Nos. 14-1198, 14-1227, 14-1244, 14-1245, 14-1247, and 14-1389

IN THE UNITED STATES COURT OF APPEALS
FOR THE SEVENTH CIRCUIT

NICK PEARSON, *et al.*, and RICHARD JENNINGS,
Plaintiffs-Appellees, Cross-Appellants,

v.

NBTY, INC., a Delaware corporation, *et al.*,
Defendants-Appellees.

APPEALS OF: THEODORE H. FRANK,
SIMONE THOMAS, PEGGY THOMAS, KATHLEEN MCNEAL, and ALISON PAUL
Objectors-Appellants, Cross-Appellees.

On Appeal from the United States District Court
for the Northern District of Illinois, No. 1:11-cv-07972,
Judge James B. Zagel

Opening Brief of Appellants Theodore H. Frank, Kathleen McNeal, and Alison Paul With Required Short Appendix

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CIRCUIT RULE 26.1 DISCLOSURE STATEMENT

Appellate Court No: 14-1198

Short Caption: Nick Pearson, et al. v. NBTY Inc., et al.

To enable the judges to determine whether recusal is necessary or appropriate, an attorney for a non-governmental party or amicus curiae, or a private attorney representing a government party, must furnish a disclosure statement providing the following information in compliance with Circuit Rule 26.1 and Fed. R. App. P. 26.1.

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Theodore Harold Frank

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Stein, Ray & Harris LLP (district court local counsel)

The Tucker Firm, LLC (district court local counsel)

Center for Class Action Fairness (non-profit public interest law firm)

(3) If the party or amicus is a corporation:

i) Identify all its parent corporations, if any; and

N/A

ii) list any publicly held company that owns 10% or more of the party's or amicus' stock:

N/A

Attorney's Signature: s/ Theodore H. Frank Date: February 5, 2014

Attorney's Printed Name: Theodore H. Frank

Please indicate if you are *Counsel of Record* for the above listed parties pursuant to Circuit Rule 3(d). **Yes** X **No** ____

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CIRCUIT RULE 26.1 DISCLOSURE STATEMENT

Appellate Court No: 14-1389

Short Caption: Pearson v Target et al

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(1) The full name of every party that the attorney represents in the case (if the party is a corporation, you must provide the corporate disclosure information required by Fed. R. App. P 26.1 by completing item #3):

Kathleen McNeal and Alison Paul

(2) The names of all law firms whose partners or associates have appeared for the party in the case (including proceedings in the district court or before an administrative agency) or are expected to appear for the party in this court:

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i) Identify all its parent corporations, if any; and

N/A

ii) list any publicly held company that owns 10% or more of the party's or amicus' stock:

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Please indicate if you are *Counsel of Record* for the above listed parties pursuant to Circuit Rule 3(d). **Yes** X **No** ____

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Statutes and Rules

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.

(3) The parties seeking approval must file a statement identifying any agreement made in connection with the proposal.

…

(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.

…

(g) Class Counsel.

...

(4) *Duty of Class Counsel.* Class counsel must fairly and adequately represent the interests of the class.

(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, direct to class members in a reasonable manner.

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

…

Jurisdictional Statement

The district court has jurisdiction under 28 U.S.C. § 1332(d)(2) because this is a class action where the amount in controversy exceeds $5,000,000 exclusive of interest and costs; many of the millions of class members in the nationwide class are citizens of states other than a defendant's state of citizenship; and no exception to the Class Action Fairness Act applies. Dkt. 64 at 4.[1] For example, named plaintiff Nick Pearson is an individual and citizen of Illinois, while defendant Target Corporation is a citizen of Minnesota because it is a corporation incorporated under the laws of Minnesota, where its headquarters are located. *See id.* at 4-7.

The district court issued final judgment under Fed. R. Civ. Proc. 58 on January 22, 2014. A22. Appellant Theodore H. Frank is a class member who objected to the settlement, filed a claim, and appeared at the fairness hearing through counsel (A107-A148; A151); he filed a notice of appeal with the district court on January 29, 2014. Dkt. 145. Appellants Kathleen McNeal and Alison Paul are class members that filed objections to the settlement (Dkt. 104); they filed a notice of appeal on February 21, 2014. Dkt. 175. These notices of appeal are both timely. Fed. R. App. Proc. 4(a)(1)(A). The United States Court of Appeals for the Seventh Circuit has jurisdiction under 28 U.S.C. § 1291. Appellants, as class-members who objected to settlement approval below,

[1] "Axyz" refers to page xyz of the objectors' Appendix. "Dkt." refers to docket entries in Case No. 11-cv-07972 (N.D. Ill.) below. "App. Dkt." refers to docket entries in this appeal, No. 14-1198 (7th Cir.).

have standing to appeal a final approval of a class action settlement without the need to intervene formally in the case. *Devlin v. Scardelletti*, 536 U.S. 1 (2002).

Statement of the Issues

1. Did the district court abuse its discretion by approving a class action settlement where, of the $6.5 million constructive common fund actually paid by the defendants: (a) class attorneys received $1.93 million; (b) the defendants received a reversion of $2.57 million; (c) the Orthopedic Research and Education Foundation received $1.13 million; and (d) class members came in a distant fourth with $865,284 in distributions and prospective injunctive relief that the plaintiffs failed to prove had any value?

2. Did the district court commit reversible error in valuing the settlement as worth $20.2 million when (a) the settlement was structured to result in less than one percent of the class making claims and with only $865,284 actually being distributed to the class; (b) the district included all $4.5 million of hypothetically possible attorneys' fees as a settlement benefit, though $2.57 million of that amount reverted to the defendants; and (c) the district court included $1.5 million paid to a third party for notice as a class benefit?

3. Is it reversible error to approve a class action settlement where class counsel negotiated an excessive $4.5 million fee for itself, but over half that amount reverted to the defendants instead of the class because of self-dealing "kicker" and clear-sailing clauses designed to protect the fee request from scrutiny?

4. Is it reversible error to approve a class-action settlement that provides that $1,134,716 will be paid to a third party as so-called *cy pres* instead of to class members, when (a) individual notice to millions of class members was feasible; (b) checks will be mailed out to 30,425 claimants in a class of twelve million people; and (c) it was feasible to simplify the claims process to significantly increase participation and distributions to class members?

Statement of the Case

A. Pearson and others sue over glucosamine.

NBTY and its subsidiary Rexall Sundown manufacture glucosamine pills for distribution and sale under Rexall's label and the labels of numerous other vendors, including defendant Target. Dkt. 124 at ¶ 5.

Plaintiff Nick Pearson sued Target on November 9, 2011 (Dkt. 1), alleging that its in-house glucosamine product label made misrepresentations about the product in violation of state consumer fraud law: that it would "help rebuild cartilage" or "support renewal of cartilage"; help "maintain the structural integrity of joints"; "lubricate joints"; and "supports mobility and flexibility." Dkt. 21 at ¶¶ 1-6. The district court denied in part a motion to dismiss. Dkt. 56.

Meanwhile, plaintiff Richard Jennings and the other four named plaintiffs brought five similar complaints in four other districts against NBTY, Rexall, and various vendors of Rexall-manufactured glucosamine products. A46. We will refer to the defendants collectively as Rexall.

B. Rexall settles the actions.

On October 1, 2012, Jennings and Rexall informed the court in *Jennings v. Rexall Sundown*, No. 11-cv-11488 (D. Mass.) that they had reached a global settlement of all claims, and Jennings moved for preliminary approval of the settlement on January 9, 2013. Dkt. 124 at ¶13; *Jennings* Dkt. 79, 87, 88-1, 90. For reasons not stated in the record, the parties instead decided to proceed with a settlement in this action, and moved for preliminary approval of a settlement on May 7, 2013. Dkt. 73; A46-A97 (“Settlement”); *Jennings* Dkt. 97.[2] Under the Settlement, plaintiffs filed a second amended complaint adding named plaintiffs, defendants, class counsel, and allegations. Dkt. 64. Among the new allegations was a complaint that some of the “Covered Product labels also claim to provide improvements in joint comfort within seven days.” *Id.* ¶2.

The Settlement covered a settlement class of purchasers of the “Covered Products,” several dozen different glucosamine products sold under numerous brand names. Settlement ¶1 and Exh. A (A48-A49; A86-A87). Class members who saved receipts from 2005 to 2013 purchases could obtain a check of up to $50 ($5/bottle for up to ten bottles); class members without proofs of purchase could claim a check of up to $12 ($3 for up to four bottles). Settlement ¶¶7, 17 (A51; A59-A62). The claim form

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[2] The *Jennings* memorandum of understanding was filed under seal in *Jennings* and was not filed in this case (nor disclosed until after objections were due), notwithstanding Fed. R. Civ. Proc. 23(e)(3), so it is unclear what the differences between the two settlements are.

required class members to identify the month within the eight-year class period that they purchased a Covered Product and attest to their purchases under penalty of perjury. A142-A143. If class members claimed under $2 million, class members' recovery would be increased *pro rata* up to double the original planned payment; if after those increases, class members were still receiving less than $2 million, Rexall would donate the difference to the Orthopaedic Research and Education Foundation. Settlement ¶17.d (A60-A61).

Rexall agreed—for a period of thirty months—to add the language "individual results may vary" and to remove some of the contested language from its labels. For example, instead of saying "Osteo Bi-Flex works by providing the nourishment your body needs to build cartilage, lubricate, and strengthen your joints [sic]," Rexall's label could say "Osteo Bi-Flex works by providing the nourishment your body needs to support cartilage, lubricate, and strengthen your joints [sic]." Settlement ¶8 and Exh. B (A51-A52; A88). Rexall would not be required to change any of the complained-about labeling regarding joint lubrication, mobility, flexibility, or the seven-day time frame. *Id.* Class members released all labeling-related consumer claims (including future labeling-related claims for labels that conformed to the Settlement language) against Rexall and others in the chain of distribution. Settlement ¶¶11-14 (A54-A58).

Four sets of law firms would be entitled to seek a total of $4.5 million in attorneys' fees; Rexall agreed not to oppose the request; any amounts not awarded would revert to Rexall. Settlement ¶9 (A52-A53). Each of the named plaintiffs would be

entitled to request $5,000 in incentive awards without opposition from Rexall. Settlement ¶10 (A53).[3]

The district court granted preliminary approval, setting the claims deadline for December 3, 2013, months after the fairness hearing. A106.

There were about 12 million class members. In addition to publication notice, individualized notice went to 4.7 million class members through retailers' and NBTY's records of glucosamine purchases through loyalty or membership programs. A6; A4. Though these same records provided proof of purchase, the postcard notice failed to communicate to the recipients that they were actually class members with the right to make a claim, and the claims process provided no way to access the underlying data that would have permitted the class members to submit an accurate claim. A97;[4] A143.

C. Class members object.

Theodore H. Frank is a class member who purchased Covered Products and received individualized notice. A141-A143. Frank is an attorney who, in this Circuit and others, has previously successfully challenged settlements that have favored class

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[3] While other terms of the *Jennings* settlement are under seal and undisclosed in this case, an unredacted filing in *Jennings* indicates that the original agreement would pay class representatives a $2,000 incentive award. *Jennings* Dkt. 91 at 5.

[4] The postcard notice is also available at http://www.glucosaminesettlement.com/documents/postcard-notice.pdf (last accessed March 30, 2014).

attorneys over their putative clients.[5] A143-A145. He was represented below by the non-profit Center for Class Action Fairness. A118; A143-A145.

Frank objected that the settlement was structured to benefit the attorneys at the expense of the class. He argued that the claims process was structured to throttle the number of claims that would be filed, so that Rexall was under no risk of paying more than $2 million; moreover, he objected, money would almost certainly be paid to third-party *cy pres* instead of class members. As a result, the attorneys—who had unfairly protected their fee request with "clear sailing" and a segregated fund that did not revert to the class—would receive much more than the class did. Frank noted that the timing of the fairness hearing and claims deadline were structured to hide the poor class recovery from the Court. The tweaks to the label that the prospective injunctive relief required were not a benefit to the class justifying the fee request; the notice and administration expenses were not a benefit to the class, either. A117-A148. Other appellants were class members who filed objections on similar grounds. Dkt. 104.

In response, the settling parties argued that the settlement should be valued at the "potential recovery" of $14.2 million, or 4.7 million class members times $3, plus the notice and administration expenses, plus $4.5 million in fees, plus a claimed valuation of the injunctive relief of $21 million. Dkt. 113. They defended the *cy pres* and other

[5] *E.g.*, *Robert F. Booth Trust v. Crowley*, 687 F.3d 314 (7th Cir. 2012); *In re Baby Products Antitrust Litig.*, 708 F.3d 163 (3d Cir. 2013) ("*Baby Prods.*"); *In re Bluetooth Headset Prod. Liab. Litig.*, 654 F.3d 935 (9th Cir. 2011). *See also* Adam Liptak, *When Lawyers Cut Their Clients Out of the Deal*, N.Y. TIMES, Aug. 13, 2013, at A12 (calling Frank "[t]he leading critic of abusive class action settlements").

provisions of the settlement that objectors challenged. *Id.* The settling parties complained that Frank had previously brought successful objections that merited him attorneys' fees and had testified in support of tort reform before Congress, but neither explained why that was relevant to the merits nor identified anything Frank said in his testimony that was untrue. *Id.* at 35-36 & n.24.

D. The fairness hearing and settlement approval.

Counsel represented Frank at the fairness hearing. A149-A186. Plaintiffs had originally claimed through an expert report that the value of the injunctive relief to the class was in the tens of millions of dollars. Dkt. 120 at 7; Dkt. 121 at 44. Plaintiffs backed off of that claim after the fairness hearing and instead argued that the benefit was unascertainable, but was a "great value" as a "social good." Dkt. 137. Frank disputed the valuation as a question of law and of fact. A189-A194.

As Frank's objection predicted, the claims process resulted in minimal claims: "only 30,245 claims had been filed, amounting to a distribution of $865,284.00 to Class members." A9; Dkt. 141 at 1. Thus, under Settlement §17, the "remaining $1,134,716.00 of the guaranteed fund of $2 million is to be remitted in cy pres to the Orthopedic Research and Education Foundation." A14.

The district court approved the settlement. A1-23.

