NO. 11-17799

IN THE UNITED STATES COURT OF APPEALS
FOR THE NINTH CIRCUIT

CHAD BRAZIL and STEVEN SEICK,
individually and on behalf of all others similarly situated,
Plaintiffs-Appellees,

KENNETH BROWN,
Objector-Appellant,

v.

DELL INC.,
Defendant-Appellee.

On Appeal from the United States District Court
for the Northern District of California, No. 5:07-cv-01700-RMW

Opening Brief
of Appellant Kenneth Brown

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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 California 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. The plaintiff class consists of citizens of the state of California, and defendant Dell, Inc., is a Delaware corporation with its principal place of business in Texas.

The court's final judgment, pursuant to Fed. R. Civ. Proc. 58, issued on October 28, 2011. ER1-6.[1] Objector Kenneth Brown, the appellant in this case, filed a notice of appeal on November 21, 2011. ER30-32. This notice is timely under Fed. R. App. Proc. 4(a)(1)(A).

This court has appellate jurisdiction because this is a timely-filed appeal from a final judgment under 28 U.S.C. § 1291. Brown, as a class-member and objector, 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).

[1] "ER" refers to Brown's Excerpts of Record. "Dkt." refers to the docket in this case.

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, 947 (9th Cir. 2011). Did the district court err as a matter of law when it approved a settlement and fees where class received approximately $0.5 million in cash, but class counsel sought and received $7 million in fees and expenses, aided by a clear-sailing agreement?

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) (rejecting settlement). 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. Is a claims-made settlement that paid class members approximately $500,000 worth approximately $500,000 for purposes of Fed. R. Civ. Proc. 23(e) or is it equivalent to a hypothetical settlement that issued $19.6 million in $50 checks to class members?

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;

(B) unjustified awards are made to certain plaintiffs at the expense of other class members; and

(C) confusing notices are published that prevent class members from being able to fully understand and effectively exercise their rights.

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:

…

(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.

(h) Attorney's Fees and Nontaxable Costs.

In a certified class action, the court may award reasonable attorney's fees and nontaxable costs that are authorized by law or by the parties' agreement. The following procedures apply:

(1) A claim for an award must be made by motion under Rule 54(d)(2), subject to the provisions of this subdivision (h), at a time the court sets. Notice of the motion must be served on all parties and, for motions by class counsel, directed to class members in a reasonable manner.

(2) A class member, or a party from whom payment is sought, may object to the motion.

(3) The court may hold a hearing and must find the facts and state its legal conclusions under Rule 52(a). …

Statement of the Case

Plaintiffs' third amended complaint alleged that Dell deceives customers by creating the illusion of discounts and savings through false discounts from false former prices, and by offsetting advertised rebates and discounts by raising list prices. Dkt. No. 217. The complaint sought actual and compensatory damages, disgorgement

of "all profits and unjust enrichment," and punitive damages. *Id.* Claims for statutory and common law misrepresentation survived a motion on the pleadings. Dkt. No. 305. On December 21, 2010, the district court certified a class of "All persons or entities who are citizens of the State of California who on or after March 23, 2003, purchased via the Home & Home Office segment of Dell's Web site Dell-branded products advertised with a represented former sales price (i.e., a 'Slash-Thru' price)" over Dell's objections that the class encompassed thousands of different advertised prices. Dkt. No. 306. The district court excluded from the class definition sales made through Dell's Small & Medium Business segment as well as sales made to consumers exposed only to Dell's "starting price" advertising. On January 5, 2011, Dell filed a Rule 23(f) petition. Dkt. No. 307; Appeal No. 11-80000. This Court denied the petition on March 17, 2011. Dkt. No. 308.

The parties reached a settlement (ER74-138), and the district court issued a preliminary approval order. Dkt. No. 318. Class member Kenneth Brown objected. ER41-70. After a fairness hearing on October 28, 2011 (ER10-32), the district court approved the settlement and a payment of $7 million to the plaintiffs' attorneys the same day. ER1-6. Brown filed his notice of appeal November 21, 2011. ER33-35.

