COUPON SETTLEMENTS:
THE EMPEROR'S CLOTHES OF CLASS ACTIONS

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Class actions can allow for the convenient and efficient grouping of plaintiffs sharing a common complaint to link up in a single lawsuit. Such suits have deep roots in English common law. When used correctly, class actions allow courts to resolve in one action many smaller, similar claims that might otherwise remain unheard because the cost of any particular suit would exceed the possible benefit to the claimant. Class actions also can allow defendants to focus their energies on resolving all claims in one lawsuit, and prevent courts from being flooded with duplicative claims.

Over time, class action litigation has strayed from its usefulness as an efficient means of dispensing justice and has become, for the most part, the epitome of injustice. Class action litigation has become warped by the seduction of gargantuan contingency fees combined with a change in the court rules that allows people to be dragooned as plaintiffs in a class action lawsuit unless they affirmatively notify the plaintiffs' attorneys they want out.[1] Rule 23 was changed by jurists in 1966, reversing an "opt-in" provision to an "opt out" provision. As a result, countless thousands of plaintiffs have been conscripted into class actions, often unknowingly.

So-called "coupon settlements" are the unhealthy offspring of this combination. Instead of cash awards, plaintiffs receive coupons or other promises for products or services, while their lawyers receive cash fees in many times the amount recovered by an individual plaintiff. As we have learned over the past decade, coupon settlements are subject to abuse and should be carefully scrutinized.

At first, coupon settlements appeared to be a win-win situation. Plaintiffs would receive a benefit, and an incentive would be created to correct whatever defects may have existed, if any, in the product, service or pricing mechanism at issue. Defendants then could resolve the litigation and focus on the business of business.

But something happened on the way to the courthouse. Some plaintiffs' lawyers structured coupon settlements so their fees would consume a greater percentage of the money the defendants were willing to spend on the settlement. They inflated the apparent value of the coupons by overstating the number of anticipated class members so that the accumulative value of the settlement would be artificially high when it was used as the basis for the plaintiffs' lawyers fees. And, in some cases, it appears that the process of redeeming coupons was so cumbersome that only a few would be redeemed.

One such case involved price-fixing claims in the early 1990s by consumers against the airline industry arising out of the use of a computerized clearinghouse for ticket prices jointly owned by the airlines.[2] While the claims apparently were of questionable merit,[3] the settlement provided the class members a total of $408 million in discount airline ticket coupons and more than $50 million in attorneys' fees and administrative costs.[4] The discount coupons were heavily

restricted, as they were subject to black-out dates, could not be combined or used with other discounts, and were good only for up to 10 percent off a flight. Critics charged that the settlement was primarily "a promotional scheme to induce travelers to fly" during off-peak travel periods and "a deal" worked out so class counsel could reap their fees, calculated at between $500 and $1,400 an hour.[5]

Rather than being a way to settle honest disputes between a company and its customers, most coupon settlements degenerated into another get-rich-quick scheme for plaintiffs' lawyers.

Behind the Litigation Veneer

In many coupon settlement cases, the factual dispute and elements of the cause of action can be illusory, leading to significant potential for fraud or abuse. They differ from the traditional class action where people who believe they were injured by others seek lawyers, expand the suits into class actions upon finding out that others are in the same situation and, if successful, are compensated for their loss. Here is how:

First, in coupon settlement cases, the litigation is usually generated by the lawyers.[6] As a *Wall Street Journal* editorial writer explained, "[t]he typical case begins with a lawyer scanning the press for some business miscue so small that no single consumer would bother to complain about it. When thousands of consumers are aggregated in a class action, however, the prospect of a big fee begins to loom."[7] Once plaintiffs' lawyers identify the miscue, they typically find a friend or colleague to be the representative plaintiff.[8] Often, there are no real plaintiffs, nobody has been injured, and the trial lawyers just represent themselves. As class action lawyer Bill Lerach candidly admitted: "I have the greatest practice of law in the world . . . I have no clients."[9]

