NO. 11-16097

IN THE UNITED STATES COURT OF APPEALS
FOR THE NINTH CIRCUIT

In re HP INKJET PRINTER LITIGATION

NICKLOS CIOLINO, *et al.*,
Plaintiffs-Appellees,

v.

Kimberly Schratwieser and Theodore H. Frank,
Objectors-Appellants,

v.

HEWLETT-PACKARD COMPANY,
Defendant-Appellee.

On Appeal from the United States District Court
for the Northern District of California, No. 5:05-cv-03580-JF

Opening Brief
of Appellants Kimberly Schratwieser and Theodore H. Frank

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Statement of Subject Matter and Appellate Jurisdiction

The district court had diversity jurisdiction under the Class Action Fairness Act, 28 U.S.C. §1332(d)(2)(A), because the case is a class action filed under Fed. R. Civ. Proc. 23 involving allegations of violations of state consumer fraud law; at least one member of the class is a citizen of a state different from one defendant; the number of members of all proposed plaintiff classes in the aggregate is at least 100; the aggregate amount in controversy exceeds $5 million, exclusive of interest and costs; and no statutory exception to 28 U.S.C. § 1332(d)(2) applies. For example, class member and objector Kimberly Schratwieser is a citizen of Illinois, and defendant Hewlett-Packard Co. ("HP") is a Delaware corporation with its principal place of business in California.

The court's final judgment, pursuant to Fed. R. Civ. Proc. 58, issued on March 29, 2011. ER16; ER32. Objector Lori Meyer filed a timely notice of appeal, No. 11-16092, on April 27, 2011. Dkt. 292. Objectors Kimberly Schratwieser and Theodore Frank (collectively "Schratwieser"), the appellants in this case, filed a notice of appeal on April 28, 2011. ER43-50. This notice is timely under both Fed. R. App. Proc. 4(a)(1)(A) and 4(a)(3).

This court has appellate jurisdiction because this is a timely-filed appeal from a final judgment under 28 U.S.C. § 1291. Schratwieser has standing to appeal a final approval of a class action settlement without the need to intervene formally in the case. *Devlin v. Scardeletti,* 536 U.S. 1 (2002).

Statement of the Issues

1. The Ninth Circuit requires a district court evaluating a settlement under Fed. R. Civ. Proc. 23 to consider "signs that class counsel have allowed pursuit of their own self-interests" to unfairly "infect the negotiations," such as disproportionate attorney-fee requests, clear-sailing agreements, and "kickers" providing reversions to the defendant. *In re Bluetooth Headset Prod. Liab. Litig.*, 654 F.3d 935, ---, 2011 U.S. App. LEXIS 17224 at *28–31 (9th Cir. 2011). Did the district court err as a matter of law when it failed to consider signs of self-dealing in approving a settlement where the value of the benefits to the class was at most $1.5 million, but class counsel sought $2.9 million in fees and expenses, aided by a clear-sailing agreement, and the court's reduction of the fee request by $0.8 million reverted to the defendant instead of the class? (Raised at ER149, ER59–63. Ruled on at ER6, ER21–32.)

Standard of Review: A district court decision to approve a class action settlement is reviewed for abuse of discretion. *Molski v. Gleich,* 318 F.3d 937, 953 (9th Cir. 2003). A failure to apply the correct law is an abuse of discretion. *Casey v. Albertson's Inc.*, 362 F.3d 1254, 1257 (9th Cir. 2004).

2. The Ninth Circuit holds that where "the defendant is willing to pay a certain sum in attorneys' fees as part of the settlement package, but the full fee award would be unreasonable, there is ***no apparent reason*** the class should not benefit from the excess allotted for fees." *Bluetooth* at *34–35 (emphasis added). Is a settlement *per se* unfair under Rule 23(e) when the defendant was willing to pay a certain sum in attorneys' fees as part of the settlement package, the court held the full

fee award unreasonable, and the excess did not revert to the class? (Raised at ER149, ER59–63. Ruled on at ER6, ER21–32.)

Standard of Review: Questions of law about the interpretation of the Federal Rules of Civil Procedure are reviewed *de novo*. *United States v. Clifford Matley Family Trust*, 354 F.3d 1154, 1159 n.4 (9th Cir. 2004).

3. Did the district court err as a matter of law in failing to consider hundreds of objections filed with the settlement administrator pursuant to the instructions in the class notice? (Raised at ER115–16. Ruled on at ER20.)

Standard of Review: Questions of law about the interpretation of the Federal Rules of Civil Procedure are reviewed *de novo*. *Id.*

4. If the district court correctly held that hundreds of objections were invalid, is notice adequate when it, in fact, misleads nearly 99 percent of class members who wish to object to the settlement? (Raised at ER115–16. Ruled on at ER5–6.)

Standard of Review: Whether notice of a proposed settlement in a class action satisfies due process is a question of law that is reviewed *de novo*. *Molski*, 318 F.3d at 951; *Torrisi v. Tucson Elec. Power Co.*, 8 F.3d 1370, 1374 (9th Cir. 1993).

5. The Ninth Circuit requires "adequate explanation in the record of any 'special circumstances' justifying a departure" from a 25% benchmark for attorneys' awards. *Bluetooth* at *14. The Class Action Fairness Act requires attorneys' fees in a coupon settlement to be based on the actual redemption rate of the coupons. Did the district court abuse its discretion in calculating the value of the settlement benefit

without knowing the redemption rate, finding prospective injunctive relief to have value, and then awarding 58% of the settlement benefit to the attorneys without providing any explanation for a departure from the 25% benchmark? (Raised at ER141–52, ER59–63, ER105–15. Ruled on at ER29–31.)

Standard of Review: The district court's decision to award attorneys' fees is reviewed for abuse of discretion. *Bluetooth* at *8. A district court must specify its reasons for approving a particular attorneys' fee award, so that the appellate court may conduct meaningful review. *Powers v. Eichen,* 229 F.3d 1249, 1256 (9th Cir. 2000). A failure to apply the correct law is an abuse of discretion. *Casey v. Albertson's Inc.*, 362 F.3d 1254, 1257 (9th Cir. 2004).

6. Should the Ninth Circuit join other courts in holding that one should not infer class support of a consumer class action settlement from the invariable fact that only a small percentage of class members will take the trouble to object? (Raised at ER152–54. Ruled on at ER28.)

Standard of Review: Questions of law about the interpretation of the Federal Rules of Civil Procedure are reviewed *de novo*. *United States v. Clifford Matley Family Trust*, 354 F.3d 1154, 1159 n.4 (9th Cir. 2004).

Statutes and Rules

28 U.S.C. § 1711 note.

…

§2(a) Findings. Congress finds the following: …

(3) Class members often receive little or no benefit from class actions, and are sometimes harmed, such as where—

(A) counsel are awarded large fees, while leaving class members with coupons or other awards of little or no value; …

28 U.S.C. § 1712.

(a) Contingent Fees in Coupon Settlements. If a proposed settlement in a class action provides for a recovery of coupons to a class member, the portion of any attorney's fee award to class counsel that is attributable to the award of the coupons shall be based on the value to class members of the coupons that are redeemed.

Federal Rule of Civil Procedure 23. Class Actions.

(a) Prerequisites.

One or more members of a class may sue or be sued as representative parties on behalf of all members only if

…

(4) the representative parties will fairly and adequately protect the interests of the class.

…

(e) Settlement, Voluntary Dismissal, or Compromise.

The claims, issues, or defenses of a certified class may be settled, voluntarily dismissed, or compromised only with the court's approval. The following procedures apply to a proposed settlement, voluntary dismissal, or compromise:

(1) The court must direct notice in a reasonable manner to all class members who would be bound by the proposal.

(2) If the proposal would bind class members, the court may approve it only after a hearing and on finding that it is fair, reasonable, and adequate.

…

(5) Any class member may object to the proposal if it requires court approval under this subdivision (e); the objection may be withdrawn only with the court's approval.

Statement of the Case

On October 1, 2010, the district court consolidated three separate putative class complaints against HP over its business practices relating to their inkjet printers' use of ink cartridges. ER2. The complaint in the lead case, *Ciolino v. Hewlett-Packard Co.*, No. 05-cv-3580-JF, had alleged a variety of consumer fraud and contractual violations relating to HP's "low on ink" warnings; *Rich v. Hewlett-Packard Co.*, No. 06-cv-3361-JF, had alleged a variety of consumer fraud and contractual violations relating to HP's disclosures relating to "underprinting" (the use of color ink when printing black text and images); the complaint in *Blennis v. Hewlett-Packard Co.*, No. 07-cv-333-JF, had alleged a variety of claims sounding in consumer fraud, tort, and contract relating to an alleged design that shuts down printers and cartridges on an undisclosed expiration date when there is still usable ink available. Dkt. 18; *Rich* Dkt. 1; *Blennis* Dkt. 1.

