfavored "Subclass." The Touareg platform consistently had higher claim rates than the Audi A4 B6 or Audi A6 C5, but the Touareg is in the disfavored "Subclass 7," while the Audis are in the reimbursement-eligible "Subclass 5." JA1188–89; JA437. The "platform" explanation is not any less arbitrary and capricious than the vehicle-model claim-rate explanation originally provided to the district court for disfavoring "Subclass 7."

Third, even if "Subclass 7" claims were somehow qualitatively weaker than the favored Subclass claims (a finding the district court did not attempt to make, and one the appellees present no evidence for), that would not preclude the need for separate representation for the differential treatment. *Literary Works* is again directly on point. The Second Circuit there acknowledged that the "Category C" claims to which the settlement allocated $20 were weaker than the "Category B" claims that collected $150. 654 F.3d at 252–53. "The problem, of course, is that we have no basis for assessing whether the discount applied to Category C's recovery appropriately reflects that weakness. We know that Category C claims are worth less than the registered claims, but not by how much. Nor can we know this, in the absence of independent representation." *Id.* at 253. "*Even in the absence of any evidence that the Settlement disfavors Category C-only plaintiffs*, this structural flaw would raise serious questions as to the

adequacy of representation here." *Id.* (emphasis added). The same is true here, except here the disparity is even worse: favored "Subclass" class members with claims would receive an average of over $500 (Def. Br. 13), while disfavored "Subclass 7" class members such as West receive $0 compensation for their four-digit claims—and unlike in *Literary Works*, there was no finding and no evidence that the disfavored "Subclass" had a qualitatively weaker claim.

Fourth, even if it were true that there was a reason to treat different platforms within the same class differently, it is dispositive evidence that the class fails to meet the standard of commonality required by *Wal-Mart Stores, Inc. v. Dukes*. 564 U.S. __, 131 S.Ct. 2541 (2011). Class members' claims must depend upon a common contention that "must be of such a nature that it is capable of classwide resolution—which means that determination of its truth or falsity will resolve an issue that is central to the validity of each one of the claims in one stroke." If it possible that one "Subclass" of platforms is defective, but the other "Subclass" is not, as the parties seem to be arguing, then there is no commonality within the single class; at a minimum, the "Subclasses" must be certified as subclasses. West argued this in his opening brief; the appellees do not even mention *Wal-Mart*, and must be considered to have waived any argument that that decision does not preclude commonality here. *See generally* West Br. 35–36.

The differential classifications of "Subclasses" with wildly disparate relief within the same single settlement class was arbitrary, unfair, and approval of that distribution scheme was an abuse of discretion.

C. In the Alternative, Notice Deceived "Subclass 7" Members (and the Court and Plaintiffs' Own Expert) About the "Residual Fund."

It is telling that plaintiffs (but not defendants), apparently recognizing that the settlement they actually negotiated is indefensible, represent to this Court that the settlement offers compensatory relief to "Subclass 7"—contrary to what the settlement says (JA314–20), what the classwide notice said (JA403), what the plaintiffs' expert said (JA437), what settlement administrators told a "Subclass 7" class member who attempted to make a claim (JA479 n.1), and what the district court found (JA131 ("Subclass 7 is not eligible for reimbursement"); JA128 n.70 (same)).[4] *Compare* Pl. Br. 38–40 *with* Def. Br. 12 (only "subgroup (a)" eligible to seek reimbursement). The fact that the plaintiffs have to resort to such tactics shows the fundamental weakness of their arguments.

In any event, even under the plaintiffs' newly-conceived conception of the settlement, the settlement still impermissibly burdens "Subclass 7." *First*, the goodwill claims only can happen if the settlement fund is not depleted by the other claims. The district court found that the fund would be depleted by the initial claimants, and approved the settlement in part upon the parties' representation that that would be true. JA133, 137. The appellees now wish to argue different facts to this Court than

[4] Plaintiffs incorrectly cite the district court to support their new settlement interpretation. *Compare* Pl. Br. 35 ("The settlement also allocates the residual reimbursement fund to cover *the past or future claims* of all class members which are not covered by warranty" (emphasis added and subtracted)) *with* JA102 (goodwill program "specifically cover[s] *future* claims" (emphasis added)). *Cf. also* West Br. 28 (noting that court's finding of value to future claimants contradicted other court findings).

the ones they argued to the district court (Pl. Br. 16–17; Def. Br. 13), but they are judicially estopped from claiming that the settlement fund will not be depleted by the favored "Subclasses." West Br. 27 n.3. That, as plaintiffs argue (Pl. Br. 37 n.16), there was a contingency in the settlement for the settlement fund not to be depleted is irrelevant to whether they benefited from asking the district court to find that the settlement fund would be depleted, and are thus judicially estopped from claiming otherwise.[5]

Second, the residual payments are completely discretionary, to be provided on a "case-by-case" basis. JA321. "Subclass 7" members thus have no enforceable recourse

[5] Even if the parties were not judicially estopped, the post-appeal evidence cited by both appellees about the current state of the settlement fund should not be considered. The number of claims and the size of the residual fund were not known at the time of the negotiations and were not before the district court; the settling parties did not make a Rule 60 motion to correct the record below; and only the record that was before the district court is relevant on appeal. "The only proper function of a court of appeals is to review the decision below on the basis of the record that was before the District Court." *Fassett v. Delta Kappa Epsilon*, 807 F.2d 1150, 1165 (3d Cir. 1987). Appellate courts will not accept new evidence into the record that was not before the District Court. *Id; see also Kirshner v. Uniden Corp. of America,* 842 F.2d 1074, 1077–78 (9th Cir. 1988) (Papers submitted to the district court after the ruling that is challenged on appeal should be stricken from the record on appeal) (*citing United States v. Walker,* 601 F.2d. 1051, 1054–55 (9th Cir. 1979) ("We are here concerned only with the record before the trial judge when his decision was made.")); *Heath v. Helmick,* 173 F.2d 156, 156–57 (9th Cir. 1949) (striking from record on appeal papers that were filed in district court after judgment from which appeal was taken). The relevant time frame for consideration is the time the agreement was negotiated. *Cf. Literary Works,* 654 F.3d at 246 & n.2 (evaluating settlement based on registration costs at time of settlement approval).

if the settling parties, perhaps having changed its mind about the scope of the settlement once, change their minds a second time.