For many plaintiffs' lawyers, this indeed is clientless law. Certainly many of the lawsuits go unnoticed by the plaintiffs. Pinellas County, Florida Circuit Judge W. Douglas Baird wrote of one action that it "appears to be the class litigation equivalent of the 'squeegee boys' who used to frequent major urban intersections and who would run up to a stopped car, splash soapy water on its perfectly clean windshield and expect payment for the uninvited service of wiping it off."[10]

Second, until recently, the legitimacy of the lawsuits and merits of the settlements were rarely scrutinized. Now, many judges are aggressive in their rejection of these suits and their aims. But because class actions are by definition concentrated, they can thrive by clustering in a relatively small number of jurisdictions – many of them small, rural and remote from the social consequences of coupon settlements or another result of unwarranted class action litigation, bankrupting verdicts. Trial lawyers know that many companies are likely to settle once class actions are certified. Instead of facing a judge who might exert discretion and deny class certification or strike down coupon settlements as unfair, trial lawyers seek to bring their cases in jurisdictions known to support this type of litigation.[11]

Such jurisdictions have been termed "judicial hellholes" by the American Tort Reform Association[12] and "magic jurisdictions" [13] by prominent plaintiffs' attorney Dick Scruggs (who is

voicing growing skepticism of some recent practices). What are magic jurisdictions? They are venues, Scruggs says, "where the judiciary is elected with verdict money"[14] and "[t]he trial lawyers have established relationships with the judges."[15] In these courts, "it's almost impossible to get a fair trial if you're a defendant"[16] and [a]ny lawyer fresh out of law school can walk in there and win the case, so it doesn't matter what the evidence or the law is."[17] These venues are critical to the class action coupon settlement industry.

Third, as noted above, the allegedly injured class members often do not receive real compensation.[18] The coupons come with so many restrictions that the realization percentage is predictably low.[19] In one case involving ITT Financial Corporation, only 2 coupons out of 96,754 were ever redeemed.[20] Consider a number of examples of this kind of abusive litigation:

- A coupon suit against the maker of Cheerios alleged that certain pesticides approved for other grains, but not oats, came into contact with the cereal's oat grains.[21] The plaintiffs' lawyers conceded that no consumers were injured.[22] Nevertheless, the lawyers received $1.75 million and the consumers received coupons for a free box of Cheerios, but only if they had kept their grocery receipt to prove their previous purchase.[23]

- Poland Springs was sued for selling bottled water that allegedly was not "pure." The plaintiffs' lawyer constructed the settlement so they would take $1.35 million; the "injured" class received more of the bottled water.[24]

- The settlement of a class action against Carnival Cruise Lines, for the alleged inflation of port charges, awarded former passengers with coupons worth $25 to $55 to be used for a future cruise, or redeemed for cash at 15 percent to 20 percent of face value. The class action plaintiffs' counsel were to receive up to $5 million in attorney fees as part of the settlement.[25]

- Ralph Lauren settled class action allegations that it inflated the suggested retail price on its Polo line at outlet stores. The take? Plaintiffs' lawyers walked away with $675,000 in fees. Their clients – the actual customers – can apply for 10 percent-off coupons (assuming they still have receipts from purchases made between July 15, 1991, and January 10, 2000).[26]

The Coupons Are Not About Compensating for Alleged Injuries

As the cases outlined above suggest, the value of the coupons generally has no relationship to the alleged injury. In the Cheerios case, if the pesticide actually harmed someone, what solace would a free box of Cheerios provide? The $4 or $5 value of the coupons would hardly compare to the cost of any necessary medical care.