The district court denied class certification in *Ciolino*. Dkt. 170. Before class certification in *Rich* and *Blennis*, the parties settled all three actions. The district court granted preliminary approval of the settlement on October 1, 2010. ER33–42.

Objectors Kimberly Schratwieser and Theodore H. Frank ("the appellants" or "the Schratwieser objectors" or collectively "Schratwieser") timely objected. ER129–56. Hundreds of other class members objected pursuant to the instructions in the class notice (ER211; ER83; ER95–97), but the settling parties never submitted these objections to the district court. The district court characterized the hundreds as "non-

filed comments/complaints" and considered only the five objections filed on the docket by attorneys. ER2; ER20; ER28.

The district court held a fairness hearing on January 28, 2011. ER51–81. The district court issued final judgment and an order and opinion approving the settlement and determining attorneys' fees on March 29, 2011. ER1–32. The court valued the combination of coupon and injunctive relief at $1.5 million. ER30–31. The settlement provided for a class counsel request of $2.9 million in fees and expenses. ER177 (Settlement § 44). The attorneys divided that request into one for just over $2.3 million in fees and one for $596,990.70 in expenses. Dkt. 261. The district court awarded $1.5 million in fees and the full expense request. ER10, 31.

Schratwieser and Frank filed their notice of appeal on April 28, 2011. ER43–50.

Statement of the Facts

A. The Settlement Agreement.

In exchange for a release of all claims against HP related to the claims in the case (ER166–68, 179–80), HP provided the opportunity for class members to obtain up to $5,000,000 face value of what the parties called "e-credits"—coupons to purchase products on the HP.com website. (One of the lead class counsel admitted in an article he wrote in a trial-lawyer magazine that the "e-credit" was "a new term for the much maligned coupon." ER90.) A *Ciolino* class member was eligible for "up to a $5.00 e-credit"; a *Rich* class member was eligible for "up to a $2.00 e-credit," and a *Blennis* class member was eligible for "up to a $6.00 e-credit." ER174–76. To make a

claim for a coupon, class members would have to complete an electronic claim form using the printer serial number and (with respect to two of the three classes) submit a signed declaration form. *Id.* This was sufficiently burdensome (ER123) that only 122,410 of the 40 million or so class members claimed coupons with a face value of only $1,465,629. ER20–21. The provision of the settlement calling for *pro rata* reduction in the face value of the coupons if claims exceeded $5 million (ER174) was therefore not exercised.

The coupons expire six months after issue, cannot be transferred outside of the owner's immediate family, may not be used in combination with other rebates or coupons for HP products (including other e-credits), and may only be used at the HP.com website. ER25; ER176–77 (Settlement § 42). The coupons do not issue until after the Effective Date when all appeals have been resolved (ER177 (Settlement §43)), so the redemption rate is still unknown.

The settlement provided that class counsel could request a total of fees and expenses of $2.9 million. ER177 (Settlement § 44). The settlement contained a clear sailing clause prohibiting HP from challenging the fee request and a "kicker"; any reduction in the attorneys' fees would revert to HP. *Id.*; ER178 (Settlement § 48).

Under the settlement, HP also agreed to a number of minor changes to its business practices for future purchasers of printers and ink, such as discontinuing the use of certain pop-up messaging technology that displayed an image of an ink gauge and changing disclosures on its website, packaging, manuals, and user interfaces of its products. ER19; ER171–74 (Settlement §§33–37).

B. The Schratwieser/Frank Objectors and Objections

Kimberly Schratwieser purchased a HP Officejet Pro 8500 Premier All-In-One Printer in 2009; she is therefore a member of the *Rich* and *Blennis* classes. ER137, 168, 271. She never filed a claim because she was able to purchase HP ink more cheaply from Staples, which gives store credit for recycling used ink cartridges, than from the HP website; the e-credits were therefore worthless to her. ER137.

Theodore Frank received as a gift an HP Officejet Pro L7580 All-In-One in 2008, making him a member of the *Rich* and *Blennis* classes. ER137, 168, 271. After spending 20 minutes on the task, Frank was able to file for a *Rich* e-credit electronically that the settlement valued at "up to $2.00." ER123. He found the process of filing for a *Blennis* e-credit of "up to $6.00" to be too burdensome to be worth the bother after finding that the settlement website was incompatible with Google Chrome. ER123–24. Frank emailed the claims administrator suggesting that the problem be fixed, but never received a reply. *Id.* The coupon is worthless to Frank: purchasing ink is cheaper on Amazon.com without the coupon than on hp.com with the coupon. ER124–25.

The Schratwieser objectors were represented *pro bono* through the non-profit Center for Class Action Fairness. ER138.

Schratwieser criticized the settlement on several grounds. First, she argued that the e-credits constituted a coupon settlement that was particularly objectionable because it failed to provide a benefit to the class while simultaneously providing a benefit to the defendant. ER141–42. Second, Schratwieser argued that any injunctive

relief that the settlement provided was worthless to the class as a matter of law, because it failed to compensate for any past harms. ER145–47. Third, Schratwieser argued that class counsel's fee request disproportionate to the benefits that the settlement allegedly procured for the class, combined with a "clear sailing" agreement that insulated the fees from challenge by the defendant, made it a self-serving fee-driven settlement at the expense of the class that could not meet the Rule 23(a)(4) or Rule 23(e) standard. ER149. Under the Class Action Fairness Act, any fees had to be proportional to the number of coupons actually redeemed. ER149–52.

C. The Silenced Objectors.

Hundreds of other class members objected, but their objections were classified as "comments/complaints" and ignored. ER2. These class members apparently followed the instructions in the section of the class notice labeled "Your Rights and Choices—Objecting to the Proposed Settlement," which instructed objectors to email their objections to the settlement administrator and the settling parties' lead attorneys. ER220–21. This is a common means of lodging objections; in such cases, the settling parties then compile the objections and file them with the court. ER83.

In this case, however, the settling parties claimed that class members who followed the instructions contained in the class notice, but who did not formally file their objections with the district court, waived their objections. The settling parties never submitted the hundreds of other objections to the court, and those class members were never heard. One such class member got in touch with Frank, who noted and objected to this procedure. ER115–16. That class member, the

Connections Academy, was entitled to tens of thousands of dollars of coupons under the settlement because it had purchased 36,000 printers for its students, but objected through its in-house counsel that the settlement's requirement to redeem those coupons only through tens of thousands of separate purchase orders $2 at a time made the settlement unfair to it. ER95–97. Ultimately, the district court determined that "only five [people] have filed formal objections"; when the court weighed the reaction of the class to the settlement, it found that "only a handful filed objections," and used that finding to infer class approval of the settlement, using that conclusion as a factor in its determination to approve the settlement. ER28.

D. The Fairness Hearing and Rulings.

The court held its fairness hearing on January 28, 2010. ER51–81. It issued its order and opinion approving the settlement and determining attorneys' fees on March 29, 2011. ER1–32.

The court held that "only five [people] have filed formal objections." ER20. It found that "$1,465,629.00 in e-credits have been approved." ER21. It certified the action for settlement purposes (ER4), and found that the settlement was fair, reasonable, and adequate. ER3.

The district court agreed with the objectors that the e-credits were coupons that could not be valued at face value: it found that the nature of and restrictions on the coupons "significantly reduces their cash value" and makes them, in many ways, "indistinguishable from a marketing technique that HP might employ to attract consumers." ER25.

On the question of the value to the class members of injunctive relief, the Schratwieser objectors had contended that prospective relief is no compensation for past harm; the court, apparently agreeing, called this an "obvious point." ER26. The court nevertheless found that "injunctive relief is of some value to the class," but rejected the plaintiffs' valuation of the injunctive relief and disregarded a speculative expert report. ER26–27.

Yet when making its final decision to approve the settlement, the court based its conclusion on "the limited value of the relief obtained … in relation to the strength of Plaintiffs' claims," saying that objectors "uniformly failed to address this question." ER27. Finding that "there is no evidence of fraud or collusion," and noting that "only a handful filed objections," the court held that the reaction of class members to the settlement was a factor that favored its approval. ER28. In short, because "the settlement was arrived at as a result of arms-length, non-collusive negotiations, and the value of the settlement is reasonable in light of the evident weakness of the case and the modest value of Plaintiffs' claims," the district court approved the settlement agreement. ER28.