Third, and most importantly, if "Subclass 7" members are entitled to relief, then they received constitutionally defective notice. West Br. 32 n.4. The notice gives no indication that "Subclass 7" members may make claims; indeed, the settlement administrator has told at least one "Subclass 7" member otherwise. JA542, 550, 479 n.1. Plaintiffs assert that the settlement website overrides all of this record evidence (Pl. Br. 38–40), because a lay class member could, if they so choose, ignore the notice that told them they could not make a claim, read through a 41-page settlement written in legalese (JA302–42), and independently come to a legal conclusion that, notwithstanding the clear language of the notice and what the settlement administrator was telling "Subclass 7" members who attempted to make claims, a "Subclass 7" class member could make a claim. The proposition is laughable on its face. Plaintiffs do not dispute that the district court thought that "Subclass 7" members could not make claims (JA131) or that the settlement administrator was telling "Subclass 7" members they could not make claims (JA479 n.1)—if the settlement and notice is confusing the district court judge and settlement administrator, it is surely confusing lay class members. It is exceedingly unfair to affirmatively mislead a million class members.

Plaintiffs' offer to publicize this on the settlement website in the future—aside from being unenforceable under the existing settlement without a reversal and remand—is worthless. Why would a "Subclass 7" member who suffered injury in

2008 check a class settlement website years after receiving a class notice that she was not entitled to relief?

Plaintiffs offer to fix this problem with supplemental notice to the class "if necessary." Pl. Br. 40 n.17. This would also require remand; no provision in the existing settlement or final judgment makes this offer enforceable.

II. Eads's Testimony Flunked *Daubert* and Was Insufficient to Support the Court's Valuation.

In his opening brief, West demonstrated that Eads's methodology necessarily created nonsensical results, could not possibly survive a legitimate *Daubert* inquiry, and that it would necessarily be clearly erroneous to credit it. West Br. 44–46. Appellees simply ignore this argument. They provide no reason to distinguish the informational letter from the zero-dollar-coupon scenario, no defense of Eads's argument that an "informational letter" has the same value as a fully-paid for repair and maintenance procedure, and no reason that it would not be clearly erroneous to value the "informational letter" as anything other than zero. They have thus waived a defense of Eads's testimony. This, by itself, is grounds for reversal of the settlement approval.

The appellees misrepresent the record in multiple respects. West did not "concede[] at the Fairness Hearing that" the informational letter had value. *Compare* Pl. Br. 19 n.7 *with* JA1100–01 ("It's possible that it does have value, but they haven't proven it because they've used improper economic methodology to get there."). That parenthetical's quote also demonstrates that Plaintiffs' argument that West does not "take issue with the methodologies that [Eads] employed to arrive at the $13.1 million

figure" (Pl. Br. 47) is categorically false. *Id.*; West Br. 42–44 (challenging methodology); JA920–29 (same); JA1092–94 (same).

Dr. Ordover did not "agree[] with this aspect of Dr. Eads's analysis" on the valuation of the informational letter—he did not issue an opinion or perform any analysis on the subject at all, but simply assumed it *arguendo*. *Compare* Pl. Br. 19 n.8 *with* JA761, 763 (premising argument on "[a]ssuming that Dr. Eads' specific calculations of each component of the settlement benefits are correct").[6] An *ipse dixit* assumption such as Dr. Ordover's is not by itself admissible evidence for the truth of the assumption. *Gen Elec. Co. v. Joiner*, 522 U.S. 136, 146 (1997); *Elcock v. Kmart Corp.*, 233 F.3d 734, 749 (3d Cir. 2000). And Defendants are incorrect when they state that West's arguments against Eads were "duly considered by the court." Def. Br. 45. The

[6] In contrast, defendants avoid affirmatively misrepresenting the record by telling the more precise half-truth that Ordover did not "[take] issue on this point." Def. Br. 10. Of course, it would disadvantage the defendants if their expert *did* take issue on this point, because the Eads calculation was the only evidence of benefit to "Subclass 7." The fact that Ordover failed to opine at all on this aspect of the Eads methodology even in the face of it being challenged by objectors is a negative pregnant: evidence in support of West's critique of the methodology, rather than in support of the validity of the methodology. One suspects that the reason Ordover was pulled from the witness list at the last minute (JA970–87) was the fear that his devastating demonstration of Eads's failure to meet *Daubert* standards (JA747–90) would be too devastating.

A closer look at Ordover's report shows that, if he *had* opined on this aspect of Eads's report, he would either have agreed with West's analysis or have risked issuing conflicting opinions. (JA760 at ¶14 (settlement must be valued on the benefit of preventative measures that *Volkswagen pays for* minus the cost to consumers)).

court's opinion failed to address several of West's arguments against Eads, and at one point adopted one of Eads's arguments on the incorrect premise that a disputed contention had not been "challenged." West Br. 38–46; JA130.

The court below failed to conduct any kind of *Daubert* analysis to determine the admissibility of Dr. Eads testimony; it did not even mention *Daubert*.[7] The court did not analyze Eads's opinion's factual underpinnings or the methodology he used, despite challenges from West. The court merely skipped to considering the weight to be given to the evidence without the threshold determination that underlying methodology was reliable and admissible. JA126. The entire report should have been excluded for its double-counting, invalid assumptions and failure to take costs to the class into account.

Dr. Eads' methodology in determining the value of the non-pecuniary benefits was unreliable in two ways: he failed to consider the cost to the class of the revised maintenance recommendations, and he based his opinion on assumptions and speculation. Courts have barred expert testimony when the factual basis underlying

[7] Plaintiffs' citation quote to the contrary (Pl. Br. 45–46) is not from the record. It is from an impermissible post-appeal opinion issued by the district court in violation of Local Appellate Rule 3.1, and cannot and should not be considered by this Court. *United States v. Smalley*, 517 F.3d 208, 213 (3d Cir. 2008) (refusing to consider an amended judgment that "added a new concept without counsel having an opportunity to address it. That goes beyond the intent of [LAR 3.1]."); *accord In re United States*, 273 F.3d 380, 382 n.2 (3d Cir. 2001); *Fassett*, 807 F.2d at 1165 ("The only proper function of a court of appeals is to review the decision below on the basis of the record that was before the District Court.").

the opinion is missing or unreliable. West Br. 39–44. *See also, e.g., Bielskis v. Louisville Ladder, Inc.*, No. 10–1194 (7th Cir. Nov. 18, 2011) (expert testimony excluded as unreliable where, in part, his opinion was based on speculation).[8]

The parties do not deny that the only evidence about the cost to the class members of the maintenance-only part of the settlement is Dr. Eads' testimony at the fairness hearing; his report had no facts underpinning his assumptions at issue. See JA442, 449–50. The self-contradictory testimony, however, does not include any factual basis for his apparent assumption of no cost.