The court held that class counsel failed to prove any benefit from the injunctive relief, and refused to attribute it any value. A11, A18-A21. It left the question open for plaintiffs to prove the benefit of the injunctive relief in the future. A21. Following Seventh Circuit precedent, it held that because the injunctive relief was prospective, it

would primarily benefit future customers rather than class members, and did not support attorneys' fees. A14-A15.

The court, adopting the settling parties' calculation, measured the settlement benefit as a constructive common fund worth $20.2 million: $14.2 million for the possibility that 4.7 million class members would each make a $3 claim; $1.5 million for notice costs; and $4.5 million for the uncontested amount of attorneys' fees. A13-A14. However,

> The low claims rate in combination with funds being remitted to *cy pres* in an amount greater than the actual benefit to the Class suggests that there is substantial reason to decrease the percentage of the attorneys' fee award from the "standard" 25% percentage of the settlement.

A14. It thus chose to base fees on lodestar and expenses with no multiplier, paying $1.93 million to the two sets of class counsel. A17-18. It called this a 9.6% award based on the $20.2 million denominator, and 13.6% of the "available common fund" of $14.2 million, though $12.2 million of that latter figure would remain in Rexall's pockets. A18.

The district court rejected the Thomas and McNeal objections that the settlement was not large enough, even excluding the *cy pres* and injunctive relief as class benefits. A5-10. The court rejected both the objectors' complaint that the settlement was unfair because it was structured to disproportionately benefit the attorneys relative to what the class actually received, as well as Frank's complaints that while Rexall was willing to pay $4.5 million in cash to the attorneys to settle the case, over $2.5 million of that amount would be returned to it under its order; it held that arm's-length negotiations and the lack of actual collusion put the clear-sailing and segregated-fund provisions

beyond objection. A8-A9. The district court did not resolve objections that the claims process was too burdensome in its opinion. However, at the fairness hearing, the district court informally suggested that it felt direct payments to ascertainable class members would be unfair. A168.

The settling parties had claimed the right to use sealed materials in opposition to Frank's objection; Frank objected and moved to unseal the documents. Dkt. 109, 133. The district court held the motion moot (A197), but did not appear to rely on the sealed documents in its opinion.

After final judgment issued (A22-A31), five objectors brought four sets of timely appeals; two sets of plaintiffs cross-appealed the district court's refusal to award the entire $4.5 million request. This Court consolidated the six appeals and cross-appeals for briefing. App. Dkt. 22. On April 2, this Court granted the motion of the *pro se* Thomas appellants to voluntarily dismiss Appeal Nos. 14-1244 and 14-1247.

Summary of the Argument

This Court has long recognized the inherent conflict of interest between class counsel and the class: "the structure of class actions under Rule 23 of the federal rules gives class action lawyers an incentive to negotiate settlements that enrich themselves but give scant reward to class members, while at the same time the burden of responding to class plaintiffs' discovery demands gives defendants an incentive to agree to early settlement that may treat the class action lawyers better than the class." *Thorogood v. Sears, Roebuck, & Co.*, 627 F.3d 289, 293-94 (7th Cir. 2010) (citing authorities) (denying rehearing *en banc*), *underlying opinion rev'd on other grounds*, 131 S.Ct. 3060

(2011); *accord Mirfasihi v. Fleet Mortg. Corp.*, 356 F.3d 781, 785 (7th Cir. 2004) ("*Mirfasihi I*"). Congress, too, has expressed concern about class-action settlements where "counsel are awarded large fees, while leaving class members with … awards of little or no value." 28 U.S.C. § 1711 note § 2(a)(3)(A). Does Rule 23 permit class counsel to exploit the class-action settlement process so that the attorneys are the primary beneficiary of a settlement at the expense of their clients?

This is a settlement that "treat[ed] the class action lawyers better than the class." Nevertheless, the district court approved the settlement with a permissive set of legal standards proposed by class counsel. If not reversed, plaintiffs' proposed legal standards, as adopted by this district court and others, will permit other class counsel to similarly abuse the class-action process in future cases.

Rexall believed that the risk of litigation in this case required it to agree to a settlement where it would face a real cash expense of $6.5 million. Frank does not argue that the settlement is unfair because it provided a $6.5 million fund instead of a $65 million fund or even an $8 million fund. The district court held that the payments fairly reflected the risk of proceeding with litigation, and Frank, who did not object to the settlement size, does not challenge that holding on appeal.

Rather, the problem is the allocation of that $6.5 million. The parties agreed to a settlement structure that ensured that class members would receive little of that money, and that most would instead go to *cy pres*. Worse, class counsel, in an effort to shield its fees from scrutiny, structured the settlement so that $4.5 million of that $6.5 million expense would be in a separate fund for an attorney-fee request that even the district

court found to be inflated. As a result, when combined with the *cy pres* provision, of the $6.5 million Rexall was willing to pay to obtain a release of past and future class claims:

- $2.57 million went back to Rexall;
- $1.93 million went to the attorneys;
- $1.13 million went to a third-party charity; and
- $0.87 million went to class members.

As a matter of law, this allocation cannot satisfy Rule 23 for three independent reasons: *first*, the settlement "treats class counsel better than the class", through a self-dealing fee award disproportionate to the reasonably expected class compensation provided by the settlement; *second*, class counsel breached its fiduciary duty to the class by attempting to shield their fees from scrutiny by structuring their fees in a separate fund that reverted to the defendants, costing class members millions; *third*, there is no reason for money to go to *cy pres* when it was possible to have a claims process that would pay individually identifiable class members. $3.7 million that could have gone to the class instead went to Rexall and a third party as a result.

The district court erred as a matter of law in holding that such self-dealing was permissible in the absence of explicit collusion between class counsel and the defendants. Arms-length negotiations between class counsel and defendants provides no protection for absent class members not at the negotiating table. The "adversarial process … extends only to the amount the defendant will pay, not the manner in which that amount is allocated between the class representatives, class counsel, and unnamed class members." *In re Dry Max Pampers Litig.*, 724 F.3d 713, 717 (6th Cir. 2013). A settling

defendant is concerned only with its total liability, and not that allocation—unless district courts are required to reject settlements where self-dealing occurs.

The district court further erred by holding that a settlement that paid the class $0.87 million (and the attorneys $1.93 million) was really a $20.2 million settlement. That fictional conclusion is the result of a series of fictional premises that creates perverse incentives for class counsel in the settlement process and is legal error. But class action settlement "[c]ases are better decided on reality than on fiction. The reality is that this settlement benefits class counsel vastly more than it does the consumers who comprise the class." *Id.* at 721 (internal quotation and citation omitted).

This settlement evinces the conflicts of interest that *Thorogood* and *Mirfasihi I* warned of. This Court must reverse the district court's approval if Rule 23(e) is to mean anything.

Standard of Review

Although the Seventh Circuit's "review of a district court's approval of a class action settlement is limited to whether there was an abuse of discretion, we insist that district courts exercise the highest degree of vigilance in scrutinizing proposed settlements of class actions." *Synfuel Techs. v. DHL Express (USA)*, 463 F.3d 646, 652 (7th Cir. 2006) (internal quotation and citations omitted). "Abuse of discretion occurs when the district court commits a serious error of judgment, such as the failure to consider an essential factor." *United States v. Lowe*, 632 F.3d 996, 997 (7th Cir. 2011). Also, a "district court by definition abuses its discretion when it makes an error of law." *Maynard v.*

Nygren, 332 F.3d 462, 467 (7th Cir. 2003) (citing *Koon v. United States*, 518 U.S. 81, 100 (1996)). Questions regarding the legal principles undergirding review of class settlement approval motions are questions of law about the proper interpretation of Rule 23(e). They are reviewed *de novo*. *See Gwin v. Am. River Transp. Co.*, 482 F.3d 969, 974 (7th Cir. 2007).

Argument

I. The settlement approval cannot stand because class counsel negotiated $4.5 million for themselves for a settlement where the class would receive less than $900,000.

The settlement in this case required Rexall to pay a minimum of $2 million to charity and the class. But it established a claims procedure that all but guaranteed that Rexall would not pay more than $2 million to the 12 million class members. Meanwhile, class counsel negotiated for itself a $4.5 million payday, shielded by a clear-sailing agreement and a segregated fund. Even once that $4.5 million was reduced by the district court to $1.93 million, it by far outstripped the $0.87 million the class would recover under the claims process.

Perhaps it is the case, as the district court implicitly held, that a settlement that paid only $0.87 million to the class was adequate given the risks of continued litigation. A10. But the fact of the matter is that the defendants' fear of further litigation meant they were willing to put $6.5 million on the table. If in the district court's hindsight defendants overpaid, a fair settlement requires that the class proportionately share in

any overage, rather than that miscalculation being a windfall solely for the attorneys and a third-party charity.

The district court's settlement approval is ironic, because its opinion explicitly recognized the problem Frank raised:

> A recent study, commissioned by the Institute for Legal Reform and conducted by Mayer Brown LLP, found that in the vast majority of class action lawsuits, the fees awarded to class counsel far exceeds the payout received by the class. "Do Class Actions Benefit Class Members? An Empirical Analysis of Class Actions," Mayer Brown, available at www.instituteforlegalreform.com. While the study suffers from nontrivial limitations, it raises an important issue regarding the frequently misaligned goals of class counsel and the class. [A11]

The district court nevertheless endorsed a settlement and a fee award that "far exceeds the payout received by the class," providing little check on the "frequently misaligned goals of class counsel and the class."

Frank's argument is one of simple math. A consumer class-action settlement designed to make class counsel the primary beneficiary—and where class counsel *is* the primary beneficiary—is *per se* unfair under Rule 23(e); in the alternative, it demonstrates a lack of adequacy under Rules 23(a)(4) and (g)(4). This Court has intimated at this principle in multiple cases. *Thorogood*, 627 F.3d at 293-94 (warning of risk of settlements treating class counsel better than the class); *Creative Montessori Learning Ctrs. v. Ashford Gear LLC*, 662 F.3d 913, 917 (7th Cir. 2011) (counsel must show the district court that "they would prosecute the case in the interest of the class … rather than just in their interests as lawyers who if successful will obtain a share of any judgment or settlement

as compensation for their efforts."); *cf. also Robert F. Booth Trust*, 687 F.3d at 319 (preempting settlement hearing and dismissing case because "only goal of this suit appears to be fees for the plaintiffs' lawyers"); *In re Aqua Dots Prod. Liab. Litig.*, 654 F.3d 748, 752 (7th Cir. 2011) (class cannot be certified when only beneficiary of the case will be the attorneys); *Crawford v. Equifax Payment Services, Inc.*, 201 F. 3d 877, 882 (7th Cir. 2000) (rejecting settlement providing only injunctive relief and *cy pres*). What this Court has implied in the past it should make explicit now: except in extraordinary circumstances, a disproportionate allocation of settlement proceeds in a consumer class action precludes Rule 23(e) settlement approval. Class counsel who negotiate and class representatives who approve such settlements breach their fiduciary duty and are inadequate representatives of the class.[6]

[6] Note the limiting principle of "consumer class action"; Frank is not proposing that this rule be applied to 42 U.S.C. § 1983 class actions to enforce civil rights. In such situations, where 42 U.S.C. § 1988 or other statutory fee-shifting applies, the Seventh Circuit recognizes that fees should not be mechanically tied to recovery. "Fee-shifting provisions signal Congress' intent that violations of particular laws be punished, and not just large violations that would already be checked through the incentives of the American Rule"; "[i]n this context, we have rejected the notion that the fees must be calculated proportionally to damages." *Anderson v. AB Painting & Sandblasting, Inc.*, 578 F.3d 542, 545 (7th Cir. 2009) (internal quotations and citations omitted); *see generally discussion at id.* at 544-46. The concerns of *Anderson* do not apply to a class action settlement intentionally structured so that over 99% of the class will receive no relief. Even in individual civil rights cases with fee-shifting and without the concern of fairly representing absent class members, however, this Court requires some consideration of proportionality. *E.g.*, *Cole v. Wodziak*, 169 F.3d 486, 487-88 (7th Cir. 1999).

Even if the Court is not willing to explicitly adopt this rule, the decision below must be reversed because the district court applied the wrong legal standard by requiring a showing of actual collusion as a prerequisite to finding the disproportionate allocation problematic.

A. Disproportionate allocation violates Rule 23(e) even without a showing of actual collusion.

The district court acknowledged that Frank objected to the disproportion between class counsel's recovery and the class's recovery as "self-dealing." A4; A8-A9. But it overruled the objection on the grounds that the negotiations were "arms-length." A9-A10.

This is legal error requiring reversal. Impermissible self-dealing can occur without the settling parties explicitly conniving in a smoke-filled room to unfairly treat the class. Arm's-length negotiations protect the interests of the class only with respect "to the amount the defendant will pay, not the manner in which that amount is allocated between the class representatives, class counsel, and unnamed class members." *Dry Max Pampers*, 724 F.3d at 717.

Thus, 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*, 654 F.3d at 947. Rather than explicit collusion, there need only be acquiescence for such self-dealing to occur: "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." *Id.* at 949 (quoting *Staton v. Boeing Co.*, 327 F.3d 938, 964 (9th Cir. 2003) and *In re Gen. Motors Corp. Pickup Truck Fuel Tank Prod. Liab. Litig*., 55 F.3d 768, 819-20 (3d Cir. 1995)); *see also Thorogood*, 627 F.3d at 293-94 (citing literature and cases).

The self-dealing here not only included a disproportionate fee, but a clear-sailing agreement and a segregated fund for the proposed attorneys' fees that would revert to the defendant rather than the class. *See generally Bluetooth*, 654 F.3d at 947-49. The combination unfairly insulates the fee request from scrutiny. 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"); *see also In re General Motors Corp. Engine Interchange Litigation*, 594 F.2d 1106, 1130-31 (7th Cir. 1979). A class member who objects to an excessive fee request would have to do so *pro bono*: because the fee reduction would create no benefit for the class, the class member would not be entitled to attorneys' fees for his success in this Circuit. *Mirfasihi v. Fleet Mortg. Corp.*, 551 F.3d 682, 688 (7th Cir 2008) ("*Mirfasihi II*"). Moreover, an excessive fee award would be partially shielded from appellate review: an objector would not have standing to challenge the fee award if she does not also challenge the settlement approval.[7] Thus, the segregation deprives the class of the benefits of objector participation and appellate review. *E.g., Vollmer v. Selden*, 350 F.3d 656, 660 (7th Cir. 2003) (objectors "counteract any

[7] *Contrast Silverman v. Motorola, Inc.*, 739 F.3d 956, 957 (7th Cir. 2013) (no standing for objector who only challenges attorneys' fees without challenging settlement when objector cannot benefit from fee reduction) *and Glasser v. Volkswagen of Am., Inc.*, 645 F.3d 1084 (9th Cir. 2011) (same) *with Bluetooth*, 654 F.3d at 949 n.9 (objectors who challenge disproportionate fee as part of challenge to Rule 23(e) approval of $0 settlement have appellate standing).

inherent objectionable tendencies by reintroducing an adversarial relationship into the settlement process…"); *Crawford*, 201 F.3d at 881 ("[A]ppellate correction of a district court's errors is a benefit to the class.").