Statement of the Facts

A. The Lawsuit and Settlement Agreement.

Plaintiffs' third amended complaint alleged that Dell deceives customers by creating the illusion of discounts and savings through false discounts from false

former prices, and by offsetting advertised rebates and discounts by raising list prices. Dkt. No. 217. The complaint sought actual and compensatory damages, disgorgement of "all profits and unjust enrichment," and punitive damages. *Id.* Class members had differently valued claims. For example, named plaintiff Steven Seick alleges that he paid $1.49 in excess of the true regular sales price for his computer instead of receiving an advertised $50 savings; named plaintiff Chad Brazil alleges that he paid $157.66 more for his notebook computer than the average actual sales price for that model offered by Dell for the three months preceding his purchase instead of receiving a $314 savings. *Id.* ¶¶ 75-77, 84.

Under the settlement (ER74-138), the settlement class was defined as "All individuals and entities in California who purchased a Dell-branded product identified below and advertised with an instant-off discount online from Dell's Home & Home Office segment during the time frame listed for that product" with 27 different Dell models listed. ER81-82. There were 392,979 Class Member purchases, by 354,759 Class Members. ER40. Though Dell had contact information for the majority of the class (ER40), class members could only recover by making a claim. ER82-83. A class member had 105 days to file a claim for $50 for each covered purchase; Dell had the right to challenge the claim. *Id.*

The settlement permitted class counsel to ask for up to $7 million in fees and expenses, with Dell agreeing not to challenge that fee amount. ERxxx. Class counsel asked for the full $7 million payment, which they claimed was slightly above their lodestar. Dkt. No. 320.

B. Kenneth Brown's Objections and the Fairness Hearing.

In May of 2007, class member Kenneth Brown purchased a Dell Inspiron 1501 notebook computer that was advertised with an instant-off discount from the Home and Home Office section of Dell's website. ER68-69. Brown objected that the settlement was structured so that class members were unlikely to be compensated, yet the attorneys' fees were based on a 100% payout assumption; as such, in combination with the indicia of self-dealing, it would violate this Court's command in *Bluetooth* to approve the settlement. ER44-69; ER22-28.

Brown's prediction was borne out. The response rate was less than 3%: there is record evidence of only 9,686 claims being made; even if Dell chooses to pay all of these claims without demanding further evidence, the total payout is under $500,000, less than a tenth of what class counsel was claiming for themselves. ER39. (The fairness hearing was set before the claims period ended, ER39, and the parties made no effort to update the record with the final total number of valid claims. The settling parties, however, represented to the court that they believed the settlement fair even with just $500,000 paid to the class. ER12-14.)

The court approved the settlement. It found the "claim procedure was reasonable." ER8-9. It noted that "we always have to be very careful to look at the settlement versus the attorneys' fees, particularly in a situation where there is a large discrepancy, to make sure that the settlement is fair and monies that should have gone to settle a class action are going to the attorneys as attorneys' fees," but then proceeded to hold that the settlement was fair "whether Dell agreed to pay too much

in attorneys' fees." ER9. The court emphasized that "it was negotiated between or among very good firms, with a mediator." *Id.* The court's decision did not mention the 25% benchmark or explain why it was departing from it, did not make an explicit finding valuing the class benefits, and did not mention *Bluetooth*. ER1-9. Though less than 3% of the class recovered partial damages, the class counsel was paid in full their $7 million request. *Id.*

Summary of the Argument

Brown's position is straightforward: Rule 23(e) and its fairness requirement mean something. Class counsel negotiated a settlement that paid themselves $7,000,000, negotiated separate provisions to ensure that their fee request could not be effectively challenged, but only bothered to negotiate their own clients a tiny fraction of that amount. If the class attorneys have structured a consumer class action settlement so that the defendant is paying the class attorneys fourteen times as much as the class members, and the class is not fully compensated under the allegations of the complaint, the settlement should be considered unfair as a matter of law. This Court has recognized the principle that a settlement must be structured for the benefit of the class, rather than the benefit of the attorneys, and the district court erred by ignoring it. *In re Bluetooth Headset Prod. Liab. Litig.*, 654 F.3d 935 (9th Cir. 2011). The settlement approval must be reversed.