In the past few years, the Federal Trade Commission ("FTC") has begun fighting coupon settlements of this nature. It has filed *amicus curiae* briefs in courts urging the judges to reject them.[27] As former FTC Chairman Timothy Muris observed, "If … the result for the consumers is largely valueless … then the result for the attorneys who produced it should be largely

valueless."[28] One such lawsuit involved H&R Block, where the company allegedly received kickbacks from a bank that issued loans to H&R Block's tax-preparation customers.[29] The settlement gave the plaintiffs a maximum $45 per year in coupons for tax software and planning books, while the plaintiffs' lawyers received $49 million in fees.[30]

In its response to this settlement, the FTC reasoned that if H&R Block owed a fiduciary duty to plaintiffs and its violation was intentional, willful and deliberate, then the plaintiffs would be entitled to the license fees H&R Block received as well as the fees the plaintiffs paid to H&R Block.[31] In that instance, the FTC said, the coupons were woefully inadequate.[32] If not, the FTC continued, the value of the coupons may be adequate, but attorneys fees are "even more unreasonable."[33]

Another characteristic of coupon settlements is that they often require plaintiffs to spend a significant amount of money on products they do not need or want in order to realize the "benefit." In the H&R Block case, for example, to receive the benefit of a $20 coupon towards the cost of one year's tax returns, the typical plaintiff would have to spend $102.[34] Another such settlement involved Blockbuster, where the company was charged with unfair fees for overdue video rentals. As part of the settlement, the plaintiffs received $1 off coupons for additional rentals.[35] And in a suit regarding potential misrepresentations made about the size of computer monitors, the class received $13 rebates on new computers and monitors.[36] Plaintiffs wanting cash would have their awards reduced to $6.[37]

There also have been a number of class action lawsuits that were unnecessary, as the defendants took appropriate remedial action on their own. There was no need for additional compensation, and the resulting settlements provided no additional value to class members. For example, Intel Corporation noticed a minor flaw in a chip that would arise once in every nine billion random division operations.[38] Intel created a program consumers could run to see if their chip was flawed, expanded its toll-free user hotline for inquiries and offered a free lifetime replacement. As soon as it widely publicized the problem and solution, 13 class actions were filed.[39] In the settlement, the plaintiffs' lawyers took $4.3 million and the plaintiffs received nothing more than for the company to continue its existing solutions.[40]

Secondary or Derivative Users Provide No Value To Plaintiffs

Plaintiffs' lawyers have tried to make coupon settlements more palatable by suggesting that plaintiffs could sell their coupons to receive some cash value or allow unused coupons to be donated to charity. The secondary market for coupons was created in 1993, just two years after the first coupon settlements. When BMW was charged with overselling a "limited edition" model, it offered customers a $4,000 coupon toward the future purchase or lease of a BMW.[41] James Tharin of Chicago formed the Chicago Clearing Corporation to buy and sell these certificates.[42] He bought about 750 certificates for an average of $2,600.[43]

Transaction costs, though, significantly reduce the face value of a coupon. According to those who have looked into this market, a coupon can only have value in a secondary market if its face value is more than $250.[44] Most of the coupons in these settlements are only for a

handful of dollars. Therefore, relying on the secondary market to make coupon settlements more fair is impractical.

Plaintiffs' lawyers also have begun naming charities as beneficiaries for unclaimed coupons. In a lawsuit involving Microsoft where the plaintiffs' lawyers received $30 million, the plaintiffs were given coupons for $5 to $12 towards the cost of computer products.[45] Fifty percent of all unclaimed coupons would go to the Florida public school system.[46] While giving coupons to charities and government agencies certainly makes one "feel better" about coupon settlements, it does not change the inherent legal problems with lawyer-generated suits where there are no real plaintiffs or injuries to be redressed. Allowing part of a jury award to benefit the public purse also creates the incentive for courts to certify more class actions and for juries to find for the class.[47]

Solutions

There are several avenues for stopping these settlements. The United States Congress is considering the Class Action Fairness Act, which, among other things, provides that a court would only be able to approve coupon settlements after a hearing and making a written finding that the settlement is fair, reasonable and adequate for class members.[48] The bill also would prohibit charitable contributions and base lawyer fees on the number of hours spent on the case or on the value of coupons their clients receive.[49]