The district court allowed its finding that arm's-length negotiations occurred to short-circuit its inquiry over whether class counsel had unfairly treated the class with its own self-dealing. This is by itself reversible error requiring remand even if this Court is unwilling to hold on its face unreasonable a settlement that class counsel proposes to pay the attorneys five times what the class received—an outrageous proposal apparently to be repeated on cross-appeal.[8]

[8] The fact that fees may not be negotiated until after the rest of the settlement should make no difference. The settling parties are economic actors with rational expectations. 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 as a matter of basic game theory, because both class counsel and defendants have an incentive to leave extra "space" for that future negotiation in a bifurcated negotiation that the parties do not need to have when they are simply negotiating for a single pot of money to go into a common fund. *Cf. Bloyed v. General Motors*, 881 S.W.2d 422, 435-36 (Tex. App. 1994); *Bluetooth*, 654 F.3d at 948 (separation of fee negotiations from other settlement negotiations does not demonstrate that a settlement with disproportionate fee proposal is fair); *see also* Brian Wolfman and Alan B. Morrison, *Representing the Unrepresented in Class Actions Seeking Monetary Relief*, 71 NYU L. REV. 439, 504 (1996).

B. A settlement that pays class members less than $900,000 is not worth $20 million; it would be legal error to hold otherwise.

The settling parties will likely argue that the attorney fee is not disproportionate because the district court valued the settlement at over $20 million. A13-A14. This was not the district court's reasoning for rejecting the argument of disproportionality (A8-A10); rather, the district, operating under the premise that the settlement was fair, used the $20.2 million figure to calculate the Rule 23(h) award. A13-A18.[9]

In making the calculation that the settlement was "worth" $20.2 million, the district court adopted the following calculation from class counsel's brief (Dkt. 113):

> At a recovery rate of $3 per bottle with no required documentation by the 4,718,651 members given direct notice, the value of the constructive fund is $14.2 million. Of the available common fund, the Class is guaranteed only two million dollars. Counsel also secured for the Class an additional $1.5 million for notice costs and requests $4.5 million in attorneys' fees and expenses, which Defendants have agreed to not contest. Not including the value of any injunctive relief, the total direct monetary relief made available by the settlement through a constructive fund, notice costs, and attorneys' fees and expenses is $20.2 million. [A13-A14]

We can see that the district court was not using the $20.2 million figure to determine settlement adequacy, because it specifically held that it did not consider the $1.13

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[9] The district court held that the plaintiffs failed to prove that the injunctive relief over minor labeling changes—many of which explicitly permitted Rexall to include language alleged to be consumer fraud (Settlement ¶8 and Exh. B (A51-A52; A88))—was not proven to be a benefit to the class compensating them for their past injuries. This was correct as a matter of fact and law. *Synfuel*, 463 F.3d at 654; A19-A21; A189-A194. The court seems to have left open the possibility that class counsel could submit new evidence on the value of the injunctive relief in the future. A21.

million paid to *cy pres* to be a class benefit for purposes of settlement fairness. A10. That holding is inconsistent with a holding that the settlement is worth $20.2 million, because the latter figure includes not only the $1.13 million *cy pres*, but $12.2 million that never left Rexall's coffers; indeed, the district court made an explicit distinction between "the total funds made available to the Class" and "the funds actually claimed by the Class." A13.

Under either interpretation of the district court's ruling, the district court's finding is based on legal fictions that are errors of law. They are certainly untenable in the context of determining whether the allocation of settlement funds is disproportionate for purposes of Rule 23(e) settlement fairness. *Cf. Reynolds v. Beneficial Nat'l Bank*, 288 F.3d 277, 286 (7th Cir. 2002) (it is "the *incremental* benefits" conferred on the class that matter, "not the total benefits" (emphasis in original)).

1. Rexall did not "make available" $14.2 million in a constructive common fund when there was no realistic chance that class members would claim that money.

Class counsel argued below, and the district court agreed, that the settlement "made available" $14.2 million, because 4.7 million class members who got individualized notice could each apply for a $3 award. A13-A14. But, as in any claims-made settlement, the odds against 4.7 million class members each making claims were astronomical. As Frank argued below (A127) and the district court acknowledged (A14), empirical evidence reveals claims rates in claims-made consumer settlements are extremely low.

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 (*see, e.g.*, Brian Grow, "The Great Rebate Runaround," *Business Week* (Dec. 5, 2005)),[10] parties can reasonably predict response rates based on the hoops that they require claimants to jump through. Thus, parties can reduce the number of claims made through tactics that will assuredly reduce the number of claims made: a postcard that says class members "may" be entitled to relief (A97), when the parties knew for a fact that the settlement *did* entitle them to relief; and a claim form that, between the jurat requirement and the detailed questionnaire, assuredly intimidated some class members entitled to make a claim from doing so (A143).

The only reason to require class members to jump through the hoops of making a claim for $3 before being paid was because Rexall did not actually want to write $14.2 million of checks to class members. *Cf.* 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 direct-payment 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

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[10] *Available at* http://www.businessweek.com/stories/2005-11-22/the-great-rebate-runaround.

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) (emphasis added). If Rexall had issued $3 coupons to class members, and only $865,000 of them were redeemed, the parties would not be permitted to value the settlement as more than $865,000. 28 U.S.C. § 1712(a). Given that a claims-made 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* 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. 463 F.3d at 654. Similarly, this is not a coupon settlement, but a claims-made settlement "shares come characteristics" of 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. Any other result permits precisely the danger *Thorogood* warned about: class counsel obtaining an exaggerated share of the settlement proceeds by creating the illusion of relief without actually requiring the defendant to compensate the class.

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. For example, in *Dry Max Pampers,* the settling parties attempted to defend the settlement by arguing that it established a claims process entitling class members to full refunds; the Sixth Circuit correctly recognized that a refund process that required class members to retain for years both a

receipt and an empty diaper box was intrinsically worthless. 724 F.3d at 718-19. "Cases are better decided on reality than on fiction." *Id.* at 721. *See also Baby Products,* 708 F.3d at 174 (district court should consider actual receipts to class to determine settlement fairness); 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* AMERICAN LAW INSTITUTE, PRINCIPLES OF THE LAW OF AGGREGATE LITIG. § 3.13 (2010) ("*ALI Principles*"); Federal Judicial Center, *Manual for Complex Litigation (Fourth)* § 21.71 (2004) ("In cases involving a claims procedure…, the court should not base the attorney fee award on the amount of money set aside to satisfy potential claims. Rather, the fee awards should be based only on the benefits actually delivered."); *cf. Dennis v. Kellogg Co.*, 697 F.3d 858, 868 (9th Cir. 2012) (chronicling problem of "fictitious" fund valuations that "serve[] only the 'self-interests' of the attorneys and the parties, and not the class.").

The district court relied upon *Boeing v. Van Gemert*, 444 U.S. 472 (1980) for the proposition that fees should be awarded based on "the fund as a whole[], not just the portion of the fund actually claimed by class members." A10.[11] This Court should find *Boeing* inapplicable for at least three reasons.

[11] In the same string-cite, the district court also referenced *Mirfasihi II*, 551 F.3d at 687, and *In re HP Inkjet Printer Litig*., 716 F.3d 1173 (9th Cir. 2013), but neither of those

First, *Boeing* was superseded by the 2003 amendments to Federal Rule of Civil Procedure 23, which created Rule 23(h). *Cf.* Samuel Isaacharoff, *The Governance Problem in Aggregate Litigation*, 81 FORDHAM L. REV. 3165, 3171-72 (2013) (describing *Boeing* as marking an "older line of cases" that eventually "prompted legislative rejection of compensating lawyers on the face value of the settlement, regardless of the take-up rate of the benefits by class members"). The amendments (as the Advisory Committee Notes indicate) 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) (respecting *certiorari* denial 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* was not superseded, it is distinguishable from this case because it was purely a case regarding the litigation of attorneys' fees between class counsel and a defendant. It was not a case involving the Rule 23(e) fairness inquiry;

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cases stand for that proposition. Indeed, *Inkjet* took exactly the opposite stance, and held the district court committed reversible error by awarding attorney fees based on the potential value of coupons without determining the actual value to the class of the redemption value.

Boeing was a class action litigated to judgment, not a settlement.[12] Nor is it a case involving a self-serving clear-sailing agreement where class counsel negotiated a settlement with a claims-made procedure. Thus, even if *Boeing* permitted such a disproportionate fee notwithstanding the creation of Rule 23(h), it does 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.[13]

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[12] *Williams v. MGM-Pathe Communications Co.*, 129 F.3d 1026 (9th Cir. 1997) did, however, apply *Boeing* to a class-action settlement. *Williams*, a securities class-action, did not reconcile its decision with either 15 U.S.C. §§ 77z-1(a)(6) or 78u-4(a)(6), and seems to be simply wrong. In any event, it is distinguishable: like *Boeing*, it involved a dispute between a defendant and a class counsel over the size of the fee award, rather than a Rule 23(e) fairness inquiry.

[13] *Americana Art China Co., v. Foxfire Printing & Packaging, Inc.*, No. 13-2569, 2014 U.S. App. LEXIS 2930 (7th Cir. Feb. 18, 2014), which held that it was not an abuse of discretion for a district court to award lodestar in a case where lodestar substantially outstripped class recovery, is similarly distinguishable. *Americana Art China* involved class counsel appealing the district court's Rule 23(h) decision and seeking a higher fee, and did not consider the fairness of a settlement structured to reward class counsel so in the absence of any class members objecting. This appeal involves an objector protesting that class counsel's self-dealing with respect to a fee greater than class recovery (combined with a clear-sailing agreement and a separate fund) implicates the Rule 23(e) fairness determination.

Americana Art China cannot possibly stand for the proposition that an award of lodestar is always a reasonable Rule 23(h) fee no matter how scanty the class recovery. *See Hensley v. Eckerhart*, 461 U.S. 424, 437 (1983) (When applying lodestar method, district court must "consider[] the relationship between the amount of the fee awarded and the results obtained.") (superseded on other grounds); *Cole v. Wodziak*, 169 F.3d 486, 487-88 (7th Cir. 1999). If *Americana Art China* did stand for that, then it would be reasonable for class counsel to negotiate a settlement where the class receives a single peppercorn as consideration for its waiver, and class counsel could be paid its

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 be formally 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"). A claims-made process with reversion to the defendant, like coupons or *cy pres*, is precisely the sort of settlement term that creates the illusion of relief without actual relief to class members.

Third, to whatever extent it remains valid, *Boeing* applies only to cases with an actual common fund, not to a constructive common fund settlement like the one at issue here. *Strong v. Bellsouth Tel. Inc.*, 137 F.3d 844 (5th Cir. 1998), is directly on point. In *Strong*, the district court had denied class counsel's fee request based on an "illusory" $64 million fund and instead reserved awarding fees until the actual amount of distributions to the class could be determined. 137 F.3d at 848. Affirming the district court's decision, the Fifth Circuit distinguished *Boeing*, which had involved a "traditional common fund." *Id.* at 852. *Strong* explained that in *Boeing*, the district court had ordered the judgment to be deposited into "escrow at a commercial bank." *Id*. Each

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lodestar—and what incentive would class counsel have to attempt to accomplish any more than that in the face of resistance by a defendant? Such an interpretation of the Seventh Circuit's precedents would exacerbate the conflicts of interest in class-action representation that this Court has repeatedly condemned.

class member had an "undisputed and mathematically ascertainable claim to part" of that judgment. *Id*. The Fifth Circuit noted that "[i]n contrast to *Boeing*, in the [*Strong*] settlement no money was paid into escrow or any other account—in other words, no fund was established at all in this case." *Id*. Instead, class members could either continue to participate in a maintenance service plan or, if eligible, receive a credit. *Id*. Class counsel's fee award was properly based on actual class member participation—the real value of the settlement—rather than the "phantom" $64 million value assigned by class counsel. *Id*. Similarly, no fund was created in this case. There was no $20 million escrowed fund of which class members can claim a portion. Like *Strong*, class counsel should not be awarded based on this $14.2 million "phantom" fund but on the actual amounts distributed to class members.

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, 2014, 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 might even 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 Rexall 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 0.01% 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 1% of the class *actually* made claims? 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. 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, 122 (2d Cir. 2005) (quotation omitted). If settlement fairness is calculated and 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 demands burdensome information about the claim, or whether notice actually communicates class members' rights, class counsel has no incentive to make the settlement more beneficial to the class.

It is therefore not appropriate to determine the fee proportionality that settlement fairness requires 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 settlement fairness is based on "potential" benefits, 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 settlement valuation is to be based on the amount actually received by the class.[14] To the extent the district court did otherwise in evaluating settlement fairness, it erred.

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[14] The Court should go further. 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 best practices require 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 deadline for Rule 23(h)(2) objections to fee request before basis of fee request known).

2. The $1.5 million paid to third parties for notice is not a class benefit.

The district court credited $1.5 million of settlement value to the amount paid for notice. This is wrong and pernicious.

In re Aqua Dots Prods. Liab. Litig., 654 F.3d 748 (7th Cir. 2011) is informative. There, this Court recognized that items such as notice and class administration expenses are a social cost that present an argument against class certification, rather than a benefit to the class. 654 F.3d at 751. If notice and administration expenses were a class benefit, then *Aqua Dots* was wrongly decided. The fact that the putative class counsel in *Aqua Dots* was proposing to incur such expenses would have meant that the Seventh Circuit was wrong in holding that the attorneys would be the only beneficiary of the class action and the superiority requirement was not met—after all, the settlement would presumably require the defendant to pay for notice! That reasoning is absurd, but it is impossible to reconcile the district court's erroneous legal conclusion with any other result.

