

The New Class Action Law: Coupons, “Fairness,” and Notice

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On February 17, after failed efforts in two recent legislative sessions, Congress passed the Class Action Fairness Act of 2005, which President Bush signed into law the next day. All efforts to amend the legislation failed as the bill sailed through both chambers with newly strengthened Republican majorities.

The substantive provisions of the Act are called a “Consumer Class Action Bill of Rights and Improved Procedures for Interstate Class Actions.” Most of the public discussion and analysis of the legislation related to the “Improved Procedures” which modify diversity jurisdiction and removals.

This article focuses on the new law’s attack on coupon settlements with the regulation of attorneys’ fees, its provisions that purport to compel fairness, and notice to state and federal officials.

FEE RESTRICTIONS IN COUPON SETTLEMENTS

The new chapter which the Act adds to Title 28 is a broadside on contingent fee recoveries based on coupon settlements. Under section 1712(a), if a proposed settlement provides for a recovery of coupons, the portion of attorneys’ fees attributable to the coupons must be based on the “value to class members of the coupons *that are redeemed.*”¹

This value-based fee calculation undermines the contingent fee leverage which class counsel could obtain through the use of coupons without regard to whether the coupons were used. The amendment also destroys a good deal of both parties’ flexibility in attempting to resolve actions. Plaintiffs’ counsel will be strongly discouraged from bringing class actions involving real, but small claims, in which a coupon might provide the most cost-effective vehicle for giving value to consumers.

When a case has been well-enough discovered to fully develop claims and expose weaknesses, and the parties are ready to negotiate, class-action plaintiffs will have little willingness to accept coupon offers, except in conjunction with cash. Contingent fees based on cash recoveries are only affected when cash is awarded in conjunction with a coupon, and some effort is made to avoid using the coupons as a basis for a fee award.

Subsection 1712(b)(1) attempts to prevent any circumvention of the coupon settlement fee provision. It uses ambiguous language stating that if a settlement offers a coupon recovery and “a portion of the recovery of coupons is *not* used to determine the attorney’s fee,” then the award shall be based upon time expended.

The clause might be interpreted in two ways: 1. To convert any case in which a single coupon is not redeemed from a contingent fee case into an hourly case. 2. Or, to undermine attempts to circumvent the fee-regulating provisions by designating a fee in a settlement and claiming that the coupon recovery is not the basis for the fee recovery.

Any litigation over the meaning of the subsection will be made more difficult by the dearth of legislative history and the absence of any committee making a substantive report on the bill.² The ambiguity itself is a product of Congress’ decision not to transpose the subsection (a) language “value to class members of the coupons that are redeemed” into subsection (b)(1) as a basis for compelling that “any” attorneys’ fee award be based on hours. It is this failure to transpose the subsection (a) language into subsection (b)(1) that should lead to the adoption of the second interpretation.

Under this latter interpretation, counsel in consumer class actions should be wary of artful drafting of settlement agreements that would minimize the attribution of coupons as a basis for fee awards. When a member of a settlement class would receive both cash and coupon benefits, and even “a portion” of the coupon recovery is *not* used to determine fees,” then the value of the cash too will be disregarded as a basis for a contingent fee recovery.

The negative language of section 1712(b)(1) provides a strong incentive in mixed cash-coupon settlements for class counsel to candidly attribute 100 percent of the coupon recovery as a basis for a fee award. Any failure to fully attribute the coupons as a basis for a fee award will result in the entire award being based on time reasonably expended.

Subsection (b)(2) takes a similar approach to injunctive relief. It requires that settlements “shall include an appropriate attorney’s fee, if any,” for equitable relief obtained.³ Then, subsection (c) provides that the coupon-based portion must be calculated in accordance with subsection (a) and the equitable relief portion must be based on subsection (b). Again, the clear implication is that a contingent fee may still be based on the cash portion of a settlement providing for both a cash recovery and equitable relief.

The legislation also provides for expert testimony upon motion of either party to determine the “actual value” to the class members of the coupons that are redeemed. Nothing in Rule 23 would have prohibited such testimony if it was desired by one of the parties before the Act became law. But since the provision invites such testimony, it will likely be used.

Clearly, the provision will be a useful tool when both parties are persuaded that a settlement is in their best interests. The subsection could preserve some of the value in coupon settlements by allowing the parties to resolve the issue of

“value” without contest. A settlement agreement might provide an opportunity for plaintiffs to file a motion for expert testimony, and the parties could stipulate to the expert witness’s qualifications.