At the fairness hearing, when asked if the cost was *de minimus*, Dr. Eads testified that he had no basis to calculate the cost. JA 1087. When asked by the court about the possible cost to class members, he testified:

> THE WITNESS: Well, it's my understanding -- I've read the Settlement Agreement, the letters that are provided, basically the information says: Here's a potential problem on some of your vehicles. You should have it checked, have the drains checked once every 40,000 miles, I think is what it is. That doesn't mean you take them in for a special check. *I would imagine* that would be included in the 40,000, 80,000, 120,000 mile check-up. So it's not a special trip in, it's one item of a large number of things that get done at 40,000 miles.

[8] Plaintiffs assert that the cases cited in West's brief demonstrating the inadmissibility of Eads's testimony are "inapposite," Plaintiffs' Brief p. 45 n.20, but do not explain how; as their own parentheticals show, they involve expert testimony excluded because the experts, like Eads, ignored critical facts and/or based their testimony on speculation. They have thus waived the issue.

> But then as I was describing *in my own experience*, basically you're advised to check these drains to see if there's stuff piling up in them. You can pour water to see if it comes through, as I do with the plenum, just to see if there's leaves and all in it and I turn on the Shop-Vac and vacuum it out.
>
> So I don't know -- I don't know -- I certainly wouldn't put a value on the amount of time I spend. If I'm doing it, it's sort of like the same thing about washing my windshield and getting the bird doo off the vehicle.
>
> In terms of what happens when they take it in to the vehicle -- the dealer, as I say, it's not a separate trip. *I would imagine*, you know, *it could be* that they don't charge anything extra. *It could be* that they add a de minimus amount.
>
> *I just have no way of projecting*.

JA 1065–66 (emphasis added).

As this excerpt demonstrates, Dr. Eads was merely speculating about the possible cost to class members of complying with the new recommendations. (His own experience is irrelevant, because he drives a Volvo, not a Volkswagen or Audi; there was no evidentiary showing that the two vehicles are materially similar. JA1060.) Furthermore, the revised maintenance information does not specify the procedure to use to clean the drains, JA423–31, so Dr. Eads's discussion of the cleaning procedure is not based on any particular expertise or relevant information, even if an economist could be qualified as a human-factors expert.[9] Moreover, this opinion—like his

[9] *Athletic Sales Co. v. American Gym, Recreational & Athletic Equipment,* 546 F.2d 530 (3d Cir. 1976), a pre-*Daubert* case relied upon by plaintiffs (Pl. Br. 47), is not relevant. In that case, the court concluded the district court erred in giving controlling

speculative opinion about the costs of the maintenance to the class—was introduced for the first time at the fairness hearing. Because it was not in his expert report, it is not an admissible opinion under Fed. R. Civ. Proc. 26(a)(2)(B)(i). *Walter Int'l Productions, Inc. v. Salinas*, 650 F.3d 1402, 1410 (11th Cir. 2011).

The parties have not presented any evidence, much less expert evidence, of the efficacy of the revised maintenance instructions, that is, how many owners will follow the recommendations and how many water incidents will be prevented. The language used by the parties reveals that the efficacy is assumed but not demonstrated. For example, Plaintiffs state that the new maintenance instructions are "intended" to prevent sunroof drain clogs. Pl. Br. 49. Defendants state that "[i]t *is expected* that these revised maintenance instruction, *if followed*, will drastically reduce, if not entirely eliminate" water entry. Def. Br. 26 (emphasis added).

The defendants do not address the admissibility issue other than to merely assert that the West Objectors did not produce evidence to support a cost for the maintenance. This is false. West pointed to Eads's own testimony that maintenance costs $91.52/hour. JA1092; JA446. Thus, if every class member incurs a mere three minutes of additional maintenance expenses on average—consistent with the "*de minimus* amount" Eads speculated might be added to the average maintenance bill (JA1066)—the additional marginal costs to the three million class members would outweigh Eads's calculated benefits of $13 million. Eads provided no basis for finding

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weight to expert testimony provided by a minimally qualified expert. The standard of review has changed after *Daubert*. West Br. 7 (citing cases).

that the additional marginal costs of maintenance would not be passed on to class members by dealers. In any event, it is the proponent's burden to establish the admissibility of the expert testimony by a preponderance of the evidence. *Daubert,* 509 U.S. at 592 n.10, *Oddi v. Ford Motor Co.,* 234 F.3d 136, 144 (3d Cir. 2000). Moreover, had the court below permitted Objectors' counsel to question Dr. Eads (Section III, below), more information could have been elicited about the lack of foundation for his opinion.

The foundation of Dr. Eads opinion is insufficient to support his conclusion and the report should not have been admitted; without the report, there was no evidence of value to "Subclass 7." Nor could Dr. Eads retroactively bolster his methodology with opinions that were not in the report. In the alternative, it was clear error to assign a value to the benefits in "Subclass 7," as the court failed to consider offsetting costs to the class, and the parties failed to demonstrate that the educational letter was a net benefit to the class. The economic analysis adopted by the court has the effect of valuing a letter about a possible fix as equal in value to the class as Volkswagen sending mechanics to every class members' home to perform the fix *gratis*: this plainly violates common sense, if nothing else, and is clearly erroneous.

III. The District Court Committed Reversible Error in Limiting Objectors' Participation in the Proceedings Without Notice.

The appellees' sole argument defending the district court's denial of West's right to cross-examine Eads is that the "district court's insistence that all parties abide by the deadlines clearly set forth in her order does not violate due process." Pl. Br. 40.

But that begs the question, because there was no "deadlines" or "order" on cross-examination. It is thus notable that the appellees repeatedly refer to these "deadlines" without identifying any language that required West to give notice of a desire to cross-examine witnesses at a hearing. Retroactively creating deadlines and requirements without notice is entirely improper. West's request to cross-examine was not "untimely" (Pl. Br. 42), because there was no deadline—much less requirement—to make such a request.