Notice benefits the *defendant*, rather than the class. A defendant has every incentive to fund notice, because constitutionally adequate notice is a prerequisite for the defendant to obtain the only consideration it receives from a settlement: the waiver and release of class members' claims. *See e.g.*, *Hecht v. United Collection Bureau*, 691 F.3d 218 (2d. Cir. 2012) (permitting relitigation of class action because of inadequacy of class notice in previous settlement); *Twigg v. Sears, Roebuck & Co.*, 153 F.3d 1222, 1226-29 (11th Cir. 1998) (same); *Besinga v. United States*, 923 F.2d 133, 137 (9th Cir. 1991) (same) (citing cases). Notice enables class members to make claims, but those amounts claimed are already included in the final tabulation of settlement value, there is no need for double-

counting by including the costs of the notice in addition to its yield. As such, the expense of class notice should not be counted as a benefit on the class's side of the ledger. Refusing to count notice costs is just one instantiation of the general principle that costs imposed on the defendant—divorced from class benefits—are not the measure of compensable class value. *See Bluetooth*, 654 F.3d at 944 ("[T]he standard [under Rule 23(e)] is not how much money a company spends on purported benefits, but the value of those benefits to the class." (quoting *In re TD Ameritrade Accountholder Litig.*, 266 F.R.D. 418, 423 (N.D. Cal. 2009))); *cf. Mirfasihi I*, 356 F.3d at 784 (putting defendant out of business not valuable).

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

class benefit, the hypothetical Bailey Building & Loan settlement would pass § 1713 muster at the expense of the class members whom § 1713 is meant to protect.[15]

Refusing to count notice expenses as a class benefit properly aligns incentives. Every dollar the settlement administrator receives is a dollar that is not available to the class in settlement. If attorney fees are paid only on what the class receives, class counsel will have appropriate incentive to ensure that settlement administration is efficient and to take steps to prevent overbilling or wasteful expenditures. But if class counsel is given a commission based on the size of administrative expenses, it would have no financial incentive to oversee the efforts of the administrator, magnifying the conflicts of interest in the class action process. No paying client in the marketplace would agree to a rubber-stamp markup of outside expenses.

For these reason, notice expenses should not be counted as a class benefit, and this Court should so hold.

C. In the alternative, the settlement is unfair because the claims process precluded the distribution of over $12 million to the class.

If this Court is to accept the appellees' argument that the fee request was not self-dealing because *Boeing* means this claims-made settlement is "worth" $14.2 million, then it should still reverse the settlement approval for an alternative reason: the settlement was unfair because the parties used a claims-made process instead of simply

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[15] This 27:1 ratio may seem extreme, but this settlement as approved had a remarkable ratio as well: for every $1.00 to be paid to class members, $1.73 was paid for notice expenses and $2.23 will be paid to class counsel. And class counsel's Rule 23(h) request proposed being paid more than five times as much as the class.

paying $14.2 million in checks to the 4.7 million identifiable class members. The claims-made process, combined with the settlement's $2 million floor, meant that $12.2 million that could have gone to the class ended up in Rexall's pockets. This is unfair. *Managing Class Action Litigation* 12-13. The district court did not address this objection in its formal opinion.[16]

"Wait a minute!" Rexall will likely exclaim. "We didn't agree to pay $14.2 million in cash; we didn't think plaintiffs' case was worth that much given the merits of the case and the difficulties of certifying a class and proving injury. We only agreed to pay $3 a claim because there *was* a claims process that ensured that there would not be 4.7 million claims paid. The claims process was a material term of the settlement, and we would not have agreed to the settlement without that clause limiting our exposure."

Fair enough—but this is precisely Frank's point. The parties can argue that the settlement has a *real* economic value of $2 million[17] (in which case the claims process is not unreasonable, but the settlement is unfair because class counsel engaged in improper self-dealing) or they can argue that the settlement should be considered a $14.2 million settlement (in which case the fees are not disproportionate, but the claims process makes the settlement unfair, because it was feasible to pay the class $14.2 million, but the parties chose not to). But they cannot have their cake and eat it too.

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[16] At the fairness hearing, the court suggested that sending checks to the identifiable class members would be unfair to those class members that were not identified. A168. We discuss why this proves too much in Section III.A below.

[17] Less, if *cy pres* is excluded, as it should be. *See* Section III, below.

II. The reversion of over $2.5 million in a segregated fund to defendants because of an excessive fee request makes this settlement *per se* unfair.

As discussed in Section I.A above, 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. *See generally Bluetooth*, 654 F.3d at 947-49. 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 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. Settlement ¶9 (A52-A53).

The clause is especially pernicious because 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 (*citing Mirfasihi I*). 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.* at 949.

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 947 (quoting *Staton*, 327 F.3d at 964, 965). The district court certainly scrutinized the attorneys' fees—it reduced the $4.5 million request to $1.93 million because of the scant relief to the class.

But, after determining the kicker arrangement did not evince explicit collusion, the district court failed to account for the unfairness of the settlement the proposed oversized award to the attorneys demonstrates. 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*, 654 F.3d at 949 (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).

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); *cf. also Creative Montessori and Aqua Dots*, *supra*.

Here, there was actual detriment to the class. Rexall was willing to put up $6.5 million in cash to settle the case. By attempting to shield their fees, class counsel ended up leaving $2.57 million on the table to be reclaimed by Rexall, when that money could have gone to the class without opposition from the defendants had the parties used a conventional common fund.

The district court erred when it failed to consider this particular instance of self-dealing, though Frank's objection explicitly warned of it. A132-A133; A139-A140 ("the settlement's kicker deprives the class of that overage" if fees are reduced).

Aside from the "no apparent reason" *dicta* in *Bluetooth*, Frank is unaware of any appellate court that has considered this particular scenario. In this case of first impression, this Court should hold that, in the absence of extraordinary circumstances, such self-dealing requires a Rule 23(e) finding that a settlement is unfair, whether or not there are other signs of collusion.

III. The district court's approval of a settlement that favored *cy pres* over class compensation was reversible error.

The legal construct of *cy pres* (from the French "*cy pres comme possible*"—"as near as possible") has its origins in trust law as a vehicle to realize the intent of a settlor whose trust cannot be implemented according to its literal terms. *Nachshin v. AOL, LLC*, 663 F.3d 1034, 1038 (9th Cir. 2011). Imported to the class action context, *cy pres* is a "misnomer—though one common in the legal literature." *Ira Holtzman, C.P.A., & Assocs. Ltd. v. Turza*, 728 F.3d 682, 689 (7th Cir. 2013) ("*Turza*") (citing *Mirfasihi I*, 356 F.3d at 784). Nevertheless, *cy pres* has recently become an increasingly popular method of distributing settlement funds to non-class third parties in lieu of class members. *Marek v. Lane*, 134 S.Ct. 8, 9 (2013) (Roberts, C.J., respecting denial of *certiorari*); Martin H. Redish, Peter Julian & Samantha Zyontz, *Cy Pres Relief and the Pathologies of the Modern Class Action: A Normative and Empirical Analysis*, 62 FLA. L. REV. 617, 661 (2010).

Still, non-compensatory *cy pres* distributions, disfavored among both courts and commentators alike, remain an inferior avenue of last resort. *See, e.g.*, *Turza*, 782 F.3d at 689; *Nachshin*, 663 F.3d at 1038 ("[A] growing number of scholars and courts have observed, the cy pres doctrine … poses many nascent dangers to the fairness of the distribution process") (citing authorities); *Baby Prods.*, 708 F.3d at 173 ("Cy pres distributions imperfectly serve that purpose by substituting for that direct compensation an indirect benefit that is at best attenuated and at worse illusory"); *Mirfasihi I*, 356 F.3d at 784 ("There is no indirect benefit to the class from the defendant's giving the money to someone else."); *ALI Principles* § 3.07 cmt b (2010) (rejecting position that "cy pres remedy is preferable to further distributions to class members"). *See generally* Redish, 62 FLA. L. REV. at 628; Theodore H. Frank, *Cy Pres Settlements*, CLASS ACTION WATCH 1 (March 2008).[18]

Frank objected that the settlement was structured so that Rexall would pay money to so-called *cy pres* instead of uncompensated class members, even though it was possible to pay the class members. A127-A128; A188. While the district court used the fact of *cy pres* to reduce the Rule 23(h) award, it never addressed the question of whether *cy pres* affected settlement fairness. A14. This is reversible error.

A. It should be impermissible for parties to structure a settlement to pay *cy pres* when it is feasible to compensate the class.

"Money not claimed by class members should be used for the class's benefit to the extent that is feasible." *Turza*, 728 F.3d at 689. After all, "[t]he settlement-fund

[18] *Available at* https://www.fed-soc.org/doclib/20080404_FrankCAW7.1.pdf.

proceeds, generated by the value of the class members' claims, belong solely to the class members." *Klier v. Elf Atochem N. Am., Inc.*, 658 F.3d 468, 474 (5th Cir. 2011); *accord ALI Principles* §3.07 cmt. (b). *Klier* forbade the *cy pres* distribution of leftover settlement funds when it was feasible to provide a second distribution to undercompensated class members; *Turza* similarly vacated a distribution order when a district court allowed *cy pres* without any determination of whether it was feasible to compensate class members. *But see Baby Prods.*, 708 F.3d at 173 ("Although we agree with the ALI that *cy pres* distributions are most appropriate where further individual distributions are economically infeasible, we decline to hold that *cy pres* distributions are only appropriate in this context.").

Here, it was entirely possible to directly compensate class members. Though there were 12 million class members, the parties sent individualized notice to 4.7 million of them because the parties had actual knowledge of their purchases of Covered Products. But the parties created a burdensome claims process that ensured that less than 1% of the class would recover any money. A126-A127. Notice to these class members communicated only the existence of the class action and settlement, not the fact (much less the details) that there was indisputable evidence that the class members had the right to draw money from the settlement fund. A97; A143. The claims process purported to require knowledge of trivia of years-old purchases submitted under penalty of perjury, though that knowledge was already in the settling parties' possession. Experienced class-action counsel and their settlement administrator had to know that the result would be the sub-1% claims rate that was realized. The parties

intended the foreseeable consequences of this claims process: money would go to the third-party charity instead of to the class.

This is wrong. "Barring sufficient justification, cy pres awards should generally represent a small percentage of total settlement funds." *Baby Prods.*, 708 F.3d at 174. There is no reason that Rexall could not have written checks to the class instead of to the settlement administrator.

Rexall might protest that issuing $3 or $5 checks to individual class members would have made this a different settlement, one where it would be on the hook for several times more than the $2 million that it paid. If so, this just supports Frank's argument that the settlement was structured to create the *illusion* of relief rather than actual relief, and should not be considered more than a $2 million settlement.

But even if we recognized that this was a *de facto* $2 million settlement fund, and that it was not feasible to distribute $2 million to 4.7 million class members, it was possible to structure the claims process so that the $1.1 million "remainder" would be distributed to the class.

The settling parties knew which class members had purchased which Covered Products, but failed to give the class any way to access that information. There was no reason not to inform class members who received individualized notice that they *were* entitled to make a claim, not just that they "may be able to file a claim." A97. There was no reason that the claims process could not be connected to a database assigning an identifier to each individualized notice; class members could then enter the identifier when filing a claim, and be given a choice between a presumptive award based on the customer database or filing for a larger award based on the class member's files. A126.

If nothing else, it was completely feasible to use a lottery: randomly select 110,000 class members from the individualized notice and send them each $10 checks. *See generally* Shay Levie, *Reverse Sampling: Holding Lotteries to Allocate the Proceeds of Small-Claims Class Actions*, 79 GEO. WASH. L. REV. 1065 (2011). As arbitrary as that sounds, it is less arbitrary to distribute settlement money to 140,000 class members than to 30,000 class members and a third-party charity. This is especially true because when class action settlements require an intimidating claims process, the settlements disproportionately benefit more highly-educated consumers, resulting in regressive wealth transfers from average consumers to consumers (and attorneys!) in upper-income brackets.[19]

While the settling parties will no doubt complain of the supposed difficulties in getting money to class members, recent developments demonstrate that when courts

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[19] *Cf.* Omri Ben-Shahar, *Mandatory Arbitration and Distributive Equity: Access to Justice*, 628 U. CHI. INST. FOR L. & ECON. OLIN RESEARCH PAPER at 5, 32-33 (Feb. 11, 2013); Ted Frank, *Class Actions, Arbitration, and Consumer Rights*, 16 MANHATTAN INST. L. POL. REP. at 6 (2013).

For this reason, the district court's suggestion at the fairness hearing that a distribution aimed at ascertainable class members would be unfair (A168) proves too much. Any distribution process where class members' claims are not universally ascertainable—including the one in this case, where ascertainable class members with individualized notice were more likely to make claims than unascertainable class members who received only generalized notice—is going to favor some groups of class members over others. This settlement is no more fair than the hypothetical one with the distribution methodology the district court rejected on grounds of unfairness; if the district court's unfairness analysis is reason enough to reject that distribution, it is reason enough to reject the distribution in this settlement.

insist that class members be compensated, settling parties suddenly discover resourcefulness they hadn't previously had. For example, in *Baby Products*, the settling parties unsuccessfully attempted to defend a settlement with a claims process that paid less than $3 million of its $35.5 million settlement fund to the class, where over $15 million would have gone to *cy pres*. 708 F.3d at 169-70. On remand, the restructured settlement identified hundreds of thousands of class members who could be issued checks so that there would no longer be a multi-million dollar remainder. *McDonough v. Toys 'R' Us,* No. 06-cv-00242, Motion for Preliminary Approval of Settlement (Dkt. 847) (E.D. Pa. Dec. 18, 2013) (providing direct payments to class members whose contact information was available in the defendants' records); *see also In re Bayer Corp. Combination Aspirin Prods. Mktg. and Sales Practices Litig.*, No. 09-md-2023, 2013 U.S. Dist. LEXIS 125555 (E.D.N.Y. Sep. 3, 2013) (parties voluntarily transformed *cy pres*/claims-made settlement to one providing millions of dollars of direct payments after Frank objected).