The court made a finding that the combined value of the injunctive and coupon relief was "roughly $1.5 million." ER30–31. Because plaintiffs' request for fees exceeded "that amount by more than half a million dollars … the extent to which an attorneys' fee award exceeds the value of the settlement to the class is problematic, particularly given the 'coupon' nature of the settlement." ER31. Partially because "the Court still has serious questions as to whether consumers actually incurred significant

injury from HP's actions," the district court elected to reduce attorneys' fees from just over $2.3 million down to $1.5 million. ER31. The result, however, was to order payment to the class attorneys just under $2.1 million, because the class attorneys had designated that they were requesting $2.3 million in fees and $0.6 million in expenses; the court called these expenses "costs" in awarding them. ER31. The court's decision did not mention the 25% benchmark or explain why it was departing from it.

Summary of the Argument

There are several independent reasons for this Court to vacate the settlement approval and fee award.

First, the district court erred as a matter of law in focusing purely on the question of explicit collusion: in particular, the court erred by never testing whether the class attorneys impermissibly breached their fiduciary duty to the class through self-dealing provisions that gave the lion's share of settlement benefits to class counsel instead of the class, in violation of the Class Action Fairness Act. The district court conflated other objectors' complaints about the size of the settlement with Schratwieser's argument that, although the parties are entitled to negotiate a settlement with a $2.9 million value (or, as the court found, a $3.6 million value), the parties are not entitled to negotiate a settlement that benefits the attorneys more than the class. If the district court's valuation of the class benefit at $1.5 million is credited, then the attorneys are receiving over 58% of the constructive common fund (after asking for 66% of the constructive common fund). Because the "kicker" provision

prejudices the class by preventing a district court from curing the class counsel's self-dealing through reducing the attorneys' fee request, the settlement cannot stand as a matter of law. *Bluetooth* at *34–35. In any event, the failure of the district court to consider the question of self-dealing requires remand.

Second, the district court failed to address the flaw in the notice that kept hundreds of class members who wished to object to the settlement—including sophisticated counsel of a major educational institution—from doing so. The flaw could have been cured by ordering the settling parties to provide the hundreds of hidden objections to the district court. It is ironic that plaintiffs brought a case alleging that a minority of class members were deceived by HP communications, and then issued a notice that actually confused nearly 99% of the class members that wished to object. The settlement must be rejected because of failure to provide non-misleading notice. The district court found that a factor in favor of approval of the settlement was the "handful [of] filed objections"; but this premise is false and this analysis should be considered an error of law: it is groundless for courts to infer support for a settlement from a small number of objections to a low-dollar consumer class action.

Third, even if the settlement approval were valid, the fee award cannot stand. Even if the district court's hypothetical valuation could stand under the law, it resulted in the class attorneys recovering 58% of the class benefit, and the court gave no explanation for why it was appropriate to depart from the Ninth Circuit's 25% benchmark. But the district court's hypothetical valuation is clearly erroneous. The

Class Action Fairness Act requires a coupon settlement to be valued by the actual redemption rate, not a hypothetical redemption rate, when calculating attorneys' fees. And the court's valuation of the injunctive relief failed to address potential offsetting costs to the class that made the relief an illusory benefit.

For each of these independent reasons, the judgment below must be vacated; for the first reason, this Court should also hold that the settlement cannot be approved.

Preliminary Statement

The non-profit Center for Class Action Fairness LLC is representing the appellants *pro bono*. The Center's mission is to litigate on behalf of class members against unfair class-action procedures and settlements, and it has won millions of dollars for class members. *See, e.g.,* Ashby Jones, *A Litigator Fights Class-Action Suits*, Wall St. J. (Oct. 31, 2011); Allison Frankel, *Legal Activist Ted Frank Cries Conflict of Interest, Forces O'Melveny and Grant & Eisenhofer to Modify Apple Securities Class Action Deal*, American Lawyer Lit. Daily (November 30, 2010). Plaintiffs, citing cases criticizing "professional objectors" that file bad-faith objections to extort class counsel, have previously attempted to tar counsel as a "professional objector" because he has filed multiple objections to class action settlements. Dkt. 271. This is wrong: "professional objector" is a specific legal term referring to a for-profit attorney who files objections to blackmail plaintiffs' attorneys for payment in exchange for withdrawing his or her objections. Paul Karlsgodt & Raj Chohan, *Class Action Settlement Objectors: Minor Nuisance or Serious Threat to Approval*, BNA: Class Action Litig.

Report (Aug. 12, 2011) (distinguishing the Center from professional objectors); Edward Brunet, *Class Action Objectors: Extortionist Free Riders or Fairness Guarantors*, 2003 U. Chi. Legal Forum 403, 437 n.150 (public interest groups are not "professional objectors"). Neither the Center nor Frank has ever agreed to a *quid pro quo* settlement of an objection. ER263. This objection is brought in good faith to overturn an unfair settlement, and to create precedent deterring future settlements designed to benefit attorneys at the expense of their putative clients.

Argument

I. The District Court Abused Its Discretion by Failing to Consider This Settlement's Multiple Signs of Self-Dealing.

Because of the weakness of the underlying case, the district court found that the amount the class received was satisfactory and that there was no actual collusion between the defendants and the class counsel. ER28. But while this is *necessary* to approve a settlement, it is not *sufficient*. Schratwieser's objection rests (*inter alia*) on an entirely different sort of unfairness: that of impermissible self-dealing by the class counsel "when counsel receive a disproportionate distribution of the settlement." *In re Bluetooth Headset Prod. Liab. Litig.*, 654 F.3d 935, ---, 2011 U.S. App. LEXIS 17224 at *28 (9th Cir. 2011) (*quoting Hanlon v. Chrysler Corp.,* 150 F.3d 1011, 1021 (9th Cir. 1998)).

At the fairness hearing, the district judge complained that "none of the objections really address the merits of the claims," and asked objectors to discuss

them. ER57–59. In response, the Schratwieser objectors expressly stated their objection was not based on the question of the size of the settlement relative to the strength of the case; rather, that objection was based on a concern that—because of class counsel's metastasized fee request—the interests of the class weren't being fairly and adequately represented by class counsel. ER59. To wit, Schratwieser does not argue that the parties colluded to eliminate legitimate class claims; nor does she dispute that the parties can choose to settle in the neighborhood of $3 to $5 million. She does dispute, however, that class counsel can arrange such a settlement where class counsel captures a share of the benefits well in excess of the Ninth Circuit's 25% benchmark, with no hope of the class recapturing the overage of the unreasonable fee request. ER105. Such a settlement is unfair, but it does not require collusion, just a defendant's indifference to class counsel's conflict of interest. But the district court failed to address this.

When class counsel negotiates more benefits for itself than for the class in a consumer class action over quantifiable pecuniary claims (as opposed to, for instance, class actions over civil rights), it must structure the settlement to permit the district court to cure the self-dealing. Instead, class counsel negotiated a "kicker" clause in an attempt to shield their fee request. This adversely affected the class's interests without any offsetting benefit: assuming *arguendo* that the settlement benefit was $1.5 million, HP was willing to pay $4.4 million to settle the litigation, agreeing not to challenge a $2.9 million request by the attorneys. The court partially resolved the unfair fee request by reducing it $0.8 million—but that money reverted to HP instead of the

class. The very fact that HP is only paying $3.6 million instead of the $4.4 million it was willing to pay (and that the class counsel is *still* receiving the majority of the benefit) demonstrates the settlement's inherent unfairness. *Bluetooth* at *34–35 ("there is no apparent reason the class should not benefit from the excess allotted for fees"). The settlement is impermissibly self-dealing, and should not stand as a matter of law.

In any event, the failure of the district court to address the issue of self-dealing requires remand.

A. A District Court Must Protect Absent Class Members' Interests.

This Circuit's precedents call upon courts to consider an eight-factor test to evaluate the fairness of a settlement: "the strength of plaintiffs' case; the risk, expense, complexity, and likely duration of further litigation; the risk of maintaining class action status throughout the trial; the amount offered in settlement; the extent of discovery completed, and the stage of the proceedings; the experience and views of counsel; the presence of a governmental participant; and the reaction of the class members to the proposed settlement." *Churchill Vill., LLC v. General Elec.*, 361 F.3d 566, 575 (9th Cir. 2004). But "where, as here, a settlement agreement is negotiated prior to formal class certification, consideration of these eight *Churchill* factors alone is not enough to survive appellate review." *Bluetooth* at *27.