Kohn v. American Metal Climax, Inc., 489 F.2d 262 (3d Cir. 1973), supports West, rather than appellees. In *Kohn*, an appeal of procedural irregularities was rejected because the appellants "declined to examine the parties that were present at the hearing." Nowhere does *Kohn* require an objector to seek permission to cross-examine parties at a hearing in advance; indeed, the appeals court assumed that the objectors had the right to cross-examine parties, and that it was the *failure* to attempt to cross-examine that doomed their appeal. West did try to cross-examine a witness, and was unfairly precluded from doing so, violating the irreducible minimum of due process. *Phillips Petroleum v. Shutts*, 472 U.S. 797, 812 (1985).

Plaintiffs rely on *Rutter & Wilbanks Corp. v. Shell Oil Co.*, 314 F.3d 1180, 1187 (10th Cir. 2002), but this case contradicts Third Circuit precedent and is simply incorrectly decided. *Greenfield v. Villager Industries, Inc.*, 483 F.2d 824, 833 (3d Cir. 1973). A fairness hearing has to actually give objectors a fair opportunity to be heard, and cannot simply be a Potemkin village giving the illusion of due process. None of the Third Circuit precedent gives any indication that an objector's request to cross-

examine must be made in advance of the hearing. *Greenfield*, 483 F.2d 824; *Schwartzman v. Tenneco Mfg. Co.*, 375 F.2d 123, 124–25 (3d Cir. 1967).

The district court's cross-examination of Eads is not a substitute for a true adversary hearing. For example, Eads gave a rambling self-contradictory answer when questioned by the district court about the issue of costs; the district court did not follow up, as a true adversary would have. JA1065–66 (discussed in Section II, above). Indeed, appellees have argued in this appeal that Objectors do not have enough evidence to successfully challenge Eads' conclusions. Pl. Br. 18–19, 43; Def. Br. 46. West disputes this contention: Eads's testimony flunks *Daubert* and common sense on its face, as West demonstrated in his opening brief and the appellees failed to contest. But it is worth noting that West was not given the opportunity to develop additional evidence by cross-examining Dr. Eads, where he would have been able to induce admissions by highlighting the contradictions in his testimony and where it contradicted basic economic principles and common sense. For example, would Eads have been able to distinguish his methodology from the zero-dollar-coupon example in West's opening brief? West Br. 45–46. The appellees, with months to respond, failed to justify this inherent absurdity in Eads's reasoning; it is doubtful that Eads would have been able to do so on the stand. (One can also draw a reasonable inference about how the appellees expected Eads to perform on cross-examination by the fact that they risked inducing the court to create reversible error instead of simply permitting the cross-examination.) Thus, by appellees' own argument, West was unfairly prejudiced.

West does not challenge the ability of a district court to control its calendar. But if a district court is going to set deadlines, it needs to (1) give notice of those deadlines, and (2) set deadlines that give objectors a fair opportunity to be heard in response to papers filed by the parties. Here, there was no notice of a deadline to notify the court of a desire to cross-examine testifying witnesses. Here, the ambiguous scheduling order, as retroactively interpreted by the court, created an impermissible deadline that violated Rule 23(h)(1). *In re Mercury Interactive Corp. Securities Litigation*, 618 F.3d 988 (9th Cir. 2010) (courts must provide "objecting class members of a full and fair opportunity to contest class counsel's fee motion"); West Br. 47–48. The appellees make no attempt to defend the district court's retroactive violation of Rule 23(h)(1), or to distinguish this case from *Mercury Interactive*.[10] Even if there was a court order that also applied to West, it was unfairly and unevenly enforced: plaintiffs

[10] Indeed, elsewhere in the briefs, the appellees sneer that West did not present any expert witness testimony. Pl. Br. 19; Def. Br. 16. Leave aside the question of the feasibility of objectors with $1,000 claims retaining an economic expert. The plaintiffs sandbagged West's attempt to learn whether an expert would be needed by failing to disclose to West Eads's report until six days before the objection deadline (JA501; JA435); the defendants did not disclose their expert witness until after the objection deadline (JA747); each set of appellees contends West had no right to file anything (or disclose any witnesses) after the objection deadline. How was this schedule supposed to permit West to learn the need of an expert witness, retain the expert, and generate an expert report six days after the Eads report was filed and nine days before the Ordover report was filed? That the appellees contend that West cannot rebut a facially absurd expert report without hiring his own expert (whose testimony the appellees surely would have objected to if it had been presented for the first time at the fairness hearing, given that they objected to a simple cross-examination) is further evidence that the procedures below violated Rule 23(h) and due process.

were permitted to file supplemental papers relating to their fee request after the objection deadline and after the deadlines established by the district court, again in violation of Rule 23(h)(1). Dkt. 224 (filed July 8, 2010).

Defendants protest that West complains of an *ex parte* hearing (Def. Br. 18), but they do not dispute that there was such a hearing that West was not given notice of or the opportunity to participate in. West Br. 17.

The failure to permit cross-examination of Eads was prejudicial, and reversible error; the Court's other rulings violated Rule 23(h)(1), and also require reversal to give objectors a fair opportunity to be heard.

IV. Adopting the *ALI Principles* Is Appropriately Before This Court.

The parties do not argue that the *ALI Principles* contradict *Girsh v. New America Fund, Inc.,* 521 F.2d 153 (3d Cir. 1975), or other Third Circuit precedent, or that the *ALI Principles* would be a clearer elucidation of settlement approval standards than the existing precedent scattered across several cases. Plaintiffs do not even address the issue. Defendants restrict themselves to claiming that West waived this argument. Def. Br. 19 n.8. But this is not so.

First, West did argue below that *Girsh* did not and should not provide an exclusive set of reasons for evaluating a class action. JA482 (citing *In re AT & T Com.,* 455 F.3d 160 (3d. Cir. 2006)). "Once a federal claim is properly presented, a party can make any argument in support of that claim; parties are not limited to the precise arguments they made below." *Yee v. Escondido*, 503 U.S. 519, 534 (1992). "Rather than

raising a new issue upon which the district court did not rule, [West] is adducing additional support for his side of an issue upon which the district court did rule, much like citing a case for the first time on appeal." *Koch v. Cox*, 489 F.3d 384, 391 (D.C. Cir. 2007). This Court is entitled to apply the controlling law even if litigants fail to cite the best authority *on appeal*. *In re Aqua Dots Lit.*, 654 F.3d 748, 752 (7th Cir. 2011) (Easterbrook, J.) (*citing Elder v. Holloway*, 510 U.S. 510 (1994)).

