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FEDERAL COURT DRAWS ROADMAP FOR SCRUTINY OF ATTORNEYS' FEES IN "COUPON" SETTLEMENTS

By

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In certain situations, coupon settlements represent the ideal resolution for class action lawsuits. Class members obtain retail products that they regularly use rather than a check for a de minimis amount representing the wholesale or manufacturer's price of the product. Defendants, often large corporations, are able to provide class members with maximum benefit at the most efficient cost. Indeed, in some situations, the defendants themselves benefit from additional purchases made by class members redeeming coupons. But while coupon settlements offer a great benefit to class members and to defendants, that benefit has been overshadowed by the specter of bloated class counsel fees.

In several high-profile class actions, including *In re Excess Value Insurance Coverage Litig.*, No. M-21-84, MDL-1339 (S.D.N.Y. Nov. 2, 2005), class counsel has attempted to justify extraordinarily large fee awards by pointing to projected coupon redemption rates. At the close of the redemption period, however, class counsel's projections often fall far short of the actual redemption rate. The gap between attorneys' fees and coupon redemption rates indicates an even larger problem:

[I]t is not unusual for 15 or more different plaintiffs' law firms to get a nominal client and file copy-cat class action lawsuits which are later consolidated. The firms then ride each others' gravy train as they seek attorneys' fees for work that is often duplicative or unnecessary, thereby undermining one of the very purposes of allowing class actions, *i.e.*, the reduction of litigation and transaction costs...it is no secret that what drives these cases is the prospect of forcing settlements and being awarded huge attorneys' fees even where the "injury" is de minimus or liability doubtful.

Paul D. Kamenar, *The Use of "Coupon" Compensation and Other Non-Pecuniary Redress*, Address before the Federal Trade Commission's Workshop on Protecting Consumer Interests in Class Actions (Washington, D.C., 2004), *reprinted in* 18 GEO. J. LEGAL ETHICS 1161 (2005). The Washington Legal Foundation ("WLF") has long recognized that the key to reigning in runaway attorneys' fees is to align class counsels' interests with those of the class members. As such, WLF has recommended basing attorneys' fees for class counsel in coupon settlements upon a lodestar approach, rather than upon a percentage of the projected coupon redemption rate. *Id.*

Congress, also having recognized the abuses inherent in class action lawsuits, recently enacted the Class Action Fairness Act ("CAFA"), 28 U.S.C. § 1711, *et seq.* CAFA takes a first step in realigning class counsels' interests with those of class members, mandating that "the portion of any attorneys' fee award to class counsel

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that is attributable to the award of coupons *shall be based on the value to class members of the coupons that are redeemed.*” 28 U.S.C. § 1712(a) (emphasis added). If the attorneys’ fees are based upon mixed relief to the class, meaning coupons and injunctive relief, the portion of the attorneys’ fees based upon the recovery of coupons must be based upon the value of redeemed coupons. *Id.* at § 1712 (a) and (c)(1). The portion of the attorneys’ fees based upon injunctive relief must be based upon “the amount of time class counsel reasonably expended working on the action,” and may involve the application “of a lodestar with a multiplier method. . .” *Id.* at § 1712 (b)(1) and (2) and (c)(2). Section 1712 (e) expressly requires the court to review the coupon settlement to determine whether the settlement is fair, reasonable and adequate for class members. Through such new regulations, CAFA begins to lift the shadow of over-inflated attorneys’ fees for class counsel from coupon settlements in federal court.

According to recent studies, however, most state court class actions will remain in state court under CAFA, free from Section 1712’s restrictions. Consequently, state courts and state legislatures remain on the frontline facing down runaway attorneys’ fees for class counsel in coupon settlements. The holding of *In re Excess Value Insurance Coverage Litig.*, No. M-21-84, MDL-1339 (S.D.N.Y. Nov. 2, 2005), though a pre-CAFA federal district court case, offers a potential model for state court analysis.

Background for the *In Re Excess Ins. Coverage Litig. Holding.* *In re Excess Value Insurance Coverage Litig.*, No. M-21-84, MDL-1339 (S.D.N.Y. Nov. 2, 2005), was a consolidated multidistrict litigation brought against United Parcel Service, Inc., (“UPS”), and related defendants by consumers who purchased “excess value” shipping insurance offered by UPS. The matter was first addressed in the Tax Court in *United Parcel Service of America Inc. v. Commissioner*, 1999 WL 592696. The Tax Court found that UPS had engaged in “ongoing sham transactions devoid of economic substance.” That holding gave birth to a flurry of class action proceedings against UPS, alleging, *inter alia*, fraud, breach of contract, violations of insurance regulations, RICO violations, and violations of federal antitrust laws.

The purported “sham transactions” highlighted by the Tax Court arose from a captive insurance company set up by UPS to cover risks for losses on its excess value insurance. UPS had a policy of reimbursing customers for lost or damaged parcels up to \$100 in declared value. For packages in excess of \$100 in declared value, the company would assume liability and charge twenty-five cents per additional \$100 in declared value. That practice was known as the “excess value charge.”