"[W]here the court is '[c]onfronted with a request for settlement-only class certification,' the court must look to the factors 'designed to protect absentees.'" *Molski v. Gleich*, 318 F.3d 937, 953 (9th Cir. 2003) (*quoting Amchem Prods., Inc. v. Windsor*, 521 U.S. 591, 620 (1997)). "[S]ettlements that take place prior to formal class

certification require a higher standard of fairness." *Molski*, 318 F.3d at 953 (*quoting Dunleavy v. Nadler*, 213 F.3d 454, 458 (9th Cir. 2000) *and citing Hanlon v. Chrysler Corp.*, 150 F.3d 1011, 1026 (9th Cir. 1998)). Courts "must be particularly vigilant not only for explicit collusion, but also for more subtle signs that class counsel have allowed pursuit of their own self-interests … to infect the negotiations." *Bluetooth* at *28 (*citing Staton v. Boeing Co.*, 327 F.3d 938, 960 (9th Cir. 2003)).

Other circuits agree. A "district court ha[s] a fiduciary responsibility to the silent class members." *Grant v. Bethlehem Steel Corp.*, 823 F.2d 20, 23 (2d Cir. 1987). It is not enough that the settlement happened to be at "arm's length" without explicit collusion; the settlement must be objectively reasonable as well and avoid self-dealing by the class counsel. "Because class actions are rife with potential conflicts of interest between class counsel and class members, district judges presiding over such actions are expected to give careful scrutiny to the terms of proposed settlements in order to make sure that class counsel are behaving as honest fiduciaries for the class as a whole." *Mirfasihi v. Fleet Mortgage Corp.*, 356 F.3d 781, 785 (7th Cir. 2004) (Posner, J.).

B. This Settlement Has All Three Signs of *Bluetooth* Self-Dealing.

The concerns about the potential conflict of interest between class counsel and their clients "warrant special attention when the record suggests that settlement is driven by fees; that is, when counsel receive a disproportionate distribution of the settlement…" *Hanlon v. Chrysler Corp.*, 150 F.3d 1011, 1021 (9th Cir. 1998); *accord Bluetooth* at *28. "If fees are unreasonably high, the likelihood is that the defendant obtained an economically beneficial concession with regard to the merits provisions,

in the form of lower monetary payments to class members or less injunctive relief for the class than could otherwise have obtained." *Staton v. Boeing Co.*, 327 F.3d 938, 964 (9th Cir. 2003); *accord Bluetooth* at *30.

Any court judging the fairness of a class action faces "a responsibility difficult to discharge when the judge confronts a phalanx of colluding counsel. The defendant wants to minimize outflow of expenditures and the class counsel wants to increase inflow of attorneys' fees. Both can achieve their goals if they collude to sacrifice the interests of the class." *Thorogood v. Sears Roebuck & Co.*, 547 F.3d 742, 745 (7th Cir. 2008) (Posner, J.), *vacated on other grounds by Thorogood v. Sears Roebuck & Co.*, -- S. Ct. --, 2011 U.S. LEXIS 4939 (2011).

That collusion need not be explicit: "a defendant is interested only in disposing of the total claim asserted against it" and "the allocation between the class payment and the attorneys' fees is of little or no interest to the defense." *Staton*, 327 F.3d at 964 (*quoting In re General Motors Corp. Pickup Truck Fuel Tank Prod. Liab. Litig.*, 55 F.3d 768, 819-20 (3d Cir. 1995)); *accord Bluetooth* at *34; *Mirfasihi*, 356 F.3d at 785. Because of this, it is an error to conclude that once the prospect of express collusion is eliminated, the inquiry is therefore at an end: class counsel can achieve an impermissible self-dealing settlement simply through a defendant's indifference to the allocation. *Staton*, 327 F.3d at 964. Thus, courts judging the fairness of a settlement should not just simply ask whether a settlement was negotiated at arms' length, but whether the attorneys are unfairly pursuing their self-interest at the expense of the class. *Bluetooth* at *28; *id.* at *31 ("While the Rule 23(a) adequacy of representation

inquiry is designed to foreclose class certification in the face of 'actual fraud, overreaching or collusion,' the Rule 23(e) reasonableness inquiry is designed precisely to capture instances of unfairness not apparent on the face of the negotiations." (*quoting Staton,* 327 F.3d at 960)); *cf. also* American Law Institute, *Principles of the Law of Aggregate Litigation* § 3.05, *comment b* at 208 (2010) ("a proposed settlement in which the class receives an insubstantial payment while the fees requested by counsel are substantial could raise fairness concerns").

Bluetooth suggests a nonexclusive list of three possible signs. As in *Bluetooth*, all three of these "multiple indicia" of unfairness are present here. *Bluetooth* at *28–30.

First, "counsel receive[d] a disproportionate distribution of the settlement." *Bluetooth* at *28 (*quoting Hanlon*, 150 F.3d at 1021). Class counsel asked for $2.9 million for themselves, when the class would receive benefits that the district court valued at $1.5 million. That is 66% of what is a constructive common fund. *GM Pick-Up*, 55 F.3d at 820 (3rd Cir. 1995) (severable fee structure "is, for practical purposes, a constructive common fund"); *id.* at 821 ("[P]rivate agreements to structure artificially separate fee and settlement arrangements cannot transform what is in economic reality a common fund situation into a statutory fee shifting case."); *Johnson v. Comerica*, 83 F.3d 241 (8th Cir. 1996) ("[I]n essence the entire settlement amount comes from the same source. The award to the class and the agreement on attorney fees represent a package deal."). "If an agreement is reached on the amount of a settlement fund and a separate amount for attorney fees" then "the sum of the two amounts ordinarily should be treated as a settlement fund for the benefit of the class, with the agreed-on

fee amount constituting the upper limit on the fees that can be awarded to counsel." *Manual for Complex Litigation* § 21.71 (4th ed. 2008). That 66% figure is more than double, and approaches triple, the 25% benchmark in this Circuit. *See, e.g., Bluetooth* at *14; *Six Mexican Workers v. Arizona Citrus Growers,* 904 F.2d 1301, 1311 (9th Cir. 1990); *Torrisi v. Tucson Elec. Co.,* 8 F.3d 1370, 1376 (9th Cir. 1993).

"Even if the plaintiff's attorney does not consciously or explicitly bargain for a higher fee at the expense of the beneficiaries, it is very likely that this situation has indirect or subliminal effects on the negotiations." Report of the Third Circuit Task Force, *Court Awarded Attorney Fees*, 108 F.R.D. 237, 266 (1985).[1]

Second, the settlement has a "clear sailing" arrangement providing for the payment of attorneys' fees separate and apart from class funds without challenge from the defendants. *Bluetooth* at *29. A clear sailing clause stipulates that attorney awards

[1] The fact that fees may not be negotiated until after the rest of the settlement should make no difference. The settling parties are rational economic actors. Even when the negotiations over fees are severed, the parties know in advance that those negotiations are coming, that the defendants have a reservation price based on their internal valuation of the litigation, and that every dollar negotiated for the class reduces the amount the defendants are willing to pay class counsel. Because these future fee negotiations are not an unexpected surprise, the overhang of the future fee negotiations necessarily infects the earlier settlement negotiations. This is invariably at the expense of the class when there is a separate fund for fees, because both class counsel and the defendans have an incentive to leave extra "space" for that future negotiation in a bifurcated negotiation that the parties do not need to have when it is simply negotiating for a single pot of money to go into a common fund. *Cf. Bluetooth* at *31 (neither presence of neutral mediator nor separation of fee negotiations from other settlement negotiations demonstrates that a settlement is fair).

will not be contested by opposing parties. "Such a clause by its very nature deprives the court of the advantages of the adversary process." *Weinberger v. Great Northern Nekoosa Corp.,* 925 F. 2d 518, 525 (1st Cir. 1991). The clause "suggests, strongly," that its associated fee request should go "under the microscope of judicial scrutiny." *Weinberger,* 925 F. 2d at 518, 525. The clear sailing clause lays the groundwork for lawyers to "urge a class settlement at a low figure or on a less-than-optimal basis in exchange for red-carpet treatment on fees." *Id.* at 524; *accord Bluetooth* at *29. Here, class counsel put its own fees ahead of the interests of the class by negotiating a provision that insulated those fees from challenge by the defendant. ER149.[2]