Second, even if, notwithstanding *Yee*, West's argument below is insufficient to preserve this question, the issue is still not waived because it is a pure question of law. This Court will consider issues of law on appeal even if they were not raised in the lower court, because the primary focus of the waiver rule is to ensure that an adequate factual record is created below. *Tri-M Group, LLC v. Sharp*, 638 F.3d 406, 417–418 (3d Cir. 2011) ("we have been reluctant to apply the waiver doctrine when only an issue of law is raised and no additional fact-finding is necessary" (internal quotations omitted) (*citing Huber v. Taylor*, 469 F.3d 67, 74 (3d Cir. 2006))). This argument is a purely legal one about the best way to clarify existing precedent, and does not depend on an evidentiary record; it would be reviewed *de novo* in any event. By considering this issue now and adopting the *ALI Principles*, the court will give direction to the lower courts, simplify and clarify a significant area of the law and thereby conserve judicial resources. The appellees do not argue otherwise.

The appellees do not dispute that a district court should not view the silence of the class as indicative of endorsement when there are vociferous objectors. West Br. 52–53. Defendants dispute that that is what the district court did (Def. Br. 14), but

that is what the district court did, relying largely on superseded Third Circuit precedent. JA93.

V. The Appellees' Arguments for Jurisdiction Contradict *Devlin*.

Fed. R. App. Proc. 28(a)(4) requires appellants to submit a jurisdictional statement. Appellants' counsel, as an officer of the court, has the obligation to note that it is unclear if the magistrate judge correctly exercised jurisdiction. West Br. 2–4. (Appeal No. 10–3651 fails to comply with Fed. R. App. Proc. 28(b)(1) by failing to have a jurisdictional statement identifying the district court's jurisdiction.) The appellees' argument that jurisdiction exists makes several mistakes.

First, nobody can "waive" a jurisdictional issue. A federal court has the obligation to address a question of subject-matter jurisdiction *sua sponte*. *Meritcare Inc. v. St. Paul Mercury Ins. Co.*, 166 F. 3d 214, 217 (3d Cir. 1999). If the claim is the narrower one that the non-consenting objectors "waived" the right to challenge the jurisdiction of the magistrate, this is incorrect, also. *Roell v. Withrow*, 538 U.S. 580, 590 (2003), does not impose waiver of the right to challenge a magistrate's jurisdiction unless a party was "made aware of the need for consent and the right to refuse it, and still voluntarily appears… before the Magistrate Judge." The mere failure of a party to object to the exercise of jurisdiction by a magistrate judge without that notice (which no one disputes was not provided here) does not operate as consent. *Reiter v. Honeywell, Inc.*, 104 F.3d 1071 (8th Cir. 1997); *Mark I, Inc. v. Gruber*, 38 F.3d 369, 370 (7th Cir. 1994) (Easterbrook, J.). While West consented to the magistrate's

jurisdiction, the magistrate failed to obtain the consent of other objectors, or ensure that they were provided notice of the right to refuse consent. (It is unclear from the record whether the Sibley objectors, who were *pro se* below, received notice of West's jurisdictional filing; they were not signed up for ECF, and the parties never posted West's filing on the settlement website. If they did receive actual notice before the fairness hearing, then there is an argument that West's jurisdictional filing was sufficient to bind the Sibley objectors under *Roell*, though that leaves the open question of whether jurisdiction was adequately exercised as to other *pro se* objectors without PACER subscriptions.)

Second, the appellees fail to address the effect of *Devlin v. Scardelletti*, 536 U.S. 1 (2002), on their claim that class counsel has the power to bind non-intervening objecting class members. The magistrate and the appellees rely entirely on *Williams v. GE Capital Auto Lease*, 159 F.3d 266 (7th Cir. 1998) and a district court decision that relied on *Williams*. But *Williams* was based on the false premise that objectors are never parties unless they affirmatively intervene, and thus are always bound by class counsel in the absence of intervention. That was law in some circuits in 1998, but it is no longer true after *Devlin*. Appellees do not reconcile their claim of consent with *Devlin*'s reasoning. True, *Devlin* does not discuss § 636(c) or consent to magistrate jurisdiction, but it does discuss the issue of the ability of class counsel to bind objectors without their consent in the context of appeal. The appellees provide no reason why class counsel can bind objecting non-intervening class members in one context, but not the other. The *reasoning* of *Devlin*, ignored in the decisions that rely

upon *Williams* and ignored by the appellees, means that objecting class members are parties for any purpose where they would otherwise be bound by the decisions of class counsel. Any other holding would completely undermine *Devlin* by requiring objectors to intervene to preserve their rights, exactly the scenario that *Devlin* sought to prevent.[11]

Third, it is not the case, as plaintiffs claim, that "obtaining consent from every interested class member would present intractable barriers to any practical implementation." Pl. Br. 4 n.1. If class notice includes the information required by *Roell*, then consent is assumed unless an objector specifically objects to jurisdiction. West gave notice to the lower court that the parties had failed to provide *Roell* notice to the class, and the magistrate failed to correct the problem. The other possible practical solution is to convert the case from 28 U.S.C. § 636(c) to § 636(b) to avoid the jurisdictional problem. Again, the magistrate failed to apply this simple solution.

ARGUMENT RE 10–3651 AND 10–3652 CROSS-APPEALS

The 10–3651 and 10–3652 cross-appeals are mooted by the fact that this settlement approval is untenable, and must be reversed. But if this Court chooses to reach these issues to guide the district court below on remand, it should recognize that

[11] Elsewhere in their brief, plaintiffs argue that objectors *are* "clearly" "parties" for purposes of any court order mentioning "parties." Pl. Br. 40. They do not reconcile this argument with their claim that these very same "parties" are not "parties" for purposes of § 636.

each of the cross-appellants has made an incorrect legal argument in support of their cross-appeals.