In 1983, UPS, seeking certain tax advantages, formed a Bermuda subsidiary, Overseas Partners Ltd., to serve as a captive insurance company. UPS purchased an insurance policy for the “excess value” risk from National Union Fire Insurance Company. There was, in turn, a reinsurance agreement between Overseas Partners Ltd. and National Union. For tax purposes, the plan transformed a stream of income (excess value charges) into a deduction for UPS because the excess value charges became a deductible cost (insurance premiums) paid first to National Union and then to Overseas Partners Ltd. under the reinsurance contract. In short, the plan transformed a stream of income into a deduction for the parent corporation and the profit eventually resided in a foreign subsidiary (presumably taxed at lower rates).

In April, 2000, the Judicial Panel on Multidistrict Litigation consolidated before Judge Berman of the Southern District of New York several purported class actions concerning the UPS excess value insurance coverage program. *In re EVIC Class Action Litigation*, No. M-21-84, 02 CIV 2703, MDL-1339. 00 CIV 3811. This consolidated multidistrict litigation (“MDL”) involved some 27 separate class actions brought against UPS and related defendants in state and federal courts throughout the United States by purchasers of “excess value” shipping insurance (“EVIC”) offered by UPS .

In 2001, the Eleventh Circuit reversed and remanded the adverse Tax Court decision against UPS. *UPS of America Inc. v. Comm’r*, 254 F.3d 1014, (11th Cir. 2001). The court found that the purported “sham transactions” actually had real economic effect and a business purpose. As such, the Eleventh Circuit’s decision eviscerated many of the claims asserted by the purported class. Additionally, Judge Berman dismissed a plethora of state law claims on the grounds that they were barred by the filed tariff doctrine or preempted by the FAA shipping regulations. *In re EVIC*, 2002 WL 1766554; *Stein Jewelry Co. v. UPS Inc.*, 228 F. Supp. 2d 304 (S.D.N.Y. 2002). The plaintiffs’ claims were further weakened when the United States Supreme Court, in

Verizon Communications v. Law Offices of Curtis, 124 U.S. 872 (2004), reversed the Second Circuit case upon which the class members had based their antitrust claims.

Notwithstanding these body blows to plaintiffs claims, in November 2002, Judge Berman entered an Order certifying a nationwide class alleging RICO, breach of contract and intentional interference with contract claims and certifying subclasses of plaintiffs asserting claims under the insurance statutes of Texas, Kentucky, South Carolina and Kansas. As one of the objectors to the settlement noted, plaintiffs' case seemed "in search of a theory and a harm..." *In re EVIC*, 2004 WL 1724980.

Extraordinary Attorneys' Fees. The parties eventually entered into a settlement, with a major portion of it consisting of coupon vouchers to the individual class members. Additionally, UPS agreed to certain structural settlement requirements, including posting signs reminding customers that they were not obligated to buy "excess value" insurance. Plaintiffs moved pursuant to FED. R. CIV. P. 23(e) for final approval of the settlement. Plaintiffs also moved for an award of attorneys' fees and expenses in the amount of \$19,340,000. Finally, plaintiffs moved for an award of \$5,000 to each of 32 class representatives, totaling \$160,000 in incentive compensation.

Class counsel predicted that the aggregate face value of the coupon voucher program would be between \$205 to \$265 million. Based upon this projection, the attorneys' fees requested by plaintiffs' counsel would represent less than 10% of the value of the settlement. At the close of the coupon redemption period, however, *the value of goods and services for which the vouchers were redeemed totaled only \$4,863,877, only 2.4% of plaintiffs' original estimate of voucher redemptions. Based upon the actual redemption rate, the attorneys' fees requested by plaintiffs' counsel was 280% greater than the actual value of redeemed coupons.* As such, the attorneys' fees requested by plaintiffs' counsel highlight the gap between class counsel and class member interests, a gap that CAFA's section 1712 is meant to bridge. Though a pre-CAFA, federal district court case, the *In re Excess Value Ins. Coverage Litig.* court's evaluation and reduction of those proposed attorneys' fees serves as a model for the analysis that should be applied in any court's evaluation of attorneys' fees arising from coupon settlements.

Legal Analysis Used To Reduce Attorneys' Fees. Abandoning the lodestar approach and refusing to base attorneys' fees upon projected coupon redemption rates, the court awarded class counsel \$2,407,294 in legal fees and \$753,144.25 in expenses, rather than class counsel's fee application of \$19,340,000.00 (\$18,478,571.70 in legal fees and \$861,428.30 in expenses).