The Seventh Circuit suggested it would approve of expansive *cy pres* in *Hughes v. Kore of Ind. Enter., Inc.*, 731 F.3d 672 (7th Cir. 2013). While Frank disagrees with that decision,[20] this case is distinguishable from *Hughes*. In *Hughes*, the parties had no way to

[20] An all-*cy pres* settlement is inconsistent with Rule 23's requirements. If it is infeasible for a class action to make class members better off than they would have been in the absence of class-action litigation, then the class should not be certified because the plaintiffs cannot meet the Rule 23(b)(3) requirement "that a class action is superior to other available methods for fairly and efficiently adjudicating the controversy." *Cf. Aqua Dots*, 654 F.3d 748. This was especially true in *Hughes*, where individual class members were waiving the right to collect $100 each in small claims court. Moreover, if read broadly, *Hughes* would contradict Seventh Circuit precedent without acknowledging

identify the 2800 class members without "subpoenaing hundreds of banks." 731 F.3d at 676. Here, the parties do have the identities of millions of class members, but just declined to distribute settlement funds to them. "I prefer not to" is a line for Bartleby the Scrivener, not for class counsel with a fiduciary duty to class members.

B. Because of the "kicker," the district court erred in restricting its analysis of *cy pres* to the fee request, rather than settlement fairness.

Frank objected (A129) that a dollar of *cy pres* should not be counted the same as a dollar of class recovery. "There is no indirect benefit to the class from the defendant's giving the money to someone else." *Mirfasihi I*, 356 F.3d at 784. While the district court said it was not considering the *cy pres* a class benefit (A9), it counted the "potential" recovery of the class in full in valuing that portion of the settlement as $14.2 million. It could only reach this result by counting the "residual" of the $2 million fund in full, not to mention the $12.2 million that Rexall never had to pay. This inconsistency by itself is reversible error. Permitting class counsel to collect attorneys' fees based on unmoored *cy pres* awards "threatens to undermine the due process interests of absent class members by disincentivizing the class attorneys in their efforts to assure [classwide] compensation of victims of the defendant's unlawful behavior." Redish, 62 FLA. L. REV. at 666.

But more importantly, while the district court considered the *cy pres* in refusing to grant the entirety of class counsel's Rule 23(h) request (A14), but failed to consider

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the departure, as 7th Cir. R. 40(e) requires. *Mace v. Van Ru Credit Corp.*, 109 F.3d 338, 345 (7th Cir. 1997) (small recovery is not reason to use *cy pres*).

whether the *cy pres* made the settlement unfair under Rule 23(e). This was also reversible error, especially in the absence of findings that it would not have been feasible to distribute the $1.1 million remainder to any of the millions of class members left uncompensated.

C. Restrictions on *cy pres* will properly incentivize future class counsel.

As the leading law review article notes, *cy pres* awards can "increase the likelihood and absolute amount of attorneys' fees awarded," "without directly, or even indirectly, benefitting the plaintiff." Redish, 62 FLA. L. REV. at 660-61. *Cy pres* "creates the illusion of class compensation." *Id.* at 623. It is a mechanism that exacerbates the conflicts of interest this Court warned about in *Thorogood* and *Mirfasihi I*.

While there is no dispute about the *cy pres* selection in this particular case, the procedure is fraught with other potential conflicts of interest.

> [T]he selection process may answer to the whims and self interests of the parties, their counsel, or the court. Moreover, the specter of judges and outside entities dealing in the distribution and solicitation of settlement money may create the appearance of impropriety.

Nachshin, 663 F.3d at 1039 (citing authorities). For example, a defendant could steer distributions to a favored charity with which it already does business, or use the *cy pres* distribution to achieve business ends. *See Dennis v. Kellogg Co.*, 697 F.3d 858, 867-68 (9th Cir. 2012) (ruminating on these issues). In one infamous example, Microsoft sought to donate numerous licenses for Windows software to schools as part of an antitrust class action settlement, essentially using the *cy pres* as a marketing tool that would have

frozen out its competitors. *In re Microsoft Corp. Antitrust Litig.*, 185 F. Supp. 2d 519 (D. Md. 2002).

Similarly, if the *cy pres* distribution is related to plaintiffs' counsel, it would result in class counsel being double-compensated: the attorney indirectly benefits from the *cy pres* distribution, and then makes a claim for attorneys' fees based upon the size of the *cy pres*. *See Cy Pres Settlements*, *supra*; *e.g.*, 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 (class counsel attempted to use *cy pres* to benefit educational institutions where he was on board).

When the charitable distribution is related to the judge, or left entirely to the judge's discretion, the ethical problems and conflicts of interest multiply. Class action settlements require judicial approval: one can readily envision a scenario where a judge looks more favorably upon a settlement that provides money for a judge's preferred charity than one that does not. A judge that knows that a larger settlement fund will eventually result in a larger *cy pres* distribution at the end of the case for his favorite charity might be inclined to slant rulings to encourage such a larger settlement. Even if a judge divorces herself from such considerations, the parties may still believe that it would increase the chances of settlement approval or a fee request to throw some money to a charity associated with a judge. *See generally Nachshin*, 663 F.3d at 1039 (citing authorities); *accord Turza*, 728 F.3d at 689.

Chief Justice Roberts recently commented on the "fundamental concerns surrounding" *cy pres* in a statement respecting the denial of *certiorari*. *Marek*, 134 S.Ct. at 9. While not all of these concerns are present in this particular case, they provide

additional reasons why this Court should adopt a strong rule against *cy pres* in settlements.

Conclusion

For the several independent reasons identified above, this Court should vacate and reverse the settlement approval.

Dated: April 2, 2014

Respectfully submitted,

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Statement Regarding Oral Argument

Pursuant to Cir. R. 34(f), Frank requests that the Court hear oral argument in his case because it presents significant issues concerning settlements in class action cases. Exploration at oral argument would aid this Court's decisional process and benefit the judicial system.

While many appeals of class-action settlement approvals are brought by so-called "professional objectors" in bad faith to extort payments from the settling parties, this is not the practice of the Center for Class Action Fairness, which has never settled an appeal for a *quid pro quo* payment, and brings this objection and appeal in good faith to overturn an unlawful settlement. A137-38. While Frank is proceeding *pro se*, he has previously argued and won landmark appellate rulings improving the fairness of class-action and derivative settlement procedure. *E.g.*, *Robert F. Booth Trust v. Crowley*, 687 F.3d 314 (7th Cir. 2012); *In re Baby Products Antitrust Litig.*, 708 F.3d 163 (3d Cir. 2013); *In re Bluetooth Headset Prods. Liab. Litig.*, 654 F.3d 935 (9th Cir. 2011). A favorable resolution in this case would improve the class action process by deterring other class-action settlements designed to benefit attorneys at the expense of their putative clients.

Certificate of Compliance
with Fed. R. App. 32(a)(7)(C) and Circuit Rule 30(d)

Certificate of Compliance with Type-Volume Limitation, Typeface Requirements, Type Style Requirements, and Appendix Requirements:

1. This brief complies with the type-volume limitation of Fed. R. App. P. 32(a)(7)(B) because:

This brief contains 13,079 words, excluding the parts of the brief exempted by Fed. R. App. P. 32(a)(7)(B)(iii).

2. This brief complies with the typeface requirements of Fed. R. App. P. 32(a)(5) and the type style requirements of Fed. R. App. P. 32(a)(6) because:

This brief has been prepared in a proportionally spaced typeface using Microsoft Word 2010 in 12-point Palatino font.

3. All materials required by Cir. R. 30(a) & (b) are included in the appendix.

Executed on April 2, 2014.

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Proof of Service

I hereby certify that on April 2, 2014, I electronically filed the foregoing with the Clerk of the United States Court of Appeals for the Seventh Circuit using the CM/ECF system, thereby effecting service on counsel of record who are registered for electronic filing under Cir. R. 25(a).

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Required Short Appendix

Statement of Compliance
with Circuit Rule 30(d)

All materials required by Cir. R. 30(a) & (b) are included in the Appendix of Appellants Theodore H. Frank, Kathleen McNeal, and Alison Paul.

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UNITED STATES DISTRICT COURT
NORTHERN DISTRICT OF ILLINOIS
EASTERN DIVISION

NICK PEARSON, FRANCISCO PADILLA, CECILIA LINARES, AUGUSTINA BLANCO, ABEL GONZALEZ, and RICHARD JENNINGS, on Behalf of Themselves and All Others Similarly Situated,

Plaintiffs,

v.

NBTY, INC., a Delaware corporation; and REXALL SUNDOWN, INC., a Florida Corporation; and TARGET CORPORATION, a Minnesota Corporation,

Defendants.

No. 11 CV 7972
Judge James B. Zagel

MEMORANDUM OPINION AND ORDER

The resolution of a class action by settlement agreement with NBTY, Inc. ("NBTY"), Rexall Sundown, Inc. ("Rexall"), and Target Corporation ("Target") is now before us. Class Objectors challenge the settlement, contending that excessive attorneys' fees awarded to class counsel will result in a settlement that is not "fair, adequate and reasonable," in violation of Fed. R. Civ. P. 23(h).

FACTS AND PROCEEDINGS

A. Background

Defendants NBTY, Rexall, and Target are in the business of marketing, selling, and distributing, amongst many hundreds of products, a line of joint-health dietary supplements called "Up & Up Glucosamine." Within this line are two separate products. The first is Triple

Strength Glucosamine Chondroitin plus MSM ("Up & Up Triple Strength"). The second is Advanced Glucosamine Chondroitin Complex ("Up & Up Advanced"). The labeling on both products make similar representations as to the beneficial effect the product has on joint health. For example, both products' labeling states that the supplement helps to "maintain the structural integrity of joints." The Up & Up Advanced label also states that it will "help rebuild cartilage" and "lubricate joints." The Up & Up Triple Strength label states that the supplement "supports mobility and flexibility."

In or around June 2011, Plaintiff Nick Pearson ("Pearson") decided to purchase a bottle of Up & Up Triple Strength based on the representations made on the product's labeling. Plaintiff used the product as directed but did not experience any of the beneficial effects represented on its packaging. Subsequently, Pearson became aware of several clinical studies that suggested the active ingredients in the supplement, Glucosamine and Chondroitin, are ineffective in relieving symptoms of or actually curing joint-related ailments. Pearson alleges that, had he known that Defendant's representations about Glucosamine and Chondroitin were false, he would not have purchased Up & Up Triple Strength. Therefore, he claims he has suffered injury through loss of the money he spent on the product.

Similarly, starting as early as 1997 and continuing through the Class Period, Plaintiffs Francisco Padilla, Cecilia Linares, Augustina Blanco, Abel Gonzalez, and Richard Jennings were exposed to and saw Defendants' representations on the labels of Defendants' various products. After reading the representations on the label, Plaintiffs purchased and consumed Defendants' products as directed. Plaintiffs did not have the joint health benefits as represented.

B. Procedural Background

This case commenced as six separate federal court actions across the country involving various joint health dietary supplements manufactured or sold by Defendants. These actions were entitled: *Cardenas and Padilla v. NBTY, Inc and Rexall Sundown, Inc.*, No. 2:11-cv-01615-LKK-CKD (E.D. Cal.) (filed June 14, 2011); *Jennings v. Rexall Sundown, Inc.*, No. 1:11-cv-11488-WGY (D. Mass.) (filed August 22, 2011); *Padilla v. Costco Wholesale Corp.*, No. 1:11-cv-07686 (N.D. Ill.) (filed October 28, 2011); *Linares and Gonzales v. Costco Wholesale, Inc.*, No. 3:11-cv-02547-MMA-RBB (S.D. Cal.) (filed November 2, 2011); *Pearson v. Target Corp.*, No. 1:11-cv-07972 (N.D.Ill.) (filed November 9, 2011); and *Blanco v. CVS Pharmacy, Inc.*, No. 5:13-cv-00406-JGB-SP (C.D. Cal.) (filed March 4, 2013).

On April 15, 2013, Plaintiffs executed a global, nationwide settlement agreement settling and releasing for consideration, *inter alia*, all of the claims made in each case that was to be submitted to this Court for final approval. On April 22, 2013, Plaintiffs, together, filed a second amended complaint against Defendants in this Court. On May 16, 2013, we provisionally certified the Class, consisting of all consumers who purchased for personal use certain joint health dietary supplements sold or manufactured by Defendants.

A Preliminary Approval Order of the proposed class action settlement between Plaintiffs and Defendants was entered on May 30, 2013. [Doc. 89]. Objections to the class action settlement were filed subsequently.

Currently before us is Plaintiffs' Motion for Final Approval of the Class Action Settlement and Award of Attorneys' Fees, Expenses, and Incentive Awards.

C. Settlement Agreement

The Settlement Agreement, reached after protracted, arm's length negotiations over several months, secures for the Class a constructive common fund, injunctive relief, costs for notice and attorneys' fees, and a provision for incentive awards for Plaintiffs. The Settlement explains the claims process and guarantees $2 million towards a guaranteed fund, with unclaimed funds remitting to a *cy pres* fund. The injunctive relief is in the form of labeling changes on Defendants' products for a period of thirty months. Rexall identified and provided notice to approximately five million individual class members belonging to three categories: (1) members of NBTYs Ambassador Club; (2) members of Vitamin World's loyalty program or online purchasers of Vitamin Glucosamine products; and (c) Costco Wholesale club members who have purchased Costco's Kirkland-brand glucosamine products. In exchange, Class Members release Defendants from known and unknown claims.

DISCUSSION

Objectors contest both the fee award and approval order. Objectors argue that this Court should not approve as fair and reasonable a settlement agreement that, on its face, so disproportionately advances the interests of Class Counsel over those of the class itself through excessive attorneys' fees. Plaintiffs' attorneys contend that, due to the substantial benefit procured for Class Members, an award of the requested attorneys' fees would be reasonable and result in a fair settlement. We consider the reasonableness of the settlement to determine if it should be approved.

PART I: REASONABLENESS OF THE SETTLEMENT

A. General Principles of Law Under Rule 23

In class action settlements, a district court cannot rely solely on the adversarial process to protect the interests of the persons most affected by litigation—namely the class— and must rely on the fiduciary obligations of the class representatives and especially class counsel to protect those interests. The fiduciary obligation owed to clients is particularly significant when the class members are consumers, who ordinarily lack both the monetary stake and sophistication in legal and commercial matters that would motivate and enable them to monitor the efforts of class counsel on their behalf. *See Creative Montessori Learning Centers v. Ashford Gear LLC*, 662 F.3d 913, 917 (7th Cir. 2011). This is why settlements of class actions must be approved by the district court as fundamentally "fair, adequate and reasonable." Fed.R.Civ.P. 23(e)(1)(c).