VI. Federal Law Applies to the Determination of Attorneys' Fees.

Fed. R. Civ. Proc. 23(h) governs the determination of attorneys' fees in a federal class action. Plaintiffs correctly note that *Shady Grove Orthopedic Assoc. v. Allstate Ins. Co.*., 130 S.Ct. 1431 (2010) dictates this result. Pl. Br. 55–56. In *Shady Grove*, defendants attempted to defeat Rule 23 certification of a class action by arguing that state substantive law specifically precluded class-action treatment of the complaint's cause of action. The Supreme Court disagreed: state law could not override the procedural commands of Rule 23, even though the effect was to create a substantive qualitative shift in the balance of power between plaintiffs and defendants that upended the state legislative compromise. Defendants are incorrect when they state that Rule 23(h) creates no federal interest in the determination of attorneys' fees. Though Rule 23(h) does not resolve the circuit split between use of percentage-of-the-fund and lodestar, the Advisory Committee Notes to the 2003 amendments to Rule 23 most certainly take positions on the procedural determination of attorneys' fees. *See discussion* in Section VI.A below.

Chin v. Chrysler LLC, 538 F.3d 272 (3d Cir. 2008), which applied New Jersey choice-of-law rules and New Jersey attorneys' fee law to a nationwide federal class action brought under a federal statute, did not mention or consider the effect of Rule 23(h). Nor, because it was deciding a case involving a pre-2005 class action, did it

consider the effect of the Class Action Fairness Act. 28 U.S.C. § 1711 note §2(a)(4)(C) (criticizing "abuse[]" of upside-down federalism of imposing state law on national class actions). *Chin* should be considered to have been superseded by the Class Action Fairness Act's federalization of class actions and by *Shady Grove*; its failure to consider the 2003 amendments to Rule 23 makes it an unpersuasive reason to disregard them. It is not good law to the extent that it implies that it is appropriate to look to state law to determine attorneys' fees in a class action.

Even in the absence of the binding effect of *Shady Grove*, the premise of defendants' argument—that settling parties in a federal class action can contract out of using federal law for determining the fee request—must be rejected as leading to absurd results.

The fallacy of VW's argument can be seen with a hypothetical coupon settlement. The parties in the federal class action *Coyote v. Acme Products* agree to provide five-dollar coupons for rocket-powered roller skates for the class. But the class attorneys do not want to suffer the consequences of the Class Action Fairness Act's limitation on attorneys' fees in coupon settlements. 28 U.S.C. § 1712. According to VW, the parties can simply evade the Class Action Fairness Act by adding a term to the settlement agreeing to a choice of law of a state—such as, say, Missouri—that favors attorneys over class members and permits fees to be awarded based on the face value of coupons instead of the much lower amount that will actually be redeemed by the class. *Cf., e.g.*, *Bachman v. A.G. Edwards, Inc.*, 344 S.W.3d 260 (Mo. App. 2011).

VW might try to refine its position in their reply brief by distinguishing a Class Action Fairness Act coupon settlement from this particular Class Action Fairness Act settlement, but the point remains the same for fees determined under Rule 23(h). There are any number of states where state law permits class counsel to extract an unreasonable share of a class action settlement in attorneys' fees (*Chin* demonstrates an attempt at such under California law), and unscrupulous self-dealing class counsel need only identify one. If class counsel can evade federal proscription of unreasonable fees by insisting upon a contractual choice-of-law provision that unfairly inflates their award, unrepresented class members in nationwide class actions will lose the protections of federal laws against excessive attorneys' fees that was one of the motivating factors of the Class Action Fairness Act. 28 U.S.C. § 1711 note §§2(a)(3)(A), 2(a)(4)(C).

Furthermore, involuntarily applying a choice-of-law clause on unrepresented class members to disadvantage those class members relative to class counsel without those class members' consent would violate due process. *Phillips Petroleum v. Shutts*, 472 U.S. 797, 822 (1985). At a minimum, federal law must provide a cap on attorneys' fees, and state-law-determined attorneys' fees cannot be higher than what federal law would consider reasonable.

VII. A Settlement Should Be Valued on the Benefits Actually Received by the Class.

A. Hypothetical Class Benefits Are Not Class Benefits.

Class counsel may legitimately request a percentage of what the class *actually* receives, but it goes too far when it demands a share of what the class *hypothetically might* receive. *See* Notes of Advisory Committee on 2003 Amendments to Rule 23 ("it may be appropriate to defer some portion of the fee award until *actual payouts* to class members are known" (emphasis added)); *id.* ("fundamental focus is the result *actually achieved* for class members" (emphasis added); *id.* (*citing* 15 U.S.C. §§ 77z-1(a)(6); 78u-4(a)(6) (fee award should not exceed a "reasonable percentage of the amount of any damages and prejudgment interest *actually paid* to the class" (emphasis added))). *See also ALI Principles* § 3.13; Federal Judicial Center, *Manual for Complex Litigation (Fourth)* § 21.71(2004) ("the fee awards should be based only on the benefits *actually delivered*."). "[N]umerous courts have concluded that the amount of the benefit conferred logically is the appropriate benchmark against which a reasonable common fund fee charge should be assessed." *In re Prudential Ins. Co. America Sales Practices Litig.,* 148 F.3d 283, 338 (3rd Cir. 1998). "In determining the appropriate amount of attorneys' fees to be paid to class counsel, the principal consideration is the success achieved by the plaintiffs under the terms of the settlement." *Schwartz v. Dallas Cowboys Football Club, Ltd.,* 157 F.Supp.2d 561, 579 (E.D. Pa. 2001). The "key consideration in determining a fee award is reasonableness in light of the benefit *actually conferred*" (emphasis in original). *In re HP Inkjet Printer Litig.,* No. 5:05–cv-3580 JF, 2011 WL 1158635, at *10 (N.D. Cal. Mar. 29, 2011) (quoting *Create-A-Card Inc., v. Intuit, Inc.,* No. C 07–06452

WHA, 2009 WL 3073920, at *3 (N.D. Cal. Sept. 22, 2009)). In short, class counsel is entitled to request a share of the benefits it *actually provides* the class.

Class counsel attempts to defend its approach—requesting fee awards on a percentage of recovery on the basis of the entire fund, not just the amount of the fund that is claimed by the class—by relying on cases that have since been superseded, namely *Boeing v. Van Gemert*, 444 U.S. 472 (1980) and *Williams v. MGM-Pathe Communs. Co.*, 129 F.3d 1026 (9th Cir. 1997). This Court should find *Boeing* and *Williams* inapplicable for at least two reasons.