The Texas legislature has taken more pointed action. In June 2003, it enacted legislation stating that "if any portion of the benefits recovered for the class are in the form of coupons or other noncash common benefits, the attorney fees awarded in the action must be in cash and noncash amounts in the same proportion as they recover for the class."[50]

Companies also can take matters into their own hands. They can discourage class action abuse by taking frivolous cases to trial, thereby reducing the incentives for plaintiffs' lawyers to file them in the first place. Our company has been successful in doing so. For example, DaimlerChrysler successfully defended a class action suit in Cook County, Illinois alleging excessive engine noise at idle in certain Jeep Cherokees and Grand Cherokees.[51] The suit started after one of the three named plaintiffs had buyer's remorse after a vehicle purchase and demanded, unsuccessfully, that his engine be upgraded to a V-8 engine. Another named plaintiff had 135,000 miles on his vehicle. Another named plaintiff was just worried that her engine would develop a problem. While the suit was certified as a nationwide class action, the trial court found the plaintiffs failed to prove their case and entered judgment for DaimlerChrysler. The judgment was upheld on appeal.

Companies also can structure non-cash settlements so they truly serve the public's interest, rather than that of the plaintiffs' bar. DaimlerChrysler recently settled class litigation alleging that the company should have put a park-brake interlock into its vehicles so children left unattended in a running car (contrary to applicable state law) could not set the vehicle in motion.[52] DaimlerChrysler agreed in the settlement to sponsor public service announcements featuring Sterling Marlin, the popular Tennessee NASCAR driver, emphasizing that it is unsafe to leave children unattended in a vehicle. Finally, companies should not agree to excessive

plaintiffs' attorney's fees in class action litigation. This is DaimlerChrysler's policy. In fact, we generally insist that judges determine the attorneys fees only after the final settlement is presented to the court.[53]

Conclusion

As avid golfers, we'll conclude by recounting our favorite class action coupon settlement. In 1999, a company was sued because during a promotion in which it gave away golf gloves, the company ran out of gloves and gave away sleeves of golf balls.[54] When the case settled, the lawyers netted $100,000 in cash and the people who were "injured" by receiving free golf balls were awarded with, you guessed it, more free golf balls.

These anecdotes may be humorous, but they are also serious. Through civil justice reform efforts, a number of groups have been working to restore fairness and predictability to the American legal system in a way that enables people with legitimate claims to have access to courts. Laws and procedures that offer a perverse incentive to the trial bar to seek dollars over justice frustrate that purpose. They also degrade the requirement that plaintiffs' attorneys must be ethical and capable to represent the interests of the class as a whole and not themselves.[55]

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[1] Fed. R. Civ. P. 23(c)(2).

[2] *See*, *e.g.*, Editorial, *Unsettling Lawsuits; Lawyers Get Their Fees, Consumers Get Stuck with Coupons, Not Cash*, Grand Rapids (Mich.) Press, June 19, 2001, at A8, *available at* 2001 WL 19175445 (discussing *In re* Domestic Air Transp. Antitrust Litig., 137 F.R.D. 677 (N.D. Ga. 1991)).

[3] The federal district judge overseeing the price-fixing claims reportedly stated at a hearing on the proposed settlement that "I would assess the chances of plaintiffs recovering as not good. … I think the case would have a hard time surviving a motion for summary judgment." David Johnson, *Settlement of airline suit draws critics; Coupons may bring carriers more business*, Hous. Chron., Jan. 2, 1993, at 1 (Business), *available at* 1993 WL 9528039 [hereinafter "Settlement of airline suit"].

[4] *See In re* Domestic Air Transp. Antitrust Litig., 148 F.R.D. 297 (N.D. Ga. 1993) (approving settlement agreement).