Third, the "parties arrange[d] for fees not awarded to revert to defendants rather than be added to the class fund." *Bluetooth* at *29. A "kicker arrangement reverting unpaid attorneys' fees to the defendant rather than to the class amplifies the danger" that is "already suggested by a clear sailing provision." *Id.* at *34. "The clear sailing provision reveals the defendant's willingness to pay, but the kicker deprives the

[2] The problem of shielding fee requests from scrutiny is exacerbated by this Court's decision in *Glasser v. Volkswagen of Am.,* 645 F.3d 1084 (9th Cir. 2011), which holds class members have no standing to object to the amount in separate fee arrangements unless they also challenge the settlement under a constructive common fund theory. *But see Devlin v. Scardelletti,* 536 U.S. 1, 7 (2002) (no question that objectors have standing, because a class member-objector's "complaint clearly falls within the zone of interests of the requirement that a settlement be fair to all class members" (citing Fed. R. Civ. Proc. 23(e))), which *Glasser* failed to cite or distinguish. If *Glasser* remains good law, it provides an additional reason to hold such clear-sailing arrangements to be impermissible self-dealing without evidence that the clear-sailing arrangement permitted the class to realize benefits it could not have realized otherwise.

class of that full potential benefit if class counsel negotiates too much for its fees." *Id.* at *35. Unless this Court decides that "a kicker provision is in the class's best interest as part of the settlement package, the kicker makes it less likely that the settlement can be approved if the district court determines the clear sailing provision authorizes unreasonably high attorneys' fees." *Id.*

Though it did not happen in this particular instance, a "kicker" will likely have the additional self-serving effect of protecting class counsel by deterring scrutiny of the fee award. *First*, a court has less incentive to scrutinize a fee award, because the kicker combined with the clear sailing agreement means that any reversion will only go to the defendant that had already agreed to pay that amount. Charles Silver, *Due Process and the Lodestar Method*, 74 Tulane L. Rev. 1809, 1839 (2000) (such a fee arrangement is "a strategic effort to insulate a fee award from attack"). *Second*, the kicker deters scrutiny of class counsel in another way: under current Ninth Circuit law, objectors are not entitled to fees unless they provide a substantial benefit to the class. *Vizcaino v. Microsoft Corp.*, 290 F.3d 1043, 1052 (9th Cir. 2002). But because a reduction of fees in a kicker settlement revert to the defendant, a good-faith objector has no financial incentive to object to the fee arrangement. Schratwieser's objection was successful in many ways: the district court adopted much of Schratwieser's reasoning and brief language in finding that the coupons did not have full face value, in rejecting plaintiffs' expert report, and in reducing attorneys' fees by $0.8 million. But because HP realized the $0.8 million rather than the class, *Vizcaino* did not permit

Schratwieser to seek attorneys' fees. *Cf.* Dkt. 310 (denying fee request of other objectors).

"Given the questionable features of the fee provision here, the court was required to examine the negotiation process with even greater scrutiny than is ordinarily demanded, and approval of the settlement had to be supported by a clear explanation of why the disproportionate fee is justified and does not betray the class's interests." *Bluetooth* at *36. By focusing solely on the narrow question of explicit collusion without considering the problem of self-dealing and defendant indifference, the district court failed to do that, and that alone requires vacation and remand. *Casey v. Albertson's Inc.*, 362 F.3d 1254, 1257 (9th Cir. 2004) (failure to apply correct law is abuse of discretion).

C. The Excessive Fee Request Combined With the Reversion to the Defendants Violated Rule 23(a)(4) and Made the Settlement Unfair as a Matter of Law.

At a minimum, remand is required so the district court can consider the self-dealing problem identified in *Bluetooth*. But Schratwieser submits that *Bluetooth* requires this Court to go farther and hold the settlement unfair as a matter of law.

The *Bluetooth* warning signs create a special obligation for the district court "to assure itself that the fees awarded in the agreement were not unreasonably high … for if they were, 'the likelihood is that the defendant obtained an economically beneficial concession with regard to the merits provisions, in the form of lower monetary payments to class members or less injunctive relief for the class than could otherwise have been obtained.' " *Id.* at *30 (*quoting Staton*, 327 F.3d at 964, 965). The district

court certainly scrutinized the attorneys' fees—it reduced the $2.9 million request to $2.1 million (an amount that Schratwieser contends is still too high, *see* Section III below) because of the scant relief to the class.

But the district court failed to account for the unfairness of the settlement the oversized award to the attorneys demonstrates. At the fairness hearing, the court noted from the bench that "all of the objectors are saying the same thing in different ways, which is that the class really isn't getting much in proportion to what the lawyers are getting." ER67. At the hearing's end, the court said from the bench that it had to look at "the relative benefit to the class and to the lawyers." ER80. But when it came time to enter its order, the court only considered this question with respect to determining the fee amount, rather than to whether the disproportion rendered the settlement unfair. This was error. *Cf. Bluetooth* at *32–33 ("[i]t is the settlement *taken as a whole, rather than the individual component parts*, that must be examined for overall fairness. … The settlement must stand or fall *in its entirety*." (emphasis in original, quotations and citations omitted)).

The fee reduction imposed by the district court simply left the remainder in the pockets of the defendants. This is wrong. "If the defendant is willing to pay a certain sum in attorneys' fees as part of the settlement package, but the full fee award would be unreasonable, there is ***no apparent reason*** the class should not benefit from the excess allotted for fees." *Bluetooth* at *34–35 (emphasis added). The reversion of an oversized fee request to the defendant is *per se* self-dealing that makes the settlement inherently unfair under Rule 23(e).

Moreover, if "class counsel agreed to accept excessive fees and costs to the detriment of class plaintiffs, then class counsel breached their fiduciary duty to the class." *Lobatz v. U.S. West Cellular of Cal., Inc.,* 222 F.3d 1142, 1147 (9th Cir. 2000). When class counsel bring class litigation to benefit themselves, rather than their putative class clients, they cannot meet the adequacy requirements of Rule 23(a)(4), and the class should not be certified. *In re Aqua Dots Prod. Liab. Litig.*, 654 F.3d 748 (7th Cir. 2011) (Easterbrook, J.).

This fee-driven settlement cannot be approved as fair as a matter of law, and the district court decision approving the settlement must be reversed.

II. The Confusing Settlement Notice Punished 99% of the Objectors for Following Instructions; the Court Committed Reversible Error in Failing to Cure the Notice Defect.

In a case about insufficient and misleading disclosures, it is surprising that the settling parties induced the district court to approve a notice that, as interpreted by the settling parties and the court, confused nearly 99% of class members who objected. The class notice instructed objectors that they could object by emailing their objections to the settlement administrator and the settling parties' lead attorneys. ER220–21. Specifically, the notice approved by the court read:

> If you're a Class Member and don't exclude yourself, you can tell the Court you don't like the Proposed Settlement or some part of it. You can give reasons why you think the Court should not approve it. The Court will consider your views.

> To object, you must send a written objection by fax, U.S. mail, or e-mail setting forth your full name, current address, and telephone number to the Settlement Administrator and send by fax or U.S. mail a copy to Class Counsel and Defense Counsel postmarked no later than **December 8, 2010**. Please use the following addresses.
>
> [Here, the notice lists four addresses and email addresses: the settlement administrator, two of the plaintiffs' law firms, and counsel for HP.]
>
> You must also state in writing all objections and the reasons for each objection, and state whether you intend to appear at the Fairness Hearing either with or without separate counsel. You shall not be entitled to be heard at the Fairness Hearing or to object to the Settlement, and no written objections or briefs submitted by you shall be received or considered by the Court at the Fairness Hearing, unless written notice of your intention to appear at the Fairness Hearing and copies of any written objections and/or briefs are filed with the Court and served on Class Counsel and Defense Counsel on or before **December 8, 2010**. If you fail to file and serve timely written objections in the manner specified above, you shall be deemed to have waived all objections and shall be foreclosed from making any objection (whether by appeal or otherwise) to the Settlement.

(The deadline was changed in the actual notice sent to the class.) The notice did not give separate instructions on how to "file[] with the court" or the address for doing so.