Perhaps the parties will argue that the settlement was really worth $19 million because it was hypothetically possible for class members to jump through the hoops and claim that much money. This is wrong. A settlement needs to be judged by the

money it puts in class members' hands. If this Court endorses a rule that class counsel should be indifferent between a settlement that awards cash directly to class members and a settlement with a claims process where less than 3% of the class will find it worthwhile to make claims, the parties will always agree to the more burdensome claims process that ensures class counsel extracts the maximum amount of fees and defendants pay the minimum amount of money to settle the case, and the unnamed class members will be left in the cold. The abuse of claims-made settlements to inflate attorneys' fees and deflate defendants' obligations to class members has been the subject of substantial criticism. *E.g.*, Barbara J. Rothstein & Thomas E. Willging, *Managing Class Action Litigation: A Pocket Guide for Judges* 13 (2005);[2] Pamela A. MacLean, "Dealing for Dollars: Objectors allege that claims-made settlements short-change class members," *California Lawyer* (June 2011).

This is not an argument that the parties explicitly colluded to rip off the absent class members. One need not show subjective bad faith to demonstrate a settlement objectively unreasonable; the goal of the mediator and the defendant is to settle the case, and their indifference to whether the class attorneys are treating their clients fairly is all that is required to result in a settlement with impermissible self-dealing by the class counsel.

Nor is it an argument that the parties cannot choose to settle a case for $7.5 million instead of $15 million or $45 million. Brown is not claiming that Dell did

[2] This Federal Judicial Center publication is available online at http://www.fjc.gov/public/pdf.nsf/lookup/classgde.pdf/$file/classgde.pdf.

not settle the case for "enough." Nor is Brown claiming that parties cannot choose to implement a claims-made settlement. He is simply arguing that if the parties agree to structure a settlement so that the defendant is likely to pay only $7.5 million, then the class members are entitled to the lion's share of that settlement consistent with the 75%/25% benchmark this Court has repeatedly affirmed over several decades. *Bluetooth*, 635 F.3d at 942 (citing cases). In a consumer class action seeking damages (as opposed to a civil rights class action), it is a *per se* abuse of the class action process when the attorneys are getting 1400% of what their clients are receiving and the class is less than fully compensated.

Preliminary Statement

Attorneys affiliated with the non-profit Center for Class Action Fairness LLC are representing the appellant *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). Brown's counsel wishes to draw a distinction between himself and "professional objectors" that file bad-faith objections to extort class counsel. Though he has represented multiple objectors (including those who successfully appealed in *Bluetooth* and *Nachshin v. AOL*, 663 F.3d 1034 (9th Cir. 2011)), Brown's counsel is not a "professional objector." A

"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 to withdraw an appeal of an objection. ER67. This objection is brought in good faith to overturn an unfair settlement, and to create precedent deterring future plaintiffs and defendants from agreeing to abusive settlements designed to benefit attorneys at the expense of consumers, shareholders, and other plaintiffs.

Argument

I. The District Court Abused Its Discretion by Approving a Self-Dealing Settlement That Pays Class Counsel Fourteen Times as Much as Their Clients.