The Seventh Circuit has held that, in evaluating the fairness of a settlement, the district court must consider the strength of the plaintiffs' case compared to the defendants' settlement offer; the risk, expense, complexity, and likely duration of further litigation; the extent of discovery completed; and the experience and views of counsel. *Synfuel Technologies v. DHL Express (USA)*, 463 F.3d 646, 653 (7th Cir. 2006) (quoting *Isby v. Bayh*, 75 F.3d 1191, 1196 (7th Cir. 1996)). The Seventh Circuit further held that "the fairness of the settlement must be evaluated primarily on how it compensates class members for past injuries," not on whether it provides relief to future customers. *Id.*, at 654. A district court's decision regarding the approval of a settlement will not be reversed unless there is a clear showing of abuse of discretion. *Id.*

Strength of Plaintiffs' Case on the Merits Compared to Defendants' Settlement Offer

While it is difficult to calculate the precise probability of success Plaintiffs may experience through continued litigation, the Court finds non-trivial potential obstacles to Plaintiffs' prevailing on the merits. As a threshold, Plaintiffs may be refused class certification.

On the other hand, after lengthy settlement negotiations, the Defendants' offered to create an unlimited constructive fund for the approximately 12 million Class Members. Of these Class Members, about 9.1 million received notice by publication and a smaller number of 4.7 million Class Members received direct, individual notice. Each Class Member is eligible to make a claim for at least $3 for one undocumented purchase, and up to $50 for documented purchases. Even if the value of the Settlement is limited to direct notice recipients, the Settlement has made available to the Class a monetary benefit of at least $14.2 million. Of this fund, only $2 million is guaranteed to be paid out by Defendants, either directly or to a *cy pres* fund. The Settlement secures an additional $6.5 million for the cost of notice and attorneys' fees and expenses, for a total of a $20.2 million made available to the Class.

In addition to the fund, the Settlement Agreement provides for injunctive relief in the form of labeling changes that eliminate key false marketing claims alleged in the lawsuit. However, the value of the injunctive relief, while potentially significant to both Class Members who may still be looking to improve joint health and those who are not Class Members, is difficult to ascertain and does not flow directly to the Class Members.

Risk, expense, complexity, and likely duration of further litigation

Even before this dispute was "consolidated" into the present case, the Plaintiffs expended significant time and resources in prosecuting individual Plaintiffs' cases in courts across the country. During this time, Plaintiffs survived multiple motions to dismiss and Defendant's motion for summary judgment. Leading up to this Settlement Agreement, parties engaged in the lengthy period of settlement negotiations.

This class action litigation continues to involve a number of complex legal, factual, and scientific questions. The disputed issues include scientific literature and medical studies

regarding the benefits of glucosamine and chondroitin, whether Class Members obtained some benefit (excluding a known placebo effect) from the use of the products, and whether the Class Members are entitled to damages. Parties also dispute the impact of and potentially liability arising from the disputed misrepresentations. There are also contested issues relating to class certification.

In the absence of a settlement, Plaintiffs would be required to undergo extensive litigation to secure a finding of liability, and then, if successful, continued litigation on causation, damages, limitations and other defenses. Even if able to prevail at all of these stages, Plaintiffs may face an appeal. Should Plaintiffs continue to litigate, any recovery or benefit would not likely be realized for years.

Extent of discovery completed

At the time the Settlement was agreed upon, each of the individual cases were at various stages of litigation, but had undergone sufficient discovery to enable the parties and counsel to evaluate their respective cases. Thousands of pages of documents had been produced, depositions had been taken of experts and employees, and expert reports had been submitted. Discovery completed in *Cardenas* and *Jennings*, including the depositions of experts and preparation of expert reports, provided Plaintiffs and counsel a thorough record upon which to evaluate the case and determine whether settlement was in the best interests of the Class.

Experience and views of counsel

Counsel for Plaintiffs and Defendants have both investigated the claims and underlying events and transactions alleged in the complaints; conducted legal research; engaged in motion practice; reviewed evidence obtained in discovery and class certification discovery,

consultations, reports, and depositions of experts; and considered arguments made by all Parties as to the merits of the case.

Counsel has also assessed the considerable expense, length of the time necessary to continue prosecution of the claims through trial, post-trial motions, and likely appeals, as well as the significant uncertainty in predicting the outcome of the litigation.

Based on the unavoidable expense, length, and risks inherent in litigation, counsel concluded that the Settlement Agreement is fair, reasonable, and adequate and in the best interests of the Class.

Presence of Collusion in Gaining a Settlement

Objectors oppose the Settlement due to three provisions they contend are signs of self-dealing and collusion: (1) the structure of the Settlement; (2) a "clear sailing" provision; and (3) a segregated fund provision.

Objectors' central opposition to the Settlement is that it allocates $4.5 million, or 70% of what it calculates is a $6.5 million constructive common fund (comprised of $4.5 million fees and $2 million guaranteed funds), to Class Counsel. Objectors contend that this disproportionate percentage award, almost two-thirds of the total fund, to counsel suggests self-dealing.

Second, Objectors, point to counsel's inclusion of a "clear sailing" provision that provides that Defendants will not oppose class counsel awards of $4.5 million as evidence of self-dealing. Objectors contend that the clear sailing provision "decouples class counsel's financial incentives from those of the class" and creates an incentive for counsel to settle lawsuits in a manner that is favorable to counsel, even at the detriment to the Class.

Objectors finally argue that the Settlement's segregated fund provision that ensures that fees, costs, and incentive awards are paid "separate and apart from" class relief is another

indication of self-dealing. Any reduction in fees would revert back to Defendants and a change in the fee structure would create no additional benefit to Class Members, reducing the incentive for Class Members to scrutinize and challenge potentially improper fees.

Class Counsel (and, for that matter, Defendants' counsel) denies any collusion and asserts that the Settlement was achieved through arm's-length discussions by conference calls, in-person meetings and written exchanges, during which offers and demands were exchanged. Counsel maintains that only after the relief to the Class was agreed upon did the Parties discuss the issue of attorneys' fees and incentive awards.

Actual Benefit to Class

Defendants' evaluation of the benefit made available to the Class dramatically exceeds the actual benefit realized by the Class. At the close of the claims deadline on December 3, 2013, only 30,245 claims had been filed, amounting to a distribution of $865,284.00 to Class members. The actual benefit to the Class, then, was a mere 4.2% of the $20.2 million Defendants claim it made available to the Class.

Defendants claim that the remaining $1,134,716.00 of the guaranteed fund of $2 million, to be provided as a *cy pres* award to the Orthopedic Research and Education Foundation upon the Court's approval, is a benefit to the Class. Defendants further maintain that the Class also realizes an actual benefit from valuable labeling changes as a result of the Settlement's securement of injunctive relief. Neither the *cy pres* fund nor the injunctive relief provides a direct benefit to the Class, but instead creates a benefit to the general public and future glucosamine consumers.

B. Conclusion

The settlement agreement, withholding approval of the requested attorneys' fees, is fair, adequate, and reasonable and the result of arms-length negotiations. Even though the actual benefit to the Class is only a fraction of the available fund, the settlement provides for adequate economic recovery by claimants in light of the costs, likelihood of only marginal additional relief to individual consumers, and uncertainty of continued litigation. While the *cy pres* fund and injunctive relief are substantial benefits secured under the settlement agreement, they benefit the public and future consumers of glucosamine—not Class members for past injuries—and cannot be a key consideration in determining the fairness of the settlement.

I will approve reasonable incentive awards in the amount of $5,000 for each of the six named Plaintiffs, for a total of $30,000.

Because Objectors' challenge to the fairness of the settlement agreement is based on a determination that the requested fee awards are substantively unreasonable, I will now turn to the reasonableness of the fee award.

PART II: ATTORNEYS' FEES AND COSTS

A. Attorneys' Fee Award Based on Constructive Fund

1. Standard of Review

Attorneys' fees are generally awarded based on the value of the settlement (i.e. the fund as a whole), not just the portion of the fund actually claimed by class members. *Boeing Co. v. Van Gemert*, 444 U.S. 472, 480 (1980), 100 S. Ct. 745, 62 L.Ed.2d 676 (attorney is entitled to a reasonable fee from the fund as a whole); *Mirfasihi v. Fleet Mortgage Co.*, 551 F.3d 682, 687 (7th Cir. 2008) ("a proper attorneys' fee award is based on success obtained *and* expense (including opportunity cost of time) incurred"); *In Re HP Inket Printer Litigation*, 716 F.3d 1173 (9th Cir. 2013) (attorneys' fees are attributable to the relief obtained for the class).

Courts have an independent obligation to ensure that the fee award, like the settlement itself, is reasonable, even if the parties have already agreed to an amount. *Bluetooth*, 654 F.3d at 941; see also Committee Notes to Rule 23(h), 2003. A recent study, commissioned by the Institute for Legal Reform and conducted by Mayer Brown LLP, found that in the vast majority of class action lawsuits, the fees awarded to class counsel far exceeds the payout received by the class. "Do Class Actions Benefit Class Members? An Empirical Analysis of Class Actions," Mayer Brown, available at www.instituteforlegalreform.com. While the study suffers from non-trivial limitations, it raises an important issue regarding the frequently misaligned goals of class counsel and the class. Due to this issue, as well as others, it is particularly important that the Court rely on an adequate factual basis to determine whether a settlement and fee award is fair to the entire class. *In Re Baby Products Antitrust Litigation*, 708 F.3d 163, 175 (district court did not have necessary factual basis, including the amount of compensation distributed directly to the class, to determine whether settlement was fair); *Bluetooth*, at 943 (district court made: 1) no explicit fee calculation; 2) no comparison between fees award and benefit to class or degree of success in litigation; and 3) no comparison between fee calculation methods). To that end, courts may only include the value of injunctive relief to the total common fund in the unusual instance where the value to individual class members of the injunctive relief can be accurately ascertained. *Staton v. Boeing*, 327 F.3d 938, 974 (9th Cir. 2003).

2. "Percentage-of-Recovery" vs. Lodestar Method

Depending on the type of relief obtained for the class—either constructive common fund and/or injunctive relief—attorneys' fees may be calculated under either the "lodestar" method or as a "percentage-of-the-recovery." The "lodestar method" is appropriate in class actions where the relief obtained is primarily injunctive in nature and thus not easily monetized. Class actions

brought under fee-shifting statutes (such as federal civil rights, securities, antitrust, copyright, and patent acts) frequently use the lodestar method. In these fee-shifting cases, the relief sought and obtained is largely only injunctive in nature and thus not easily monetized, but the legislature has authorized the award of fees to ensure compensation for counsel undertaking socially beneficial litigation. *Bluetooth*, 654 F.3d 935, 941 (9th Cir. 2011).

A lodestar figure is calculated by multiplying the number of hours the prevailing party reasonably expended on the litigation (as supported by adequate documentation) by a reasonable hourly rate for the region and for the experience of the lawyer. *Id.*; *Staton v. Boeing*, 327 F.3d 938, 965 (9th Cir. 2003). Though the lodestar figure calculated in determining an attorney fee award is presumptively reasonable, the court may adjust it upward or downward by an appropriate positive or negative multiplier reflecting a host of reasonableness factors, including the quality of representation, the benefit obtained for the class, the complexity and novelty of the issues presented, and the risk of nonpayment. *Bluetooth*, 654 F.3d at 941-42.

On the other hand, where a settlement produces a constructive common fund for the benefit of the entire class, courts have discretion to employ either the lodestar method or the percentage-of-the-recovery method. *Harman v. Lyphomed, Inc.*, 945 F.2d 969, 975 (7th Cir. 1991); *Bluetooth*, at 942. Under the latter method, attorneys' fees are derived from a percentage of the common fund. A constructive common fund is valued based on the direct monetary relief made available to members of the proposed class, not just the portion actually claimed by class members. *Boeing Co. v. Van Gemert*, 444 U.S. 472, 480 (1980), 100 S. Ct. 745, 62 L.Ed.2d 676; *Masters v.Wilhelmina Model Agency, Inc.*, 473 F.3d 423,437 (2d Cir. 2007) ("the entire settlement fund, and not some portion thereof, was created through the efforts of counsel"). While the value of *cy pres* and injunctive relief will not be added to the amount of total funds

made available, they are relevant factors in determining what percentage of the fund is reasonable as fees. *Id.*; *Baby Products*, 708 F.3d at 179.

Courts typically calculate 25% of the fund as the "benchmark" for a reasonable fee award in cases involving recoveries of between $5 million and $15 million, and must provide adequate explanation in the record of any "special circumstances" justifying a departure. *Abrams v. Van Kampen Funds, Inc.*, 2006 WL 163023, at *19 (N.D. Ill. Jan. 18, 2006). Courts must do their best to award counsel the market price for legal services, in light of the risk of nonpayment and the normal rate of compensation in the market at the time, and may cross-check a percentage-of-recovery fee award with the lodestar method. *In re Synthroid Marketing Litigation*, 264 F.3d 712, 718 (7th Cir. 2001); *Baby Products*, 708 F.3d, at 176-77.

3. Calculating the Value of Constructive Common Fund

Counsel has primarily secured a constructive common fund to benefit the Class. An initial calculation of attorneys' fees based on a percentage-of-recovery method is appropriate. The value of the fund is based on the total funds made available to the Class—not only the funds actually claimed by the Class. Plaintiffs' counsel estimates that approximately 9.1 million members, comprising 76% of the estimated 12 million proposed Class members, were provided some type of notice. Of this, 4,718,651 Class members were provided direct notice of the class action proceeding via email or postcard.

At a recovery rate of $3 per bottle with no required documentation by the 4,718,651 members given direct notice, the value of the constructive fund is $14.2 million. Of the available common fund, the Class is guaranteed only two million dollars. Counsel also secured for the Class an additional $1.5 million for notice costs and requests $4.5 million in attorneys' fees and expenses, which Defendants have agreed to not contest. Not including the value of any

injunctive relief, the total direct monetary relief made available by the settlement through a constructive fund, notice costs, and attorneys' fees and expenses is $20.2 million. As such, attorneys' fees totaling $4.5 million constitutes approximately 22.3% of the total potential benefit and may be reasonable.