[5] *See Settlement of airline suit*, *supra* note 3.

[6] *See* Editorial, *Class War,* Wall St. J., Mar. 25, 2002, at A18, *available at* 2002 WL-WSJ 3389642.

[7] *See id*.

[8] *See* Edward F. Sherman, *Consumer Class Actions: Who Are The Real Winners?*, 56 Me. L. Rev. 223, 230 (2004).

[9] William P. Barrett, *I Have No Clients (Attorney William Lerach Sues Public Corporations When Their Stock Prices Collapse*), Forbes, Oct. 11, 1993, at 52 (Lerach practices with Milberg Weiss Bershad Hynes & Lerach, LLP).

[10] Jason Hoppin, *Florida Judge Compares Milberg to Squeegee Boy*, The Recorder, Apr. 16, 2002, <http://www.law.com/jsp/statearchive.jsp?type=Article&oldid=ZZZU1WV940D>.

[11] Victor E. Schwartz, Mark A. Behrens & Leah Lorber, *Federal Courts Should Decide Interstate Class Actions: A Call for Federal Class Action Diversity Jurisdiction Reform*, 37 Harv. J. on Legis. 483 (2000).

[12] *See* American Tort Reform Association, Bringing Justice to Judicial Hellholes 1 (2002).

[13] Richard Scruggs, Asbestos for Lunch, Panel Discussion at the Prudential Securities Financial Research and Regulatory Conference (May 9, 2002), *in* Industry Commentary (Prudential Securities, Inc., N.Y., New York) June 11, 2002, at 5 [hereinafter "Asbestos for Lunch"]. Mr. Scruggs also has described these jurisdictions as "areas where what happens in court is irrelevant because the jury will return a verdict in favor of the plaintiff." *Medical Monitoring and Asbestos Litigation – A Discussion With Richard Scruggs and Victor Schwartz*, 17 Mealey's Litig. Rep.: Asbestos, Mar. 1, 2002, at 1, 6.

[14] *Asbestos for Lunch*, *supra* note 13, at 5.

[15] *Id.*

[16] *Id.*

[17] *Id.*

[18] *See* Patti Waldmeir, *Time to End This Class Action Craziness*, Fin. Times, June 7, 2004, at 10, *available at* 2004 WL 80061781 [hereinafter "Waldmeir"].

[19] *See*, *e.g.*, Caroline Mayer, *FTC Seeks to Limit Attorney Fees in Class Action Suits*, Wash. Post, Sept. 30, 2002, at A17, *available at* 2002 WL 101064782 (reporting that coupons generally can be redeemed only for a limited time and only if the consumers buys a more expensive product or service).

[20] *See* Barry Meier, *Math of a Class-Action Suit: "Winning" $2.19 Costs $91.33*, N.Y. Times, Nov. 21, 1995, at A1.

[21] *See* Ameet Sachdev, *Coupon Awards Reward Whom*?, Chi. Trib., Feb. 29, 2004, at 1 (Business), *available at* 2004 WL 71394918 [hereinafter "Sachdev"]; David Izzo, *Lawsuit Can Mean Big Bucks for Tiny Tort*, Daily Oklahoman, Sept. 17, 1995, at 1.

[22] *See Sachdev*, *supra* n. 21.

[23] *See id.*

[24] *See* Marguerite Higgins, *Class Members Get Little in Suits*, Wash. Times, July 2, 2004, at A12, *available at* 2004 WL 64161424 [hereinafter "Higgins"].

[25] *See* Jim Burke, *Carnival Settles Lawsuit*, Boston Herald, Apr. 1, 2001, at 43, *available at* 2001 WL 3797114.

[26] *See* Susan Tompor, *Polo Has a Deal for Buyers of Overpriced Ralph Lauren Outlet Goods*, Detroit Free Press, Feb. 9, 2000.