This is a claims-made settlement. In claims-made settlements, defendants' liability is limited to the number of claims class members make within a claims period. Frequently, as in this case (ER39), the parties schedule the claims deadline for after the fairness hearing, sometimes months after the fairness hearing. This encourages district court judges to rule on the fairness of the settlement without knowing the actual class recovery. (Because Brown objected to this procedure in this case (ER55-

57), the parties stipulated that class recovery would not be much above the 9,686 claims made and that the court could rule on an assumption that less than $500,000 would be distributed. ER12-13.) Because of the potential of the settling parties to exaggerate the relief to the class by overstating the estimated claims rate, claims-made settlements have been widely criticized by the Federal Judicial Center, judges, and outside observers. *E.g.*, Barbara J. Rothstein & Thomas E. Willging, *Managing Class Action Litigation: A Pocket Guide for Judges* 13 (Federal Judicial Center 2005); *Sylvester v. CIGNA Corp.*, 369 F. Supp. 2d 34, 47 (D. Me. 2005); *Kakani v. Oracle Corp.*, 2007 WL 1793774 (N.D. Cal. June 19, 2007) (Alsup, J.); MacLean, *supra.*

This case is a poster-child example of the problems with claims-made settlements. Class counsel negotiated a settlement that paid themselves $7 million, but their clients less than $500,000. If Rule 23(e) is to mean anything, this sort of self-dealing must be considered *per se* unfair as a matter of law, and the settlement approval an abuse of discretion.

Because of the risks of the underlying case, the district court found that the amount the class received was satisfactory. ER2. But while this is *necessary* to approve a settlement, it is not *sufficient*. Brown's objection rests 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, 947 (9th Cir. 2011) (*quoting Hanlon v. Chrysler Corp.,* 150 F.3d 1011, 1021 (9th Cir. 1998)). The fact that class counsel negotiated the settlement under the eyes of a mediator does not change the risk of self-dealing: a mediator is

trying to get parties to agree to a settlement, not protect the interests of absent class members. *Cf. Bluetooth*, 654 F.3d at 948 (presence of mediator not dispositive on question of fairness). If anything, recognizing the interests of absent class members interferes with the mediator's goal of settling the case, as every dollar going to an absent class member is a dollar not going to class counsel who must agree to go forward with the settlement.

Brown is not arguing that the parties colluded to eliminate legitimate class claims. Nor is Brown claiming that Dell was required to settle the case for $45 million or $15 million or some number larger than the neighborhood of $7.5 million. He does dispute, however, that class counsel can arrange such a settlement where class counsel collects fourteen times as much as their putative clients, a share of the class 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. 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 monetary 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 potentially cure the self-dealing. Instead, class counsel negotiated a "kicker" clause in a successful attempt to shield their fee request: the fees would come from a separate pot of money, and any reversion would go to the defendant, rather than the class. This adversely affected the class's interests without any offsetting

benefit: Dell was willing to put up $6.5 million in cash to settle the litigation, agreeing not to challenge the fee request by the attorneys. For "no apparent reason" other than self-dealing, class counsel ensured that most of that money could not go to their own clients.

The settlement is *per se* unfair as a matter of law because of the disproportion between the fees collected and the amount paid to the class. In any event, the failure of the district court to correctly address the issue of self-dealing requires remand.

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

"The current case law on the criteria for evaluating settlements is in disarray." American Law Institute, *Principles of the Law of Aggregate Litigation* § 3.05 comment a at 205 (2010) ("*ALI Principles*"). 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 Village, LLC v. General Elec.*, 361 F.3d 566, 575 (9th Cir. 2004). However, this Court has never held that the *Churchill Village* factors are the exclusive means of evaluating a settlement. *See, e.g.*, *Bluetooth*, 654 F.3d at 946-47; *Molski v. Gleich*, 318 F.3d 937 (9th Cir. 2003) (reversing settlement approval for unfairness for reasons outside of *Churchill Village* test). 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 947 (*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.).