However, as Objectors foresaw, the data, compiled after the December 3 claims deadline, revealed that, like other consumer class actions with individual relief of a small value, the settlement resulted in a very low claims rate by the Class. *Spillman v. RPM Pizza, LLC*, No. 10-349-BAJ-SCR, 2013 U.S. Dist. LEXIS 72947, at *8 (M.D. La. May 23, 2013) (0.27% claims rate for $15 max claim); *Livingsocial*, 2013 U.S. Dist. LEXIS 40059, at *52 (D.D.C. Mar. 22, 2013) (.25% claims rate). A mere 30,245 claims were filed, representing 0.25% of the 12 million proposed Class Members, and 0.7% of even the 4,718,651 Class Members who received direct notice. Only a total of $865,284.00 of the available constructive common fund went to benefit the Class. This comprised a 4.2% of the available fund of $20.2 million. The remaining $1,134,716.00 of the guaranteed fund of $2 million is to be remitted in *cy pres* to the Orthopedic Research and Education Foundation.

The low claims rate in combination with funds being remitted to *cy pres* in an amount greater than the actual benefit to the Class suggests that there is substantial reason to decrease the percentage of the attorneys' fee award from the "standard" 25% percentage of the settlement. *Baby Products*, 708 F.3d at 179.

Plaintiffs' attorneys claim, however, that they have secured very valuable injunctive relief—the removal of representations on the labeling of Defendant's products for thirty months. Although injunctive relief may be a factor supporting an increase in the percentage of recovery, the benefit secured here, like in *Synfuel*, would primarily benefit future customers and not Class

Members. *Synfuel*, at 653. Consequently, any injunctive relief secured here does not support an increase in the percentage recovery rate awarded to counsel.

4. Crosscheck with Lodestar Method

While the Seventh Circuit does not require calculation of attorneys' fees by the lodestar method, it does require courts to "do their best to award counsel the market price for legal services." *Synthroid Marketing*, 264 F. at 717–21. To this end, we crosscheck the amount of attorneys' fees awarded under the percentage-of-the-recovery against a lodestar calculation. Given that Plaintiffs' attorneys have submitted declarations in support of their requests for attorneys' fees and expenses for purposes of conducting a lodestar, assessing the lodestar will not be a difficult task.

The attorneys for Plaintiff are comprised of two legal teams. The first legal team is comprised of three firms: (1) Bonnett, Fairbourn, Friedman & Balint, P.C. ("BFFB"), (2) Stewart M. Weltman LLC ("WELTMAN LLC"), and (3) Levin Fishbein Sedran & Berman ("LFSB"). The second legal team is the law firm Denlea & Carton LLP ("D&C"). Both teams have submitted data that reflects reasonable hourly rates for attorneys of the same experience and skill.

Team One: BFFB, Weltman LLC, and LFSB

BFFB, consisting of six attorneys, one litigation support specialist, and four paralegals, submitted to the court the following breakdown of its time and proposed hourly rates:

Elaine A. Ryan: 390.1 hours at $575.00

Patricia N. Syverson: 399.3 hours at $525.00

Todd D. Carpenter: 40.2 hours at 525.00

T. Brent Jordan: 42.4 hours at $500.00

Lindsey M. Gomez-Gray: 365.2 hours at $250.00

Kevin R. Hanger: 35.2 hours at $250.00

Brian R. Elser: 3.0 hours at $225.00

Rose K. Creech: 16.7 hours at $175.00

Lydia L. Rueda: 199.3 hours at $165.00

David J. Streyle: 20.6 hours at $165.00

Meredith K. Kight: 5.7 hours at $165.00

These figures total 1,517.7 hours and amount to a base lodestar figure for BFFB of $617,166.50. BFFB also submitted a breakdown of expenses, primarily composed of expert fees, totaling $57,398.04.

Weltman LLC submitted that Stewart M. Weltman spent a total of 474.75 hours on this litigation at an hourly rate of $685, for a total lodestar of $325,203.75. Weltman LLC did not report any additional expenses.

LFSB's legal team, comprised of one partner, one associate, and paralegal, submitted the following breakdown of their fees:

Howard J. Sedran: 12.3 hours at $775.00

Charles Sweedler: 59.0 hours at $525.00

James Rapone: 45.0 hours at $265.00

These figures total 116.3 hours and amount to a base lodestar figure for LFSB of $52,432.50. LFSB submitted expenses of $29,091.06.

Based on these figures, the total base lodestar figure for BFFB, Weltman LLC, and LFSB, calculated as proposed by plaintiffs' counsel, is $994,802.75, with expenses totaling $86,489.10. BFFB, Weltman LLC, and LFSB requested a fee award of $2 million. Applying a

lodestar method crosscheck at counsel's regular billing rates, a total lodestar of $994,802.75, represents a request to use a lodestar multiplier of 2 (i.e. Class Counsel's fee request equaled twice what they would have received at their regular billing rates).

Team Two: D&C

D&C, consisting of six attorneys and staff, submitted in a declaration the following breakdown of its time and proposed hourly rates:

James R. Denlea: 41 hours at $675.00

D. Gregory Blankinship: 105.40 hours at $625.00

Jeffrey I. Carton: 190.50 hours at $675.00

Peter N. Freiberg: 1076.50 hours at $650.00

Todd S. Garber: 50.35 hours at $150.00

Based on these figures, calculated as proposed by Plaintiffs' attorneys, the value of the total 1,478.75 hours D&C devoted to this action amounts to a base lodestar figure for D&C of $938,790.00. D&C's requested fee is $2,500,000, including $93,187.13 in expenses. Applying a lodestar method crosscheck at counsel's regular billing rates, a total lodestar of $938,790.00, represents a request to use a lodestar multiplier of 2.56.

5. Conclusion

Based on a comparison of the percentage-of-the-recovery method and lodestar method, I am awarding attorneys' fees exclusively for securing a common fund, while taking into account factors, such as the actual benefit to the Class. Due to the low actual relief secured for the Class and lack of other meaningful benefit to compensate the Class for past injuries, a substantial decrease in the percentage of the recovery is warranted. Based on a crosscheck with the Lodestar methodology, fees in the amount of $994,802.75 and expenses in the amount of

$86,489.10 will be awarded to BFFB, Weltman LLC, and LFSB, and fees in the amount of $938,790.00 and expenses in the amount of $93,187.13 will be awarded to D&C, for a total of $1,933,592.75.

These fees reflect a lodestar with no multiplier. This award comprises 9.6% of the total fund of $20.2 million, including notice costs and fees, and 13.6% of the $14.2 of the available common fund. This award adequately (and, arguably, more than adequately) compensates counsel for the market price of their legal services.[1]

B. Potential Attorneys' Fee Award Based on Injunctive Relief

Parties ordinarily may not include an estimated value of undifferentiated injunctive relief in the amount of an actual or putative common fund for purposes of determining an award of attorneys' fees. *Staton v. Boeing*, 327 F.3d 938, 974 (9th Cir. 2003). However, in limited cases, the legislature has authorized the award of fees to counsel undertaking socially beneficial litigation. *Alyeska Pipeline Service Co. v. Wilderness Society*, 421 U.S. 240, 95 S. Ct. 1612, 44 L.Ed.2d 141 (1975) (only Congress can authorize an exception to the standard American rule that attorneys' fees are not recoverable by the winning party in federal litigation).

[1] Calculating a lodestar, as we have done here, has its own difficulty. We accept both the hourly rates and the hours spent. Opposing counsel in a settled case rarely, if ever, challenge rates or hours spent in class action litigation. Hours and rate challenges are generally confined to non-class cases filed under fee-shifting statutes, where defendants allege that the plaintiffs' lawyer took 150 hours to complete a 95 hour job and charged rates higher than that lawyer's time was worth in his or her practice. On our own initiative, we considered the question of hours and fees. Based on the experience of our own dockets, the hourly rates were within the realm of reason and, in most, but not all cases the highest paid lawyers expended fewer hours than those with lower rates which is economically sound. The total number of hours is large in comparison to the class benefits. I approve the hours because the claims presented some difficulty. Several cases that were filed separately were constructed into an economically worthwhile case based on millions of consumers all of whom would receive very small damages, i.e., a maximum of $50.00 per class member, many in the range of $3.00 to $12.00. This case is not unique; I have cited similar cases. What is clear is that preparing this case required close analysis of the economic feasibility of proceeding and the method for doing so. In particular, the case was "soft" because there was no contention that the product physically harmed a large class of people. The harm done by purchasing a bottle of pills or capsules was inflicted on the small change in the buyer's pocket. It takes extra effort to try to prevail fully in such a case. For this reason, we conclude that hours spent were within the realm of reason.

These cases, addressing topics such as civil rights, employment, and antitrust, are identified by statutory fee-shifting provisions. *Bluetooth*, 654 F.3d at 941 (citing cases); *Gagne v. Maher*, 594 F.2d 336, 339-41 (2d Cir. 1979) (fees to recipient's attorneys was authorized under Civil Rights Attorney's Fees Awards Act of 1976 where class recovered almost all requested relief); *In re General Motors Corp. Pick-Up Truck Fuel Tank Products Liability Litigation*, 55 F.3d 768, 822 (3d Cir. 1995) (calculation of attorneys' fee by the lodestar method was not legislatively justified because fee in hybrid relief consumer case was not made pursuant to statute). Courts typically use a lodestar calculation to arrive at an award of fees to counsel because there is often no way to gauge the net value of the settlement or any percentage thereof. *Hanlon v. Chrysler Corp.*, 150 F.3d 1011 (9th Cir. 1998) (rejecting straight percentage recovery fee calculation because of uncertainty of settlement valuation).

Class Counsel argues that the labeling changes included in the settlement are of significant value and that the attorneys' fees should account for the benefit of this injunctive relief. Class Counsel asserts that the removal of representations on the packaging of glucosamine products will provide consumers with valuable information and is likely to lead to decreased prices for Class Members and future consumers. Objectors, however, argue that counsel should be rewarded only for the benefit secured directly for the Class. The benefit of the injunctive relief is not to the Class, but to future consumers of glucosamine.

Even assuming *arguendo* that the Plaintiffs' attorneys were entitled to fees for securing injunctive relief, there is a major problem regarding valuation of the removal of representations from the labels of Defendants' products.

Class Counsel submitted an initial report ("Reutter Rep.") by Plaintiffs' economist Dr. Keith Reutter estimating that the value of the injunctive relief was approximately $21.7 million

to current class members and $46.2 million to all consumers. See Reutter Rep. Ex. S. In order to assess the potential benefit to the class of injunctive relief, this Court requested Plaintiffs' counsel to submit additional briefing regarding calculating the value of the injunctive relief by analyzing the impact of the labeling changes after they are implemented. On November 6, 2013, Class Counsel submitted the Supplemental Report of Plaintiffs' economist Dr. Keith Reutter ("Supp. Reutter Report") which concluded that it is infeasible to better measure the actual economic impact of the injunctive relief by waiting for the implementation of the labeling changes. Dr. Reutter concluded that any meaningful analysis would require the consideration of competitors' and retailers' proprietary sales and marketing information, which would be difficult to obtain, take several years to perform, and be quite expensive.

Plaintiffs' counsels' argument that the economic benefit cannot be measured after the labeling changes are actually implemented undermines any possibility that such changes could be accurately estimated prior to such implementation. Dr. Reutter opines that actual economic impact cannot be gleaned from an analysis of defendant Rexall's data alone. Dr. Reutter concludes that accurately estimating the economic impact of the proposed labeling changes will "require the purchase of retail sales data from a vendor such as ACNielsen, and will require knowledge of the advertising budgets of competing manufacturers and retail outlets."

Plaintiffs' counsel's own conflicting reports by Dr. Reutter strongly suggests that there is no accurate estimate to assess the value to the Class of the injunctive relief. The Seventh Circuit has conceded that a "high degree of precision cannot be expected in valuing a litigation, especially regarding the estimation of the probability of particular outcomes," but found that a judge that does not attempt to provide a monetization of the injunctive relief abuses his discretion. *Reynolds v. Beneficial Nat. Bank*, 288 F.3d 277, 285 (7th Cir. 2002).

Plaintiffs' counsel argues that it should be awarded fees without a reasonably accurate and defensible determination of the value of injunctive relief by calculating fees based on a lodestar method with a multiplier because it has engaged in socially beneficial litigation. However, we will not award attorneys' fees for injunctive relief secured without clear indication from Congress that consumer class actions fall into fee-shifting "socially beneficial litigation."

At this time, we are neither able nor willing to award the plaintiffs' attorneys fees based on inconsistent conjecture as to what may happen in the future regarding labeling changes—especially, when the court may wait and, possibly, base such an award on accurate data. *Bluetooth*, 654 F.3d at 945 (remanded to the district court for lack of an adequate explanation for fee award). Accordingly, whether Plaintiffs' counsel can prove the value of the labeling changes that it secured on behalf of the Class is an issue that it may be able to raise after the passage of time. As of now, the value is not proven even as to the members of the Class.

CONCLUSION

We approve judgment on the final settlement and award of attorneys' fees, accepting attorneys' fees for the benefits of injunction, and expenses as follows: $617,166.50 in fees and $57,398.04 in expenses to BFFB; $325,203.75 in fees to Weltman LLC; $52,432.50 in fees and $29,091.06 in expenses to LFSB; $938,790 in fees and $93,187.13 in expenses to D&C. I further approve reasonable incentive awards in the amount of $5,000 for each of the six named Plaintiffs, for a total of $30,000.