First, the holdings of *Boeing* and *Williams* were superseded by the 2003 amendments to Federal Rule of Civil Procedure 23, which created Rule 23(h). The amendments reflect common-sense intuitions: attorneys' fees should be tied directly to what clients receive, and permitting a class member to fill out a claim form in order to receive a check simply is not equivalent to sending that class member a check directly. *See International Precious Metals Corp v. Waters,* 530 U.S. 1223 (2000) (O'Connor, J) (denying writ of certiorari but noting that fund settlements that allow attorney fees to be based upon the total fund may "potentially undermine the underlying purposes of class actions by providing defendants with a powerful means to enticing class counsel to settle lawsuits in a manner detrimental to the class" and, in turn, "could encourage the filing of needless lawsuits").

Plaintiffs rely on *Masters v. Wilhelmina Model Agency, Inc.,* 473 F. 3d 423 (2d. Cir. 2007), where the Second Circuit held that the district court's failure to calculate counsel's fee by means of the entire fund, rather than the claims made against it,

constituted reversible error. But *Masters* failed to consider the *Manual for Complex Litigation* and *ALI Principles* in so holding, even though it endorsed the use of the *ALI Principles* in evaluating another portion of the same settlement. 473 F.3d at 436. Though *Masters* cited the 2003 Advisory Committee Notes in passing, it gave no reason why it rendered the interpretative notes nugatory. 473 F.3d at 438. *Masters* cannot be considered persuasive on this point.

Second, to whatever extent they remain valid, *Boeing*, *Williams*, and *Masters* apply only to cases with a common fund, not to a settlement like the one at issue here, where the attorneys' fees are paid separately from the class recovery. *Strong v. Bellsouth Tel. Inc.*, 137 F.3d 844 (5th Cir. 1998) (holding *Boeing* inapplicable to settlements like this one). The plaintiffs structured the settlement in a self-serving manner to protect their fee request. *See In re Bluetooth Headset Prod. Liab. Litig.*, 654 F.3d 935, 947 (9th Cir. 2011) (when class counsel "arrange for fees not awarded to revert to defendants rather than be added to the class fund," it is a "sign[] that class counsel have allowed pursuit of their own self-interests… to infect the negotiations").[12] They cannot now be heard

[12] Though it is completely irrelevant to any issue in this appeal, defendants spend over a page of their brief complaining that West's counsel pointed out this questionable settlement provision in the district court below and identified it as a sign of collusion against the class's interests. Def. Br. 18; *accord* Pl. Br. 18 ("troubling"). West's legal argument below against this aspect of the settlement is no different than that which the Ninth Circuit adopted as a matter of law in *Bluetooth*. *See also* JA940–69 (law professor letter to ABA calling for *per se* ban on such clauses). There is no basis for the appellees' insinuation that West's counsel acted inappropriately by making this legally correct argument. That the district court responded by letting four separate attorneys go on at length to make personal attacks against West's counsel (JA1179–85)

to complain that there are adverse consequences to such self-serving behavior.

It is therefore not appropriate to award fees based on a speculative, maximized estimate of potential claims. As the Advisory Committee Notes point out, it is in class counsel's interest to inflate this hypothetical number of claims as much as possible so as to ensure itself the maximum recovery from which to draw its fee. This actually happened in this case, where the parties claimed in the district court that there would be over $14 million of claims, but now (in order to avoid the legal consequences from freezing out future claimants) ask this Court to evaluate the fairness of the settlement on the basis of actual claims barely a third of that. JA131; Pl. Br. 36; Def. Br. 13. If anything, the district court's multiplicand was overcompensatory, given the parties' inflated estimates of class value.

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at the same time that she rejected a legitimate request for cross-examination as too time-consuming (Section III above) is hardly evidence of the fairness of the proceedings below. Defendants' claim that West attempted no showing of collusion (Def. Br. 19) is simply incorrect: the reversion term of the settlement is a warning sign of collusion under *Bluetooth*; the surprise last-minute agreement of defense counsel not to cross-examine or raise a *Daubert* challenge to (or object to the improper leading questioning of) plaintiffs' expert witness—without any notice to objectors—is also a legitimate matter for complaint. While West does not raise the question of collusion on appeal (the settlement is unfair as a matter of law with or without collusion), West did nothing improper below by pointing out the evidence of collusion.

Even as the appellees engage in these *ad hominem* attacks on West's counsel, they do not dispute that the district court's slur of West's counsel as a "professional objector" was highly improper. West Br. 49.

B. Administrative Expenses Are Not a "Class Benefit" Meriting the Award of Attorneys' Fees.

Plaintiffs also argue that a significant portion of the value of the settlement lies in the administration it has provided in the distribution of benefits to class members. But the notion that class counsel is entitled to count the costs of claim administration as a benefit to the class is fundamentally mistaken and poor public policy. Awarding attorneys' fees regardless of whether settlement money is paid to settlement administrators, to the postal service, or to the class members who are the attorneys' actual putative clients creates poor incentives that contradict the purposes behind this Circuit's "percentage of the recovery" fee approach. The recently decided *Aqua Dots* is informative: the Seventh Circuit recognized that items such as the notice and class administration expense of class action settlement and litigation are a social ***cost*** that present an argument against class certification, rather than a benefit to the class. 654 F.3d at 751.

This is demonstrated by examining the way plaintiffs' proposed scheme would work in the real world. As part of its share of the settlement, class counsel in effect is demanding a cut of the court-approved fees and expenses of the claims administrator, as well as a cut of the administrative and maintenance fees associated with the settlement fund. But the money going to the claims administrator is money going to a third party, rather than the class, and should not be considered part of the common fund for purposes of calculating the fee award.

Such an arrangement would create a conflict of interest between the attorney and the class. Every dollar the settlement administrator receives is a dollar that is not

available to the class in settlement. If attorney fees are paid only on what the class receives, class counsel will have appropriate incentive to ensure that settlement administration is efficient and to take steps to prevent overbilling or wasteful expenditures. But if class counsel is given a commission based on the size of administrative expenses, it would have no financial incentive to oversee the efforts of the administrator, creating a perverse system of compensation that discourages assignment of resources to the class.