Given the disparate strands of precedent, Brown suggests that this Court reconcile them by formally adopting Section 3.05 of the *ALI Principles*. Section 3.05 is not inconsistent with *Churchill Village*, *Molski*, or *Bluetooth*, but replaces the amorphous nine-factor test with bright-line rules for settlement evaluation.[3] This Court has

[3] Under § 3.05, there is first an initial four-part test that all settlements must meet: the court must consider whether

> (1) the class representatives and class counsel have been and currently are adequately representing the class;
>
> (2) the relief offered to the class… is fair and reasonable given the costs, risks, probability of success, and delays of trial and appeal;
>
> (3) class members are treated equitably (relative to each other) based on their facts and circumstances and are not disadvantaged by the

previously cited to Section 3 of the *ALI Principles* in evaluating an appeal of a class action settlement approval. *Nachshin*, 663 F.3d at 1039. So have other U.S. Courts of Appeal. *Klier v. Elf Atochem N. Am., Inc.*, 658 F.3d 468, 474 n. 14 (5th Cir. 2011); *Masters v. Wilhelmina Model Agency, Inc.*, 473 F.3d 423, 436 (2d Cir. 2007) (citing to Draft). The Court need not reach that issue in this case, as existing rules and precedent are sufficient to require reversal, but doing so will provide better guidance to district courts in the future.

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*, 654 F.3d at 947. "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*, 654 F.3d at 947.

> settlement considered as a whole; and
>
> (4) the settlement was negotiated at arm's length and was not the product of collusion.

Id. § 3.05(a). In addition to these four mandatory requirements, a "settlement may also be found to be unfair for any other significant reason that may arise from the facts and circumstances of the particular case." *Id.* § 3.05(b).

There need not be explicit collusion to create the sort of self-dealing unfairness that benefits class counsel at the expense of their clients, only acquiescence: "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*, 654 F.3d at 949; *Mirfasihi*, 356 F.3d at 785. Because of this, it is erroneous to conclude that once the prospect of express collusion is eliminated because of the presence of a mediator, the inquiry is therefore at an end: class counsel can achieve an impermissible self-dealing settlement simply through a defendant's and a mediator'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 attuned to their self-interest at the expense of the class. *Bluetooth*, 654 F.3d at 947; *id.* at 948 ("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 ALI Principles* § 3.05, *comment b* at 208 ("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 of self-dealing. *Bluetooth,* 654 F.3d at 947. As in *Bluetooth*, all three of these "multiple indicia" of unfairness are present here. *Id.*

First, "counsel receive[d] a disproportionate distribution of the settlement." *Id.* (*quoting Hanlon*, 150 F.3d at 1021). Class counsel successfully asked for $7 million for themselves, when the class received approximately $0.5 million, less than a tenth of class counsel's receipts. As a practical matter, by asking for 1400% of what their clients received, class counsel has obtained 93% of the constructive common fund for itself. *In re GMC Pick-Up Truck Fuel Tank Prods. Liab. Litig.*, 55 F.3d 768, 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."); *Johnston 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).

The fact that fees may not be negotiated until after the rest of the settlement makes no economic 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. The defendants can further reasonably estimate in advance what plaintiffs will claim their lodestar to be from their own defense costs. Because these future fee negotiations are not an unexpected surprise, and because the parties know a settlement will not occur unless the parties agree to an attorney-fee clause, the overhang of the future fee negotiations necessarily infects the earlier settlement negotiations. "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." *Court Awarded Attorney Fees*, Report of the Third Circuit Task Force, 108 F.R.D. 237, 266 (1985); *cf. also Bluetooth*, 654 F.3d at 948 (neither presence of neutral mediator nor separation of fee negotiations from other settlement negotiations demonstrates that a settlement is fair). "In other words, the negotiation of class counsel's attorneys' fees is not exempt from the truism that there is no such thing as a free lunch." *Staton*, 327 F.3d at 964.

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,* 654 F.3d at 948. A clear sailing clause stipulates that attorney awards 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." *Id.* at 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,* 654 F.3d at 947. 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. ERxxx.[4]

Third, the "parties arrange[d] for fees not awarded to revert to defendants rather than be added to the class fund." *Bluetooth,* 654 F.3d at 947. 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 949. "The clear sailing provision reveals the defendant's willingness to pay, but the kicker deprives the class of that full potential benefit if class counsel negotiates too much for its fees." *Id.*

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[4] 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, as Brown has done here. *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.