Moreover, the substance of the expert report could be disclosed to defendants and even stipulated to, or objections could be waived.⁴ Of course, this approach would not necessarily bind the court as to the rate of redemption, which, it appears, could only be determined after the close of the redemption period.

There are categories of consumer class actions that may be less affected even by the redemption rate. For example, in cases involving ongoing account relationships, such as financing or service contracts, plaintiffs should be able to avoid the problem of low redemption rates by bargaining for non-cash benefits other than coupons. That is, plaintiffs may seek other specific relief relating to the underlying claim that would require no decision on the part of the consumer to obtain the benefit.

Such terms could require defendants to reverse penalties, provide back-credits, re-amortize debts, or otherwise account specifically for the monetary harm to all class members. Under those circumstances, the relief should not even be deemed a “coupon,” or if it were, then only class members that no longer have open accounts would be at risk of not “redeeming” the benefit.

Subsection (e) makes a meaningful and beneficial change in expressly authorizing distribution of unclaimed coupon benefits to charities. While this provision prohibits using such a distribution to augment a fee award, it does have a positive effect from the perspective of plaintiff’s counsel. It expressly authorizes a *cy pres* mechanism that arguably has a deterrent effect, that can help insure that coupon offers are not made merely because a defendant knows that its coupons (to the limited extent they are used in the future) will have a low redemption rate. In addition, the distribution to charities is good public relations.

FAIRNESS HEARINGS

The rest of subsection (e) provides for judicial scrutiny of coupon settlements in the form of a fairness hearing and a written finding that the settlement is “fair, reasonable, and adequate” for class members. This provision is window dressing and works no change in class action practice at all, since Rule 23 has required fairness hearings for years.

Similarly, although sections 1713 and 1714 establish fixed standards relating to fairness, they will have little effect in practice. They merely codify standards that a reasonably attentive court would have held parties to before the Act’s passage. Section 1713 protects class members from out-of-pocket payments to class counsel when those payments would result in a net loss to the class member, unless the court finds in writing that non-monetary benefits outweigh the monetary loss. Section 1714 protects class members from discrimination in the form of varying recoveries based upon their distance from the court. It is hard to imagine any circumstance under which a court would have adjudged such settlements fair.

NOTICE TO STATE OFFICIALS

A significant change in the law is subsection 1715(b)’s requirement that each defendant participating in the settlement must serve the appropriate state official for each state in which a class member resides, and the appropriate federal official, with notice of the settlement no later than 10 days after a proposed settlement is filed.

The notice to the officials must consist of the complaint, notice of any scheduled hearing, any notices for class members (depending on the stage of the case), any agreements between counsel reached at the time of the settlement, any judgment or notice of dismissal, class member names (if that is not feasible, an estimate of their number), the members’ proportionate share of the settlement, and any written judicial opinion relating to the notices, settlement, agreement, and/or judgment or dismissal.

Where the defendant is a federally regulated or state regulated depository institution, the notice requirements are satisfied by notifying either the federal or state bank supervisor regulatory body. The burdens of these notice provisions are modest and fall upon the defendant. It is unlikely that they will have a meaningful impact on plaintiffs’ class action practices.

In conclusion, the Class Action Fairness Act’s “Bill of Rights” provisions, as distinguished from its diversity and removal provisions, will sharply diminish the use of coupon settlements in many consumer contexts, but should not be as problematic in cases where consumers have ongoing relationships with the defendants. Most of the other provisions will have little practical impact on consumer class action practice.

Notes

1. 28 U.S.C. § 1712(a).

2. See *Pritchett v. Office Depot, Inc.*, 2005 WL 563979 (D. Colo. Mar. 9, 2005) at *3 (discussing floor debate comments and absence of any formal committee reports).

3. Similar language requires court approval of attorneys’ fees.

4. For example, in the settlement in *In re General Motors Corporation Pickup Truck Fuel Tank Products Liability Litigation*, 1994 WL 30301 (E.D.Pa., 1994), “Paragraph 14 provided that plaintiffs’ counsel could apply for counsel fees and expenses incurred which they deemed reasonable and appropriate. The same paragraph also stated that any such award was to be made by the court and paid by General Motors Corporation (“GM”). GM also reserved the right to object to any counsel fees or expenses it deemed excessive.”

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