The court noted a trend throughout the country towards the percentage method of determining counsel fees, which link attorneys' fees directly to actual coupon redemption rates. It found that the percentage method directly aligns the interest of the class with its counsel, while also providing a powerful incentive for efficient prosecution and early resolution of litigation. Although the court noted some value in lodestar analysis, particularly as a "cross check" to insure that attorneys' fees were in line with coupon redemption rates, the court held that lodestar analysis is inappropriate when the lodestar substantially exceeds the value to the class of the coupons redeemed.

Under the percentage method advanced by the court, attorneys' fees are determined on an evaluation of the total value of the settlement, which consists of (1) the actual value of the voucher program; (2) the value of injunctive relief, namely, the structural changes; and (3) total award of legal fees and expenses. The court found that the voucher program consisted of a total value of redeemed vouchers of \$4,863,877, representing only 2.4% of plaintiffs' original estimate of the voucher redemption. Next, the court attempted to quantify the value of the structural components of settlement.¹ The court declined to assign a specific value to the structural changes, but did find that those changes had provided some benefit to the class. Consequently, based upon those structural changes, the court decided to award legal fees at the upper end (30%) of the settlement value commonly awarded

¹Plaintiffs presented an expert who asserted that the value of the structural changes in the settlement was between \$79.8 million to \$142.4 million. The court, noting that the same expert also had valued the coupon settlement at over \$200 million, held that plaintiffs' valuation was not persuasive because "among other things, [the expert had] overestimated the value of the voucher program, i.e. by over 4,000%."

under the percentage method (280% lower than the amount sought by plaintiffs' counsel). To determine the appropriate legal fee award, the court relied on the six factors outlined in *Goldberger v. Integrated Resources, Inc.*, 209 F.3d 43, 50 (2d Cir. 2000). Under the *Goldberger* approach, attorneys' fees are determined by evaluating the complexity of the case, the risk of the case, the quality of representation, the requested fee in relation to settlement, and public policy considerations. The court relied heavily on the findings made by Magistrate Judge Fox, to whom the initial fee application was made.

The court recognized that the case was complex, involving contract, RICO, and antitrust claims filed in 27 different state and federal cases on behalf of over 2.6 million plaintiffs. Nevertheless, the court strongly agreed with Judge Fox's ruling that despite the complexity of the case, class counsel should not have had 42 sets of counsel performing identical work and traveling to court conferences or case management sessions together throughout the case. As to the third *Goldberger* factor, the court found that the risk of litigation was very low, given favorable rulings for plaintiffs by other courts. The court also focused heavily on the fifth and sixth *Goldberger* factors, namely, the requested fee in relation to settlement and public policy considerations. The court found that those factors "compelled" a fee award significantly lower than the \$19,340,000 sought by class counsel. The court held that "*it would be anomalous and unacceptable for counsel to fair better than the class, for example to receive 280% more than the class actually received, as class counsel suggest.*"

As for expenses, the court again agreed with Judge Fox's recommendations that the expense award be set at \$753,144.25, rather than class counsel's initial request of over \$861,000. The court, citing approvingly from Judge Fox's findings, upheld strict caps on class counsel's expenses, limiting reimbursements to \$500 per round trip flight, \$100 per day for meals, \$200 per night for lodging, and 25 cents per facsimile page. The court expressly disallowed expenses relating to duplicative staffing. Responding to class counsel's argument that Judge Fox did not have a complete record when evaluating class counsel's expenses, the court noted that class counsel bore the burden to establish entitlement to fees, and "it was not Judge Fox's burden to fill gaps in class counsel's application." Finally, the court noted that Judge Fox's reduction in expenses would have the positive effect of discouraging plaintiff's practice of sending multiple attorneys to court conferences. Based upon the foregoing considerations, the court held that the settlement value of the case was \$8,024,315. As such, it awarded class counsel legal fees amounting to \$2,407,294, approximately 30% of the settlement value. In addition, the court awarded class counsel \$753,144.25 in expenses, upholding Judge Fox's earlier determination.

Conclusions. The *In re Excess Value Ins. Coverage Litig.* holding provides guidance to all those courts that are not bound by CAFA but are seeking more appropriate methods of evaluating attorneys' fees for class counsel in coupon settlements. Tying attorneys' fees to actual coupon redemption rates positively realigns the interests of class counsel with those of the class, removing the specter of bloated attorneys' fees from otherwise beneficial coupon settlements. But a court's analysis must go farther than a simple percentage method. As the *In re Excess Value Ins. Coverage Litig.* court found, courts must engage in an intricate evaluation, balancing numerous factors including even the impact of the attorneys' fees on the public's perception of the settlement. Courts also must begin to stamp out duplicative fees and expenses, closing the loopholes that have long permitted class counsel to benefit economically from defeating the very purpose of the class action lawsuit. By using an approach similar to the one advanced by the *In re Excess Value Ins. Coverage Litig.* Court, courts will be able to ensure that a coupon settlement is fair, reasonable and adequate, that attorneys' fees reflect the true value received by the class, and that efficiency and conservation of judicial resources are promoted.