The most natural reading of this notice is that one objects by sending a written objection by mail or email to the four addresses listed. This is not an unusual procedure: class action settlement notices frequently ask class members to file their

objections with the settlement administrator rather than with the court, and then provide copies of those objections to the court in a single docket entry. ER83. Indeed, there is no reason to require the settlement administrator to be served with an objection if the settlement administration is not going to compile objections for the benefit of the court.

At no point is it clearly stated that an objection must be sent to a fifth address. Indeed, there is a separate instruction for filing a notice of appearance for the fairness hearing that ***does*** explicitly require mailing the notice to the district court's address. ER222. The absence of the court address in FAQ 17 when it appears in FAQ 20 is another reason that it is reasonable to read FAQ 17 to require only a mailing to the four addresses listed.

Hundreds followed the instructions that the district court had approved. ER2 (counting 458 "Non-filed comments/complaints"). But the settling parties then withheld those hundreds of objections from the district court—which, by failing to address Schratwieser's complaint about the unfairness to those objectors (ER115–16), *sub silentio* held that those class members waived their objections. ER2; ER20. The hundreds of objections followed the instructions in the class notice, and the court should have considered them. The settlement approval must be reversed anyway, but the settling parties' decision to withhold hundreds of objections from the court is independent grounds for remand.

True: the preliminary approval order is more ambiguous than the notice, and its inconsistent instructions would suggest that an especially prudent attorney might wish

to use a belt-and-suspenders approach and separately file the objection with the district court. ER38–39. If one interprets the totality of these conflicting instructions as requiring objectors to file objections separately with the district court (as the district court apparently did *sub silentio*), then the settlement notice was impermissibly confusing.

"[S]ettlement notices are supposed to present information about a proposed settlement neutrally, simply, and understandably." *Rodriguez v. West Publishing Co.*, 563 F.3d 948, 962 (9th Cir. 2009). This did not happen here. Hundreds of class members followed the notice's instructions for objecting, and thought they were objecting, only to have their objections classified as "complaints" that were not considered by the district court. Hundreds of intended objections were kept out of the case; only five successfully jumped through procedural hoops that were conveyed by ambiguous directives, and at least one of those—Schratwieser's objection—was by happenstance. ER2; ER20; ER83. We know that one of those "complaints" that thought it was an objection (ER95 ("we continue to object")) raised the meritorious concern that the settlement provided the class member with over $70,000 of coupons, but made redemption of those coupons impossible (ER95–97): what other problems with the settlement are hidden in the hundreds of undocketed objections? The fact that so many class members failed to understand the instructions for objecting should demonstrate conclusively that the notice failed to meet the requirements of providing simple and understandable notice. The strict reading of an inexcusably confusing notice unnecessarily and unfairly prejudiced class members who reasonably relied on

the most reasonable reading of the notice. This would be an independent reason requiring reversal—a result that HP might prefer in the long run, because constitutionally invalid notice cannot bind absent class members.

The district court could have cured this problem by insisting that the parties provide the hundreds of objections that had been filed with the settlement administrator. Instead, regrettably, the district court found that "only a handful" of class members filed objections, and that this alleged absence of objections was a factor that weighed in favor of settlement. ER28. This is reversible error.

III. Even if the Settlement Approval Could Be Upheld, the Award to the Attorneys Is an Abuse of Discretion.

"While attorneys' fees and costs may be awarded in a certified class action where so authorized by law or the parties' agreement, Fed. R. Civ. P. 23(h), courts have an independent obligation to ensure that the award, like the settlement itself, is reasonable, even if the parties have already agreed to an amount." *Bluetooth* at *9–10 (citing cases).

The class attorneys requested payment that was substantially larger than the settlement's benefit to the class. The district court correctly identified this as improper: "the extent to which an attorneys' fee award exceeds the value of the class is problematic, particularly given the 'coupon' nature of the settlement." ER31. The district court correctly held that "[t]o allow the immediate parties to stipulate to pay class counsel a large sum whether or not a large benefit was conferred on the class–

and indeed even when it was not–would encourage collusive settlements. … Tethering fees (in part) to benefit will help guard against collusion in the general run of cases." ER31. The district reduced the award from $2.9 million to $2.1 million. ER29–31. But in the context of the court's discussion, this is a *non sequitur* accompanied by a fee that is still too high.

First, the court's award provides class counsel with 58% of the constructive common fund, without any justification for departing from this Circuit's 25% benchmark. *Second*, the court's award is based on an estimate that the value of the award to the class is "roughly $1.5 million" (ER30), but this estimate is not only improper under the Class Action Fairness Act but also overstates the value of what the class is receiving. Even if the settlement were not illegal, these errors would require remand.

A. The District Court Failed to Justify a Departure From the 25% Benchmark.

According to the district court, the value of the benefit to the class was "roughly $1.5 million." ER30. It then awarded $2.1 million to the attorneys. ER31. But this means that, of the $3.6 million constructive common fund, the attorneys are receiving $2.1 million, or over 58%. *See, e.g., GM Pick-Up,* 55 F.3d at 820-21 (considering automotive coupons and "separate" attorneys' fees as a common fund "in economic reality"). This 58% reward was not, and cannot, be justified.

The benchmark for a reasonable award in the Ninth Circuit in a case alleging economic injury is 25% of the class benefit. *See, e.g., Bluetooth* at *14; *Six Mexican*

Workers v. Arizona Citrus Growers, 904 F.2d 1301, 1311 (9th Cir. 1990); *Torrisi v. Tucson Elec. Co.,* 8 F.3d 1370, 1376 (9th Cir. 1993). Even if the plaintiffs wish an award based on their lodestar, a court must cross-check the request against the percentage of the fund. "Just as the lodestar method can 'confirm that a percentage of recovery amount does not award counsel an exorbitant hourly rate,' the percentage-of-recovery method can likewise 'be used to assure that counsel's fee does not dwarf class recovery.'" *Bluetooth* at *21–22 (*quoting GM Pick-Up*, 55 F.3d at 821 n.40).

If the district court is to depart from the 25% figure, it must provide "adequate explanation in the record of any 'special circumstances' justifying a departure." *Bluetooth* at *14. That was entirely absent from the record here; indeed, everything the district court stated about the case—that the coupons were of low value and largely a marketing program for HP (ER25–26), that the attorneys brought a relatively meritless case (ER27), that the attorneys had exaggerated the value of the class relief (ER26–31)—suggests that the plaintiffs' conduct is not the type to be incentivized, and any departure should be ***below*** the 25% benchmark rather than above it.[3]

Powers v. Eichen is directly on point. 229 F.3d at 1256–58. There, the district court mentioned at an oral hearing that there were reasons to depart upward from the 25% benchmark, and reasons to depart downward from the benchmark, but issued an

[3] Indeed, the Seventh Circuit has held that attorneys who bring class actions that have little hope of providing legitimate relief to class members and whose only value is the ability to extort nuisance settlement value for the attorneys' fees cannot satisfy the Rule 23(a)(4) adequacy requirement. *In re Aqua Dots Prod. Liab. Litig.*, 654 F.3d 748 (7th Cir. 2011) (Easterbrook, J.).

opinion that simply awarded 30% without explanation why it departed from the benchmark. *Id.* The Ninth Circuit remanded because it could not "conduct meaningful appellate review" on the reasoning for departing from a 25% benchmark. *Id.* at 1258. Here, the district court departed much more drastically from the benchmark than did the court in *Powers*, but its only reasoning was reasoning that would suggest a lower benchmark was appropriate.

The district court failed to justify its departure from the 25% benchmark. Because of this alone, its award of attorneys' fees cannot be affirmed.

B. The District Court Impermissibly Valued the Coupons Before It Knew Their Redemption Rate.

This is a coupon settlement where the injunctive relief is relatively worthless to the class. Such low-value settlements where "counsel are awarded large fees, while leaving class members with coupons or other awards of little or no value" were a central legislative motivation of the Class Action Fairness Act. 28 U.S.C. §1711 *note* §2(a)(3)(A). That act requires that attorneys' fees "shall be based on the value to class members of the coupons that are redeemed" rather than the theoretical value of the coupons available for redemption. 28 U.S.C. §1712(a). But the district court went ahead and estimated the value of the coupons instead of deferring the attorney-fee ruling until it knew the redemption rate. This is a violation of the plain language of the statute, and would require remand even if the settlement approval were not improper.