The class is unambiguously worse off when any reduction in a fee award reverts to the defendant instead of the class. The only reason to negotiate that provision is for the 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.

This is more than a hypothetical concern in this case: the district court affirmatively stated that "whether Dell agreed to pay too much in attorneys' fees" didn't "detract from the fairness of the settlement to the plaintiffs." ER9. This is exactly the error of law, logic, and reasoning that *Bluetooth* condemned: the potential overpayment of fees in a settlement doesn't just affect the defendant, but affects the class, especially when the attorneys are receiving a "disproportionate fee" that may "betray the class's interests." 654 F.3d at 949. 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 representatives permit class counsel to 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.). The district court erred because it failed to look at the settlement holistically: it instead improperly separated the question of the excessive fees relative to the class recovery by imagining the fairness of a hypothetical settlement where the only term is Dell's payment of $500,000 to class members. ER8-9. This is wrong: the $7 million payment to the attorneys is a material part of the settlement that affects its fairness. "Even when technically funded separately, the class recovery and the agreement on attorneys' fees should be viewed as a 'package deal.'" *Bluetooth*, 654 F.3d at 948-49 (*quoting Johnston*, 83 F.3d at 245-46). The district court applied a legally incorrect test, 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).

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. It Should Be a Legal Truism That a Settlement That Pays Class Members $500,000 Is Worth Only $500,000.

Below, the settling parties argued that, though class members received about $500,000, the court should value the settlement as worth over $19 million, because it was hypothetically possible for the class to make 392,979 claims for $50. ER18-19. This is wrong.

Claims forms and claims-made settlements are a marketing science, akin to the rebates used in selling electronics equipment at a Best Buy. Just as marketers can predict how many fewer rebates will be claimed if they require customers to cut out a UPC symbol to claim a rebate, parties can reasonably predict response rates based on the hoops that they require claimants to jump through, *See, e.g.,* Brian Grow, "The Great Rebate Runaround," *Business Week* (Dec. 5, 2005). The only reason to require a claims process for a class where every class member is entitled to identical relief under a settlement and the identity and location of most of the class members is already known is to ensure that the defendant *won't* pay a high percentage of the potential claims. Barbara J. Rothstein & Thomas E. Willging, *Managing Class Action Litigation: A Pocket Guide for Judges* 13 (Federal Judicial Center 2005). Both the defendant and the class recognize a material difference between a claims-made settlement and a cash settlement. They should not be treated as legally identical.

The Class Action Fairness Act agrees. Congress expressed concern about settlements where class members "receive little or no benefit" but "counsel are awarded large fees, while leaving class members with coupons or *other awards of little or no value*." 28 U.S.C. §1711 note §2(a)(3). If Dell had issued $50 coupons to class members, and only 10,000 of them were redeemed, the parties would not be permitted to value the settlement as more than $500,000. 28 U.S.C. § 1712(a). Given that a claims process—like a coupon settlement—is a way to reduce the costs to the defendant of settling, a claims-made settlement should not be treated as the equivalent of a settlement that pays cash to every class member. *Synfuel Technologies v. DHL*

Express (USA), 463 F.3d 646 (7th Cir. 2006) (Wood, J.), is instructive. Though the relief in that case was not coupon relief, the Court held that its similarities with coupons meant that the Class Action Fairness Act coupon standards should be applied. Similarly, this is not a coupon settlement, but a claims-made settlement is similar to a coupon settlement in that it requires affirmative redemption by class members before relief can be granted, and that the defendant benefits when class members fail to redeem their potential relief. Thus, the principles of valuing a settlement under the Class Action Fairness Act are applicable to a claims-made settlement.

The Class Action Fairness Act is not the only source of authority for holding that hypothetical benefits are not actual class benefits, and that a settlement should be valued by the amount the class *actually* receives. *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.