ENTER:

James B. Zagel
United States District Judge

DATE: January 3, 2014

**UNITED STATES DISTRICT COURT
NORTHERN DISTRICT OF ILLINOIS
EASTERN DIVISION**

NICK PEARSON, FRANCISCO PADILLA, CECILIA LINARES, AUGUSTINA BLANCO, ABEL GONZALEZ, and RICHARD JENNINGS, On Behalf of Themselves and All Others Similarly Situated, Plaintiffs, v. NBTY, INC., a Delaware corporation; and REXALL SUNDOWN, INC., a Florida corporation; TARGET CORPORATION, a Minnesota Corporation; Defendants.	Case No.: 11 CV 07972 CLASS ACTION **Judge James B. Zagel**

FINAL JUDGMENT AND ORDER

The matter came before the Court on Plaintiffs' motion for final approval of the proposed class action settlement with Rexall Sundown, Inc. and NBTY, Inc. and their affiliated parties ("Rexall"), set forth in the Settlement Agreement dated April 15, 2013 between Plaintiffs and Rexall Sundown, Inc., and NBTY, Inc. ("Settlement Agreement"), and preliminarily approved in this Court's order of May 30, 2013 [Dkt. No. 89]. The Settlement Agreement, together with the exhibits attached thereto, sets forth the terms and conditions for the proposed settlement of the case, and provides for the dismissal of Plaintiffs' individual and class claims against Rexall with prejudice upon the Effective Final Judgment Date.

The Court having held a Fairness Hearing on the fairness, adequacy, and reasonableness of the settlement and considered all of the written submissions, objections, and oral arguments

made in connection with final settlement approval, and having issued a Memorandum Opinion and Order on January 3, 2014 [Dkt. No. 143], hereby finds and orders as follows:

1. Unless defined herein, all defined terms in this Final Judgment and Order shall have the respective meanings as the same terms in the Settlement Agreement.

2. Notice to the Settlement Class has been provided in accordance with the Court's Preliminary Approval Order. The notice, in form, method, and content, fully complied with the requirements of Rule 23 and due process, constituted the best notice practicable under the circumstances, and constituted due and sufficient notice to all persons entitled to notice of the settlement.

3. The settlement set forth in the Settlement Agreement is fair, reasonable, adequate, and in the best interests of the Settlement Class. The Settlement Agreement was arrived at through good-faith bargaining at arm's-length, without collusion, conducted by counsel with substantial experience in prosecuting and resolving consumer class actions. The settlement consideration provided under the Settlement Agreement constitutes fair value given in exchange for the release of the Released Claims against the Released Parties. The consideration to be paid to members of the Settlement Class is reasonable, considering the facts and circumstances of the numerous types of claims and affirmative defenses asserted in the Litigation, and in light of the complexity, expense, and duration of litigation and the risks involved in establishing liability and damages and in maintaining the class action through trial and appeal.

4. All Settlement Class members who failed to submit an objection to the settlement in accordance with the deadline and procedure set forth in the Preliminary Approval Order are deemed to have waived and are forever foreclosed from raising the objection.

5. The Parties, the Released Parties, and each Settlement Class member have irrevocably submitted to the exclusive jurisdiction of this Court for any suit, action, proceeding, or dispute relating in any way to, or arising out of, the Released Claims, the Settlement Agreement, or this Final Judgment and Order.

6. The Parties are directed to consummate the Settlement Agreement in accordance with its terms. The Parties and any and all Settlement Class members who did not timely exclude themselves from the Settlement Class are bound by the terms and conditions of the Settlement Agreement.

7. Under Rule 23(b)(3), the Court makes final its previous conditional certification of the Settlement Class, defined as all consumers who, during particular time periods and in certain U.S. locations, purchased for personal use and not resale or distribution certain joint health dietary supplements (a) sold by Rexall or any of its affiliates under the brand names of Rexall or its affiliates; or, (b) manufactured by Rexall or any of its affiliates but sold under another brand name by a company not affiliated with Rexall (collectively, "Covered Products"). The Covered Products and their geographic areas and time periods of sale covered by this Settlement are identified in Exhibit A to the Settlement Agreement. The Settlement Class does not include persons who submitted valid requests for exclusion from the Settlement Class.

8. The requirements of Rule 23(a) and (b)(3) have been satisfied for purposes of settlement. The Settlement Class is so numerous that joinder of all members is impracticable; there are questions of law or fact common to the Settlement Class; the claims of the Plaintiffs are typical of the claims of the Settlement Class; the Plaintiffs will fairly and adequately protect the interests of the Settlement Class; and the questions of law or fact common to Settlement Class members predominate over any questions affecting only individual members.

9. The preliminary appointment of Jeffrey I. Carton and Peter N. Freiberg (Denlea & Carton LLP); Elaine A. Ryan (Bonnett, Fairbourn, Friedman & Balint, P.C.); and Stewart M. Weltman (Stewart M. Weltman, LLC, Of Counsel Levin Fishbein Sedran & Berman) as Settlement Class Counsel is hereby made final. Settlement Class Counsel are experienced in class litigation, including litigation of similar claims in other cases, and have fairly and adequately protected the interests of the Settlement Class.

10. Subject to the terms and conditions of the Settlement Agreement, this Court hereby dismisses the Litigation without prejudice and without costs, except as provided in the Settlement Agreement. This dismissal without prejudice shall not allow the Parties or any members of the Class to litigate or otherwise reopen issues resolved by this judgment, or included within the Released Claims, but is "without prejudice" so as to allow the Court to supervise the implementation and administration of the Settlement.

11. By operation of this Final Judgment and Order, the Releasing Parties release and forever discharge the Released Parties from the Released Claims, and the Released Parties release and forever discharge Plaintiffs and Settlement Class Counsel, as set forth in Paragraphs 11, 12, and 14 of the Settlement Agreement.

a. As used in this Order, the Releasing Parties are Plaintiffs and each Settlement Class member (except a person who has obtained proper and timely exclusion from the Settlement Class), on their own behalf and on behalf of their spouses and former spouses, as well as the present, former, and future respective administrators, agents, assigns, attorneys, executors, heirs, partners, predecessors-in-interest, and successors of any of the foregoing.

b. As used in this Order, the Released Parties are (i) NBTY, Inc. and Rexall Sundown, Inc.; (ii) Any person or entity in the chain of distribution of the Covered Products,

including but not limited to raw material suppliers, distributors, and retailers (including but not limited to Costco, Target, and CVS Pharmacy, Inc., to the extent that they are in the chain of distribution of the Covered Products); (iii) Entities and persons related to (i) and (ii), including but not limited to their present, former, and future direct and indirect parent companies, affiliates, agents, divisions, predecessors-in-interest, subsidiaries, successors, and any entities that manufactured or sold the Covered Products from which Rexall acquired assets or contracts; and (iv) Entities and persons related to (i), (ii), and (iii), including but not limited to their respective present, former, and future officers, directors, employees, independent contractors, shareholders, agents, assigns, and attorneys.

c. The Released Claims include any and all rights, duties, obligations, claims, actions, causes of action, or liabilities, whether arising under local, state, or federal law, whether by statute, contract, common law, or equity, whether known or unknown, suspected or unsuspected, asserted or unasserted, foreseen or unforeseen, actual or contingent, liquidated or unliquidated that, as of the date that this Order is entered, arise out of or relate in any way to: (i) allegations, claims, or contentions that were or could have been asserted in the Litigation; (ii) the Covered Products, including, but not limited to, their efficacy or performance, and any and all advertising, labeling, packaging, marketing, claims, or representations of any type whatsoever made in connection with the Covered Products; or (iii) all labels or packaging for the Covered Products that conform to the terms of the Settlement. The Released Claims do not include any claims for personal injury or safety-related concerns.

12. The Release includes claims that are currently unknown to the Releasing Parties. The Release in this Order and the Settlement Agreement fully, finally, and forever discharges all Released Claims, whether now asserted or unasserted, known or unknown, suspected or

unsuspected, which now exist, or heretofore existed or may hereafter exist, which if known, might have affected their decision to enter into this release. Each Releasing Party shall be deemed to waive any and all provisions, rights, and benefits conferred by any law of the United States, any state or territory of the United States, or any state or territory of any other country, or principle of common law or equity, which governs or limits a person's release of unknown claims. The Releasing Parties understand and acknowledge that they may hereafter discover facts in addition to or different from those that are currently known or believed to be true with respect to the subject matter of this release, but have agreed that they have taken that possibility into account in reaching this Settlement Agreement and that, notwithstanding the discovery or existence of any such additional or different facts, as to which the Releasing Parties expressly assume the risk, they fully, finally, and forever settle and release any and all Released Claims, known or unknown, suspected or unsuspected, which now exist, or heretofore existed, or may hereafter exist, and without regard to the subsequent discovery or existence of such additional or different facts. The foregoing waiver includes, without limitation, an express waiver, to the fullest extent not prohibited by law, by Plaintiffs, the Settlement Class members, and all other Releasing Parties of any and all rights under California Civil Code Section 1542, which provides:

> **A GENERAL RELEASE DOES NOT EXTEND TO CLAIMS WHICH THE CREDITOR DOES NOT KNOW OR SUSPECT TO EXIST IN HIS OR HER FAVOR AT THE TIME OF EXECUTING THE RELEASE, WHICH IF KNOWN BY HIM OR HER MUST HAVE MATERIALLY AFFECTED HIS OR HER SETTLEMENT WITH THE DEBTOR.**

In addition, Plaintiffs, Settlement Class members, and all other Releasing Parties also expressly waive any and all provisions, rights, and benefits conferred by any law or principle of

common law or equity, that are similar, comparable, or equivalent, in whole or in part, to California Civil Code Section 1542.

13. Rexall may elect, in its sole and unilateral discretion, to continue the label changes identified in Paragraph 8 and Exhibit B of the Settlement Agreement beyond the thirty-month required period. For as long as a product identified in Exhibit A continues to be sold and complies with the terms of Paragraph 8 beyond the thirty-month required period, no Releasing Party who purchases such product after the thirty-month period may sue any Released Party based on any claim that was or could have been asserted in the Litigation.

14. Except as to the rights and obligations provided for under the Agreement, by operation of this Order, NBTY, Inc. and Rexall Sundown, Inc. hereby release and forever discharge Plaintiffs, the Settlement Class, and Settlement Class Counsel from any and all rights, duties, obligations, claims, actions, causes of action, or liabilities, whether arising under local, state, or federal law, whether by statute, contract, common law, or equity, whether known or unknown, suspected or unsuspected, asserted or unasserted, foreseen or unforeseen, actual or contingent, liquidated or unliquidated, which the Released Parties may now have, own or hold or which the Released Parties at any time may have, own, or hold, against Plaintiffs, the Settlement Class, or Settlement Class Counsel by reason of any matter, cause, or thing whatsoever occurred, done, omitted, or suffered from the beginning of time to the date of the Settlement Agreement, related to the subject matter of the Litigation.

15. Plaintiffs, Settlement Class members, and the Releasing Parties are permanently enjoined and barred from commencing or prosecuting any action or proceeding asserting any of the Released Claims, either directly, representatively, derivatively, or in any other capacity, whether by a complaint, counterclaim, defense, or otherwise, in any local, state, or federal court,

or in any agency, or other authority or forum wherever located. Any person or entity who knowingly violates such injunction shall pay the attorneys' fees and costs incurred by the Rexall or any other Released Party as a result of such violation.

16. The Court makes the following awards to Plaintiffs and Settlement Class Counsel:

a. $ 938,790.00 as attorneys' fees and $ 93,187.13 as costs to Denlea & Carton, LLP;

b. $ 994,802.75 as attorneys' fees and $86,489.10 as costs to Bonnett, Fairbourn, Friedman & Balint, P.C.; Levin Fishbein Sedran & Berman; Stewart M. Weltman, LLC (Of Counsel Levin Fishbein Sedran & Berman); jointly, and

c. $5,000.00 as an incentive award to each Class Representative.

17. Without affecting the finality of this Final Judgment and Order, the Court retains exclusive jurisdiction over this action, the Parties, and all Settlement Class members to determine all matters relating in any way to the Final Judgment and Order, the Preliminary Approval Order, or the Settlement Agreement, including but not limited to the administration, implementation, interpretation, or enforcement of such orders or Agreement.

18. The Settlement Agreement and the proceedings taken and statements made pursuant to the Settlement Agreement or papers filed seeking approval of the Settlement Agreement, and this Order, are not and shall not in any event be construed as, offered in evidence as, received in evidence as, and/or deemed to be evidence of a presumption, concession, or an admission of any kind by any of the Parties of (a) the truth of any fact alleged or the validity of any claim or defense that has been, could have been, or in the future might be asserted in the Litigation, or any other litigation, court of law or equity, proceeding, arbitration,

tribunal, investigation, government action, administrative proceeding or other forum, or (b) any liability, responsibility, fault, wrongdoing or otherwise of Rexall. Rexall has denied and continues to deny the claims asserted by Plaintiffs. Nothing contained herein shall be construed to prevent a party from offering the Settlement Agreement into evidence for the purposes of enforcement of the Settlement Agreement. The certification of the Settlement Class shall be binding only with respect to the settlement of the Litigation. In the event that the Court's approval of the settlement is reversed, vacated, or modified in any material respect by this or any other Court, the certification of the Settlement Class shall be deemed vacated, the Litigation shall proceed as if the Settlement Class had never been certified, and no reference to the Settlement Class, the Settlement Agreement, or any documents, communications, or negotiations related in any way thereto shall be made for any purpose in this Litigation, the Underlying Actions, or any other action or proceeding.

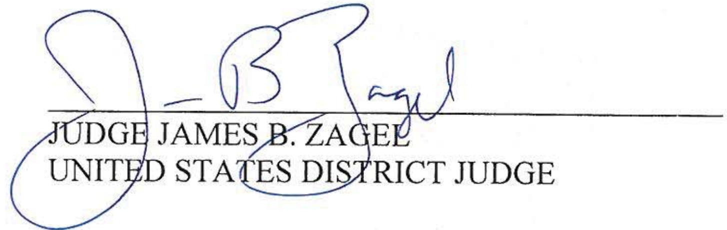
19. Without further order of the Court, the Parties may agree to reasonable extensions of time to carry out any of the provisions of the Settlement Agreement.

20. Neither Settlement Class Counsel's applications for incentive awards, attorneys' fees, and reimbursement of expenses, nor any order or proceedings relating to such applications, nor any appeal from any order relating thereto or reversal or modification thereof, shall in any way affect or delay the finality of this Judgment, and all such matters shall be considered separate from this Final Judgment and Order.

21. Based upon the Court's finding that there is no just reason for delay of enforcement or appeal of this Order notwithstanding the Court's retention of jurisdiction to oversee implementation and enforcement of the Settlement Agreement, the Court directs the Clerk to enter final judgment.

IT IS SO ORDERED.

Dated: 22 Jan, 2014



JUDGE JAMES B. ZAGEL
UNITED STATES DISTRICT JUDGE