This is especially true here where the district court effectively acknowledged that the underlying coupons were worthless. The court found that "the objectors'

concerns about the e-credits are valid." ER25. The coupons could only be used at HP.com, and then with substantial limitations. ER25. There was undisputed evidence that HP.com charged substantially more than other Internet vendors and brick-and-mortar stores, and that it would be cheaper to not use the coupons than to use the coupons. ER124–25, 127–28, 137. Indeed, the district court found that the coupons "are of value only to those class members who continue to use HP printers and who do not have access to a less expensive supply of ink cartridges." ER25–26. But this is the same thing as saying that the coupons are worth zero: it is unthinkable that anyone who has access to HP.com does not have access to Internet vendors like Amazon.com and Staples.com. Indeed, it is quite likely that HP.com will find the use of the coupons profitable: instead of selling an ink cartridge to Amazon or Staples at a wholesale price, it would be selling the same ink cartridge to an end-user at a retail price (minus a relatively insubstantial coupon value). HP is entitled to engage in a marketing program to increase its profits at the expense of consumers; it is not entitled to use the federal courts and a class action settlement to do it.

This is precisely the sort of abusive and worthless coupon settlement that was criticized by the Class Action Fairness Act. *See generally Synfuel Technologies v. DHL Express (USA),* 463 F.3d 646, 654 (7th Cir. 2006) (Wood, J.); *True v. American Honda, Inc.*, 749 F. Supp. 2d 1052 (C.D. Cal. 2010); *Figueroa v. Sharper Image Corp.*, 517 F. Supp. 2d 1292, 1321 (S.D. Fla. 2007).

The failure to wait until the redemption rate is known to value the coupons is independent error requiring remand.

C. The Injunctive Relief Delivers No Value to the Class.

The settlement also provides for prospective injunctive relief for future purchasers and users of HP ink cartridges and inkjet printers. But this prospective injunctive relief is not a benefit to the class. No changes in future HP disclosures will benefit consumers who have already been misled by previous HP statements. *True,* 749 F. Supp. 2d at 1077. ("No changes to future advertising by Honda will benefit those who already were misled Honda's representations regarding fuel economy"). Judge Wood's opinion in *Synfuel* provides persuasive authority here: "The fairness of the settlement must be evaluated primarily based on how it compensates class members for these past injuries." *Synfuel,* 463 F.3d at 654. Prospective injunctive relief does not compensate class members for past injuries.

The Ninth Circuit creates a circuit split "only after the most painstaking inquiry." *Zimmerman v. Oregon Dep't. of Justice,* 170 F. 3d 1169, 1184 (9th Cir. 1999). But the lower court's treatment of *Synfuel* falls short of this standard. Its opinion simply cited *Synfuel* as evidence for "the obvious point that prospective relief provides no compensation for past harm." ER26. The court's gloss misstates the point of the *Synfuel* ruling, which is, more precisely, that "relief" granted to a set of future consumers is inherently incapable of compensating for injuries suffered by the putative clients—the class that allegedly suffered past injury. Under Rule 23(a)(4), private class action attorneys are to represent a ***class***, and put their clients' interests first, not to act as *parens patriae* for the public to restructure future economic transactions affecting non-class-members in their view of the public interest. *Cf. Klier*

v. Elf Atochem N. Am., Inc., No. 10-20305 (5th Cir. Sep. 27, 2011) (*cy pres* in public interest impermissible where settlement money can be distributed to class members with unsatisfied claims).

The opinion, citing *Hanlon,* suggested that there would be "significant overlap" between the class members who had been harmed by HP's practices and the future consumers that would presumably benefit from these practices' end. ER26. This cannot justify a finding of class benefit for two reasons. *First*, any overlap between the sets of consumers is pure happenstance that cannot be calculated as a class benefit. (Indeed, the decision of class counsel to negotiate prospective relief that will affect only an indeterminate subset of the class at the expense of retrospective relief for the entire class arguably creates an intra-class conflict that requires separate representation under Rule 23(a)(4). *Cf. Ortiz v. Fibreboard Corp.*, 527 U.S. 815, 858, 863 (1999) (intraclass equity is a requirement); *In re Joint Eastern and Southern Dist. Asbestos Litig.*, 982 F.2d 721, 741-43 (2d Cir. 1992) (decertifying class under Rule 23(a)(4) because of conflicts of interest between different segments of class), *modified on reh'g on other grounds sub nom. In re Findley*, 993 F.2d 7 (2d Cir. 1993).)

Second, this settlement is not analogous to *Hanlon*. In *Hanlon*, plaintiffs alleged that Chrysler sold vehicles with a defective trunk latch; the case settled with Chrysler agreeing to repair class members' vehicles. That injunctive relief directly compensated the *Hanlon* class: before the settlement, class members owned a defective vehicle that was hypothetically worth less than what they paid for it; after the settlement, class members owned a vehicle that had been fixed in a recall, increasing its value at the

margin. The unique retrospective injunctive relief in *Hanlon* cannot justify the settlement at issue, precisely because the settlement at issue brings class members nothing: except, that is, for the class members who incidentally overlap with future purchasers of HP products. The proper analogy here would be if Chrysler settled the *Hanlon* case by agreeing to sell non-defective cars in the future and providing disclosures to previous customers about problems with its trunk latch. Such a settlement—like this one—is materially different than the injunctive relief actually offered in *Hanlon*, and is not of value to existing class members. "[I]f a district court's findings rest on an erroneous view of the law, they may be set aside on that basis." *Cooter & Gell v. Hartmarx Corp.*, 496 U.S. 384, 402 (1990) (discussing abuse of discretion standard) (*quoting Pullman-Standard v. Swint,* 456 U. S. 273, 287 (1982)).

Two hypothetical settlements demonstrate the problem with attributing prospective injunctive relief in a misrepresentation case to be a benefit to the class. Imagine the hypothetical consumer fraud class action *Seinfeld v. Kramer Non-Fat Yogurt* where a class sues a shop selling "non-fat yogurt" that turns out to be full of fat. *Cf.* Larry David, "The Non-Fat Yogurt," *Seinfeld* (NBC Nov. 4, 1993). If the parties settled for injunctive relief whereby the defendant agreed to correctly label their full-fat yogurt in the future, that would be of no benefit to the class for their ***previous*** injuries—even if, as here, there happened to be some overlap between the class members and the set of people who purchased non-fat yogurt in the future. The class members only benefit to the extent they make additional purchases from the

defendant, and that benefit is presumably reflected in the price they pay for those new purchases.

Another example: imagine the hypothetical consumer fraud class action *Gatsby v. West Egg*, where the class sues over West Egg selling packages of a dozen eggs that only have ten eggs in them. If the parties settled with injunctive relief that required West Egg to include at least twelve eggs in every "dozen eggs" package, that again provides no benefit to the class for their ***previous*** injuries, even if, once again, there happened to be some overlap between the class members and the set of people who purchased West Eggs in the future. The lack of benefit becomes even more apparent if West raises its price for a "dozen" eggs from $2.00 to $2.40.

Note the problem of "leakiness" in both of these settlements that demonstrates the inherent illusoriness of prospective injunctive relief in a consumer class action. A defendant forced to change business practices by prospective injunctive relief can simply choose to pass along those additional costs to its customers: West Egg customers get 20% more eggs than before the settlement, but are paying 20% more for the package. There is no benefit even to future purchasers, much less the class. Similarly, here, the settlement requires HP to change its business practices and that may mean that future customers use slightly more ink per cartridge on average—but the settlement does not forbid HP from raising prices to offset the change in its business practices that slightly reduce the frequency of ink-cartridge purchases. The court found that the plaintiffs wildly exaggerated the value of the injunctive relief, asserting it to be worth between $15.9 and $41.1 million—but even under these

inflated figures, HP need only raise the price of its ink cartridges by ***between 5 and 10 cents*** to transfer all of the additional benefit from the class back to HP. ER112. Because the settlement does not prohibit such an offsetting price increase (or even a much higher price increase), the prospective injunctive relief in this settlement is inherently illusory to future customers as well as current ones.

Moreover, plaintiffs failed to carry their burden to show that the injunctive relief had value. Their only evidence of the value of injunctive relief was a late-filed expert report that did not comply with *Daubert*. ER109–13. The district court expressed significant skepticism about the findings of the plaintiffs' expert report. It noted that there was "little support" for the settling parties' estimates of value and that the percentage of class members who would benefit from the injunctive relief could "easily be much smaller" than the settling parties' estimate. ER26-27. The district court underscored the expert report's conclusion: namely, the extent to which past HP customers would continue to be future HP customers was "unknown." ER27. The court's order ultimately concluded that the plaintiffs' arguments for the value of injunctive relief, as embodied in their expert report, was "not particularly helpful to the Court." ER27. But without that expert report (submitted far after the objection deadline, preventing objectors to have adequate time to fully rebut it (ER84)), plaintiffs had no evidence of the value of the injunctive relief.