Below, class counsel defended the approach of valuing a settlement based on the hypothetical class recovery by relying on cases that have since been superseded: *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 three 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. *Cf. 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").

Second, even if *Boeing* and *Williams* were not superseded, they are distinguishable from the case at bar because both are purely cases regarding the litigation of attorneys' fees between class counsel and a defendant. They are not cases involving the Rule 23(e) fairness inquiry; *Boeing* involved a class action judgment, not a settlement. Nor are they cases involving a self-serving clear-sailing agreement where class counsel negotiated a settlement with a claims-made procedure. Thus, even if *Boeing* and *Williams* permitted such a disproportionate fee notwithstanding the creation of Rule 23(h), these cases do not consider or speak about the Rule 23(e) fairness of a settlement where class members have complained about the *Bluetooth* indicia of self-dealing.

Indeed, the fact that class counsel chose to negotiate a claims process that results in such a low claims rate in the hopes of collecting a fee on the larger "available" fund instead of a settlement more likely to benefit class members should perhaps be officially considered another sign of impermissible self-dealing after *Bluetooth*, as suggested by the Federal Judicial Center. *Managing Class Action Litigation* 12-13 ("procedural or substantive obstacles to honoring claims" combined with "a provision that any unclaimed funds revert to the defendant at the end of the claims

period" is a "hot button indicator" of "potential unfairness"). Nothing in *Bluetooth* limits the indicia of self-dealing to the three signs listed there.

Third, to whatever extent they remain valid, *Boeing* and *Williams* 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), is directly on point. *Strong* noted that *Boeing* relied on common fund theory, and spoke to the question of whether class counsel or the defendant had first claim on the common fund. *Id.* at 851-52. Thus, when the parties negotiate a settlement without a common fund, but one where the class counsel is to be paid separately, *Boeing* does not apply. *Id.* Similarly, class counsel did not create a common fund in this case. Instead, they structured the settlement in a self-serving manner to protect their fee request. *Bluetooth*, 654 F.3d at 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"). That self-serving decision has consequences in evaluating the settlement. 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). There is no reason to depart from *Strong* here, especially given the unfairness of class counsel negotiating a settlement that pays class counsel fourteen times as much as their clients.

The claim that potential class benefits should be treated as identical to actual class receipts leads to absurd results. Imagine two hypothetical settlements of the hypothetical class action *Coyote v. Acme Products*:

Acme Settlement One	**Acme Settlement Two**
Acme Products mails a $50 check to each of one million class members who purchased their mail-order rocket roller skates.	One million class members have the right to fill out a twelve-page claim form requesting detailed product and purchase information, with a notarized signature attesting to its accuracy under penalty of perjury. The claim form must be hand-delivered in person between the hours of 8:30 a.m. and 9:30 a.m., on June 30, 2012, at Acme's offices in Walla Walla, Washington or Keokuk, Iowa. Class members with valid claim forms receive $100.

It would be malpractice for a class attorney to refuse Settlement One and insist on Settlement Two. The overwhelming majority of class members, if polled, would prefer Settlement One to Settlement Two. A defendant would clearly prefer Settlement Two to Settlement One as substantially cheaper. But under the appellees' proposed legal rule, Settlement Two is worth twice as much as Settlement One, and would entitle the class attorneys to twice as much in attorneys' fees. This Court should reject a rule that creates such "perverse incentives." *Managing Class Action Litigation* 13.