[27] *See* <http://www.ftc.gov/opa/2004/07/classaction.htm> (identifying six cases since 2002 in which the FTC has filed *amicus curiae* briefs regarding the proposed settlement relief afforded class members or size of the proposed attorneys' fee).

[28] *See Waldmeir*, *supra* note 18.

[29] Haese v. H&R Block, Inc., Cause No. CV-96-423 (Tex. Dist. Ct., Kleberg County, FTC *amicus curiae* brief filed June 4, 2003); *see also* Joseph T. Hallinan, *H&R Block Accord Draws Fire*, Wall St. J., Dec. 24, 2002, *available at* 2002 WL-WSJ 103129562 [hereinafter "Hallinan"].

[30] *See id.*

[31] FTC Press Release, *Announced Actions for June 6, 2003*, *available at* 2003 WL 21301160 (F.T.C.).

[32] *See id.*

[33] *See id.*

[34] *See Hallinan*, *supra* note 29.

[35] Johnson v. Scott, 113 S.W.3d 366 (Tex. App. – Beaumont 2003), *pet. dismissed*, 2004 Tex. LEXIS 674 (Tex. Oct. 3, 2003); *see also Higgins*, *supra* note 24 (reporting that the plaintiffs' lawyers took $9.25 million and the plaintiffs received two movie-rental coupons and a $1 coupon for an additional rental).

[36] *See*, *e.g.*, *Class Action Plaintiffs Deserve More Than Coupons*, USA Today, Oct. 9, 2002, at A12, *available at* 2002 WL 4735074.

[37] *See id.*

[38] *See Rights for Participants in Class Action Suits: Hearing on H.R. 2341 Before the House Comm. on the Judiciary*, 107th Cong., 2nd Sess. (Feb. 6, 2002), *available at* 2002 WL 25098596 (statement of Peter Detkin, vice president and assistant general counsel at Intel Corp.) (reporting that there was only one confirmed instance by a math professor that he noticed reduced precision at the 9th place to the right of the decimal).

[39] *See id.*

[40] *See id*.

[41] *See id.*

[42] *See id.*

[43] *See id.*

[44] *See id.*

[45] *See* Dan Christensen, *Consumers to Get $202M in Coupons from Microsoft Class Action*, Broward Cty. Bus. Rep., Vol. 25, No. 5, Dec. 15, 2003, at 11.

[46] *See id.*

[47] *See* Victor E. Schwartz, Mark A. Behrens & Cary Silverman, *I'll Take That: Legal and Policy Problems Raised by Statutes That Require Punitive Damages Awards To Be Shared With The State*, 68 Mo. L. Rev. 525 (2003) (discussing similar problems that arise when punitive damages awards are to be shared with the state).

[48] *See* Robert T. Horts et al., *The Class Action Fairness Act and the Revisions to Rule 23: Fixing a Broken System – Part I*, Metro. Corp. Couns., Vol. 11, No. 11, Nov. 2003, at 45.

[49] *See Higgins*, *supra* note 24.

[50] *See If Class Action Plaintiffs are Paid in Coupons, Their Lawyers Will Be, Too, Says New Law*, 2 No. 26 A.B.A. J. E-Rep. 4 (June 2003).

[51] Hasek v. DaimlerChrysler Corp., 745 N.E.2d 627 (Ill. App.), *appeal denied*, 755 N.E.2d 477 (Ill. 2001).

[52] Bell v. DaimlerChrysler Corp., CV 003457 (Tenn. Cir. Ct. Cumberland Cty., complaint filed 2001).

[53] *See*, *e.g.*, *Hanlon*, 150 F.3d 1011.

[54] *See* Martha Johanek, *Caddies or Cads? Lawyers Find the Green in Golf*, Cincinnati Enquirer, Sept. 15, 1999, at A12.

[55] *See* Fed. R. Civ. P. 23(a)(4) ("the named class members and their lawyers must be ethical and capable to represent the interests of the class as a whole").