It was thus clearly erroneous as a matter of law and as a matter of fact for the district court to find that the injunctive relief had any benefit to the class. But

attorneys' fees were awarded based on this illusory injunctive relief. This is an independent reason to require remand.

IV. To the Extent *Churchill Village* Is Interpreted to Infer Class Approval From a Small Number of Objections, It Is Not Consistent with Rule 23 or Good Public Policy.

One of the *Churchill Village* factors is the "reaction of the class." 361 F.3d at 575. In *Churchill Village* itself, the Ninth Circuit interpreted this to mean that a district court judge should be "aware of an array of objections to the settlement." *Id.* at 577. Unfortunately, in class action settlement after class action settlement, settling parties argue (and some courts find) that *Churchill Village* means that the number of objectors—invariably small relative to the size of the class—is a reason to support settlement approval. *E.g.*, *Rodriguez v. West Publishing Co.*, 563 F.3d 948, 967 (9th Cir. 2009) (not an abuse of discretion for district court to find that class reaction to settlement was favorable when there were "only fifty-four objections"). If this were the standard, it would make this *Churchill Village* factor meaningless (because it does not distinguish between good settlements and bad settlements), and would unfairly prejudice absent class members. Even if it were true that, as the court found, "only five" people had filed formal objections, ER20, it is a mistake, as many courts have recognized, to infer class approval from the fact of a small number of objectors. This Court should so hold, and clarify the use of this *Churchill Village* factor.

Almost any given class action settlement, no matter how much it betrays the interests of the class, will inevitably produce only a tiny fraction of objectors. The

predominating response will always be apathy, because objectors—unless they can obtain *pro bono* counsel—must expend significant resources on an enterprise that will create little direct benefit for themselves. Another common response from nonlawyers will be the affirmative avoidance, whenever possible, of anything involving a courtroom. It is a serious mistake to argue that this understandable tendency to ignore notices or free-ride on the work of other objectors is best understood as acquiescence in or evidence of support for the settlement. That is wrong: silence is simply *not* consent. *Grove v. Principal Mut. Life Ins. Co.*, 200 F.R.D. 434, 447 (S.D. Iowa 2001) (*citing GM Pick-Up,* 55 F.3d at 789.). "Silence may be a function of ignorance about the settlement terms or may reflect an insufficient amount of time to object. But most likely, silence is a rational response to any proposed settlement even if that settlement is inadequate. For individual class members, objecting does not appear to be cost-beneficial. Objecting entails costs, and the stakes for individual class members are often low." Christopher R. Leslie, *The Significance of Silence: Collective Action Problems and Class Action Settlements*, 59 FLA. L. REV. 71, 73 (2007).

There is usually little hope that opt-outs can recover for their claims—the entire purpose of Rule 23 class actions is to aggregate claims that would be uneconomical to bring individually. "Almost by definition, most class members have too little at stake to warrant opting out of the class litigation and filing an individual lawsuit. Thus, opting out is probably not a viable option even though a proposed settlement is unfair or inadequate." *Id.* at 109. Without *pro bono* counsel to look out for the interests of the class, filing an objection is economically irrational for any

individual. "[A] combination of observations about the practical realities of class actions has led a number of courts to be considerably more cautious about inferring support from a small number of objectors to a sophisticated settlement." *GM Pick-Up*, 55 F.3d at 812 (*citing In re Corrugated Container Antitrust Litig.*, 643 F.2d 195, 217-18 (5th Cir. 1981)); *cf. Petruzzi's, Inc. v. Darling-Delaware Co.*, 880 F. Supp. 292, 297 (M.D. Pa. 1995) ("'[T]he silence of the overwhelming majority does not necessarily indicate that the class as a whole supports the proposed settlement . . . . '"). "[A] low number of objectors is almost guaranteed by an optout regime, especially one in which the putative class members receive notice of the action and notice of the settlement offer simultaneously." *Ellis v. Edward D. Jones & Co.*, 527 F. Supp. 2d 439, 446 (W.D. Pa. 2007). "[W]here notice of the class action is, again as in this case, sent simultaneously with the notice of the settlement itself, the class members are presented with what looks like a *fait accompli*." *Mars Steel Corp. v. Continental Illinois Nat'l Bank & Trust Co.*, 834 F.2d 677, 680-681 (7th Cir. 1987) (Posner, J.). "Acquiescence to a bad deal is something quite different than affirmative support." *In re General Motors Corp. Engine Interchange Litigation*, 594 F.2d 1106, 1137 (7th Cir. 1979).

When class members have little at stake (as in an action such as this, which promises a maximum recovery of an $8 e-credit), the rate of response will be predictably low. As such, the response from class members cannot be seen as something akin to an election or a public opinion poll. *See GM Pick-Up*, 55 F.3d at 813 (finding that "class reaction factor" does not weigh in favor of approval, even when low number of objectors in large class, when "those who did object did so quite

vociferously"); Theodore Eisenberg & Geoffrey Miller, *The Role of Opt-Outs and Objectors in Class Action Litigation: Theoretical and Empirical Issues*, 57 VAND. L. REV. 1529, 1532 (2004). It is typically not worth the average citizen's time or money to object: the slight likelihood that one additional objection will be decisive, when multiplied by the slight increase in an individual class member's payout that such an objection would produce, makes individually-funded objections a losing proposition. The Court must act as a guardian for *all* class members—whether or not they have formally entered the case by registering an objection. "[T]he absence or silence of class parties does not relieve the judge of his duty and, in fact, adds to his responsibility." *Amalgamated Meat Cutters & Butcher Workmen v. Safeway Stores, Inc.*, 52 F.R.D. 373, 375 (D. Kan. 1971).

Thus, in a low-dollar case like this where no class member has the economic incentive to object, the presence of *any* substantive good-faith objections is a remarkable event. The Court should draw no inference in favor of the settlement from the number of objections, especially given the vociferousness of the objectors. *GM Pick-Up*, 55 F.3d at 812–13; *ALI Principles* § 3.05, *comment a* at 206.

The district court improperly found that the number of objectors was a reason to support settlement approval. This is wrong, and this Court should clarify *Churchill Village* to emphasize that a small number of objectors is not evidence of the fairness of the settlement when those objectors bring meaningful good-faith objections.

CONCLUSION

Because there is "no apparent reason" that a settlement should revert an excessive fee request to the defendant, yet this settlement transferred $0.8 million of class benefit to HP because of self-dealing by the class counsel, the district court decision to approve the settlement must be reversed, even if it correctly valued the class benefits as $1.5 million. At a minimum, remand is required for the district court to apply the correct standard of law to the questions of settlement approval, settlement valuation, and attorneys' fees, and to fully consider the hundreds of objections that the settling parties failed to disclose to the court.

Dated: October 31, 2011

Respectfully submitted,

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STATEMENT OF RELATED CASES
PURSUANT TO NINTH CIRCUIT RULE 28-2.6

Objector Lori Meyer filed appeal No. 11-16092 from the final judgment in this case. Meyer voluntarily dismissed her appeal on August 8, 2011.

Objectors Lisa Kahle and Sarah McDonald appealed on July 12, 2011, from a collateral final decision by the district court not to award attorneys' fees to objectors that requested fees. Dkt. 310, 312. (Schratwieser did not request attorneys' fees.) That appeal, No. 11-16675, does not raise issues relevant to this appeal, and may be mooted by this appeal.

Appeal No. 11-56709 (9th Cir.) from *Baggett v. Hewlett-Packard Co.*, No. 8:07-cv-667-AG-RNB (C.D. Cal.), is an appeal from a final judgment approving a structurally similar coupon settlement involving HP Laserjet printers. It is unclear whether that appeal will raise the same or closely related issues.

Executed on October 31, 2011.

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CERTIFICATE OF COMPLIANCE
WITH FED. R. APP. 32(a)(7)(C) AND CIRCUIT RULE 32-1
FOR CASE NO. 11-16097

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PROOF OF SERVICE

I hereby certify that on October 31, 2011, I electronically filed the foregoing with the Clerk of the United States Court of Appeals for the Ninth Circuit using the CM/ECF system, which will provide notification of such filing to all counsel of record, with the exception of the following counsel, whom I caused to be served by UPS Next Day Air.

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