These principles are not solely a matter of common-sense economics; Judge Vaughn Walker made precisely this point in a case where he was evaluating competing bids for lead class counsel: "First, an attorney generally has no incentive to minimize litigation expenses unless his fee award is inversely related to such expenses. Second, when an attorney treats a resource devoted to litigation as a reimbursable expense, the attorney has a clear incentive to substitute that resource for those paid for out of the attorney fee, even if it increases the overall cost of the litigation to the client." *In re Wells Fargo Securities Litigation,* 157 F.R.D. 467, 470 (N.D. Cal. 1994). Conversely: "If an attorney risks losing some portion of his fee award for each additional dollar in expenses he incurs, the attorney is sure to minimize expenses." *Id.* at 471. This principle of the need to align attorney incentives with maximizing class benefit is what lies behind several circuits' adoption of the "percentage-of-the-fund" approach in calculating fee awards. *In re Cendant Corp. Litig.*, 243 F.3d 722, 732 n.12 (3d Cir. 2001); *Swedish Hosp. Corp. v. Shalala*, 1 F.3d 1261, 1265–71 (D.C. Cir. 1993). *See also Wal-Mart*

Stores, Inc. v. Visa U.S.A., Inc., 396 F.3d 96, 121 (2d Cir. 2005) (attorney fee calculations should use methods that align the interests of attorney and client).

Put another way, class members are not indifferent between a settlement that spends $19 million in administrative costs to distribute $2 million to the class and a settlement that incurs $1 million in administrative costs to distribute $20 million to the class. The latter settlement is worth ten times as much to the class, but, by plaintiffs' argument, the two settlements should be treated as identical victories. This is wrong.

To award class counsel a commission on administrative expenses would produce absurd results that contradict federal law. Imagine a hypothetical settlement under the Class Action Fairness Act. The imaginary class action *Potter v. Bailey Building & Loan* settles: the defendant bank will spend $20 million in administrative expenses to precisely redistribute $1 million to the class of Bailey accountholders. Class counsel for Potter, using plaintiffs' argument here, claim that they have produced a $21 million settlement and are entitled to $7 million in fees, to be deducted from the class members' bank accounts. Such a settlement—where class members pay $7 million to attorneys but receive $1 million in cash—would contradict the intent of 28 U.S.C. § 1713, which prohibits settlements where class members lose money. *Cf. Kamilewicz v. Bank of Boston*, 100 F.3d 1348 (7th Cir. 1996) (Easterbrook, J., dissenting from denial of rehearing *en banc*) (discussing similarly abusive settlement). But if this Court adopts plaintiffs' argument that administrative expenses are a class benefit, the hypothetical Bailey Building & Loan settlement would pass § 1713 muster at the expense of the class members whom § 1713 is meant to protect. This is wrong.

Obviously, administration costs are categories of expense that must be borne. But there is no reason to give class counsel a commission on these expenses. The practice bears an uncomfortable resemblance to awarding a military contractor a cost-plus contract: as a general matter, such arrangements require additional oversight—in this case, judicial administration—to ensure that appropriate cost controls have been established, because some of the typical contract incentives for efficiency are absent. Indeed, a commission on administration actually gives an incentive to class counsel to increase these categories of expenditure. For the same reason that it is inefficient to have judges engage in "gimlet-eyed review" to audit of lodestar calculations, it is inefficient to have judges closely scrutinize settlement administrative expenses when it is much simpler to merely align class counsel's incentives to optimize those expenses. *Cf. Wal-Mart Stores*, 396 F.3d at 121.

It is thus preferable for this court to approve a superior system of attorney compensation, rather than asking district courts to shrink waste by means of judicial monitoring of cost overruns in the future. "Put another way, incentives to minimize expenses and to allocate resources properly go much farther toward cost efficiency than can *post hoc* judicial review." *In re Wells Fargo Securities Litigation,* 157 F.R.D. at 471.

Plaintiffs' argument should be rejected.

CONCLUSION

For the several independent reasons listed above, the district court decision to approve the settlement must be reversed. The Court should take the opportunity to clarify existing precedent by adopting Section 3.05 of the *ALI Principles*. If this Court

decides to reach the legal questions presented by the cross-appeals, the West objectors request that their positions be adopted by this Court.

Dated: January 4, 2011

Respectfully submitted,

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COMBINED CERTIFICATIONS

1. Certification of Bar Membership

I hereby certify that I, Theodore H. Frank, counsel for Objector-Appellants-Cross-Appellees Joshua West, Lester Brickman, Darren McKinney, and Michael Sullivan ("West Objector-Appellants-Cross-Appellees"), am a member in good standing of the bar of the United States Court of Appeals for the Third Circuit; I was admitted on May 5, 2010.

2. Certification of Service

I hereby certify that, on this 4th day of January, 2012, I electronically filed the foregoing Fourth-Stage Response and Reply Brief of West Objector-Appellants-Cross-Appellees on the electronic docketing system for the Court of Appeals for the Third Circuit, thereby effecting service on counsel of record under L.A.R. 113.4.

I hereby certify that I instructed my printer to mail, on January 4, 2012, ten true and correct copies of the foregoing brief to: Office of the Clerk, United States Court of Appeals for the Third Circuit, 21400 United States Courthouse, 601 Market Street, Philadelphia, PA 19106.

3. Certification of Word Count

I hereby certify that this brief, an "appellant's response and reply brief" that responds to two separate cross-appeals, complies with the page limitation of Fed. R. App. Proc. 28.1(e)(2)(A)(i) because this brief contains 12,391 words in the main body

of the brief, excluding the parts of the brief exempted by Fed. R. App. Proc. 32(a)(7)(B)(iii).

I further certify that this brief complies with the typeface requirements of Fed. R. App. Proc. 32(a)(5) and the typestyle requirements of Fed. R. App. Proc. 32(a)(6) because this brief has been prepared in proportionally-spaced typeface using Microsoft Word 2010 in 14–point Garamond font.

4. Certification of Identical Compliance of Briefs

Pursuant to L.A.R. 31.1(c), I hereby certify that the electronic and hard copies of Brief of Objector Appellants in the instant matter contain identical text.

5. Certification of Virus Check

Pursuant to L.A.R. 31.1(c), I hereby certify that a virus check of the electronic .PDF version of the Brief was performed using McAfee SecurityCenter software, and the .PDF file was found to be virus free.

Dated: January 4, 2012

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