Perhaps the appellees will attempt to distinguish this case from the hypothetical Acme "Settlement Two"; after all, the Dell settlement permitted claimants to file claims electronically rather than hand-deliver them. But making that argument would

concede the point that a claims process reduces the value of a settlement, and that valuing "potential" benefits is improper without taking into account the likelihood that a class member will *actually* obtain the benefit. If it is improper to fully value the potential benefits of a settlement because only 0.1% of the class will make claims under the claims process, why is it appropriate to value a settlement by its "potential" benefits when it has a claims process where less than 3% of the class *actually* made claims?[5] There is no principled dividing line: the way to judge the validity of a claims process—and to incentivize class counsel to maximize the result actually obtained by the class—is to consider the amount that the claims process will *actually* pay the class. Courts have held that attorneys' fee awards should "directly align[] the interests of the class and its counsel." *Wal-Mart Stores, Inc. v. Visa U.S.A., Inc.*, 396 F.3d 96, 121 (2d Cir. 2005) (explaining advantage of percentage-of-common-fund method). If class counsel is entitled to the same payment whether the claims period is thirty days long or ninety days long, whether the claims process requires nothing more than a name or address or whether it claims burdensome information about the claim, class counsel has no incentive to make the settlement more beneficial to the class.

It is therefore not appropriate to award fees based on a speculative, maximized estimate of potential claims. It is in the defendant's interest to make it as difficult as possible for class members to make claims. If fees are based on "potential" benefits,

[5] *Cf. Sullivan v. DB Invs., Inc.*, 667 F.3d 273, 2011 U.S. App. LEXIS 25185, at *142 n.60 (3d Cir. 2011) (*en banc*) (noting evidence that "consumer claim filing rates rarely exceed seven percent, even with the most extensive notice campaigns.").

class counsel has the incentive to inflate the hypothetical number of claims as much as possible so as to ensure itself the maximum baseline from which to draw its fee; absent class members can only be protected if class counsel is incentivized to negotiate for a process that maximizes payment to the class. To do that, this Court should hold that fees are to be based on the amount actually received by the class. Because the amount actually received by the class is highly probative evidence as to the reasonableness of a fee request, and Rule 23(h)(1) requires motions for attorneys' fees to be directed to class members in a reasonable manner so that they might object, this Court should direct district courts that the Rule 23(h) hearing should be held after the claims deadline, so that district courts have accurate information about the claims process. *Cf. In re Mercury Interactive Sec. Litig.*, 618 F.3d 988 (9th Cir. 2010) (reversible error to schedule Rule 23(h)(2) objections to fee request before basis of fee request known).

CONCLUSION

Class attorneys have fiduciary obligations to their clients, the class. If Rule 23(e), Rule 23(a)(4), and *Bluetooth* are to have any meaning, it cannot be "fair, adequate, and reasonable" as a matter of law for class counsel to negotiate a settlement to a consumer class action that pays 14 times as much to the class attorneys as to the class. This Court should reverse the settlement approval, and remand with instructions to reject the settlement. Brown also requests that this Court give guidance on claims-made settlements, and require hearings on Rule 23(h) requests to be held after the claims deadline.

Dated: March 14, 2012

Respectfully submitted,

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

Dell filed a Fed. R. Civ. Proc. 23(f) petition in this case, Appeal No. 11-80000, that was denied on March 17, 2011.

Ciolino v. Hewlett-Packard Co., No. 11-16097 (9th Cir.), raises closely related issues relating to the scope of a district court's obligations under *Bluetooth* and the Class Action Fairness Act in the context of a coupon settlement. That case is fully briefed, but oral argument has not yet been scheduled.

Fiori v. Dell, Inc., No. 11-16109 (9th Cir.), raised closely related issues with respect to a claims-made settlement where Dell paid class members approximately $0.25 million and the class attorneys approximately $5.3 million. The appellants voluntarily dismissed their appeal before there was briefing.

I am likely to file a notice of appeal on behalf of my client in *In re Magsafe Apple Power Adapter Litigation*, Case No. C09-01911-JW (N.D. Cal. Mar. 8, 2012), a case that raises closely related issues with respect to claims-made settlements and the application of *Bluetooth*.

Executed on March 14, 2012.

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CERTIFICATE OF COMPLIANCE
WITH FED. R. APP. 32(a)(7)(C) AND CIRCUIT RULE 32-1
FOR CASE NO. 11-17799

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PROOF OF SERVICE

I hereby certify that on March 14, 2012, 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.

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