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Now That That's Settled: The Status of Class Action Settlements in the Seventh Circuit after Pella, Radioshack and NBTY

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Over the last several months, **Judge Richard Posner has authored a triumvirate of opinions reversing the district courts' approval**, over objections, of consumer class action settlements—*Eubank v. Pella Corp.*, 753 F.3d 718 (7th Cir. 2014),*Redman v. RadioShack Corp.*, 768 F.3d 622 (7th Cir. 2014), and *Pearson v. NBTY, Inc.*, No. 12-1245, 2014 WL 6466128 (7th Cir. Nov. 19, 2014)—**each of which could charitably be described as scathing**. Among other things, Judge Posner takes aim at the manner in which a settlement is valued for purposes of determining attorney's fees (administration costs and *cy pres* awards are not part of the value to the settlement class), the method of calculating attorney's fees (a ratio based on actual value to the class, not the maximum potential value), and the manner and content of notice to the class as well as the claims process (simplification is key). While the class action bar awaits the impact of these decisions, there are several key lessons to be learned.

In *Pella*— a settlement described by Judge Posner as "scandalous"—a class action was brought over allegedly defective windows. After nearly seven years of litigation, the district court granted final approval, valuing class relief at $90 million and approving an $11 million attorney's fee award. Judge Posner found two issues especially troubling. First, the claims process was structured to depress claims—or in Judge Posner's words, "strew[] obstacles in the path of any owner of a defective [window]." Among the many issues: (i) the claims form was 12-13 pages long, (ii) the claim form was needlessly complicated and made obtaining relief difficult, (iii) the notice was divided into 27 sections, many of which had subsections, and (iv) the notice was "incomplete and misleading." Second, the attorney's fees award was based on an "inflated" value of relief to the class—for which there was no independent valuation. Judge Posner found the total relief to the class worth, at most, $8.5 million. Though he did not say so directly, Judge Posner indicated (perhaps foreshadowing his *Radioshack*and *NBTY* opinions) that a fee equal to 56% of the settlement (56% = $8.5m + $11m / $11m) is excessive. And this is not to mention the umbrage Judge Posner took with a provision in the settlement agreement that any money cut from attorney's fees would revert to the defendant rather than the class—a provision he later refers to in *NBTY* as a "kicker" clause.

Radioshack involved a class action lawsuit brought pursuant to the Fair and Accurate Credit Transactions Act ("FACTA"), which generally proscribes the information that may be displayed on credit and debit card receipts provided to customers at the point of sale. The class settlement provided for a $10 coupon to each Radioshack customer with an offending receipt. All told, the settlement was valued at $4.1 million ($830,000 in claims ($10/claim times 83,000 claimants) + $1 million in attorney's fees + $2.2 million in administrative costs).

In reversing the district court's approval of the settlement, Judge Posner focused his opinion predominantly on the reasonableness of the requested $1 million in attorney's fees, making two key holdings: (i) notice and administration costs are not to be included in calculating the overall benefit to the class (reasoning that they are not direct benefits and thus not rightly included in any valuation), and (ii) the ratio to evaluate the reasonableness of a fee award (as hinted in *Pella*) is the ratio of the fee to the fee plus what the class members actually received. In applying that ratio to the *Radioshack* settlement, Judge Posner found the ratio—55% ($1 million + $830,000 / $1

million), after eliminating notice and administration costs—unreasonable in and of itself, and all the more so because no attempt was made by the parties to determine the actual value of the $10 coupons sent to the 83,000 claimants who responded to the notice. The solution, Judge Posner recommended, would be to "chang[e] the relative shares of the settlement received by class counsel and class members without increasing the amount of the settlement." Importantly, in the process of setting the attorney's fee ratio, Judge Posner held that "the central consideration . . . is what class counsel achieved for the members of the class rather than how much effort class counsel invested in the litigation"—in other words, the lodestar method should not be used as a back door justification for increased attorney's fees. To hammer this point home, Judge Posner noted that "the reasonableness of a fee cannot be assessed in isolation from what it buys," (i.e., "no one would think a $1 million attorneys' fee appropriate compensation for obtaining $10,000 for the clients."). Judge Posner also took the time to remind the class action bar that clear sailing clauses—whereby defense counsel agree not to contest plaintiffs' counsel's fee request up to a certain percentage or amount) often create the appearance of collusion and are therefore disfavored.

Finally, in *NBTY*—a class action alleging false labeling of glucosamine pills—the district court approved a $5.63 million settlement, which included nearly $2 million in attorney's fees, $1.5 million in administration costs, $1.13 million to cy pres, and $865,284 to the class members. Judge Posner first took aim at the attorney's fees, finding that the settlement was improperly valued at $20.2 million, where the class in actuality received less than $900,000 in total compensation (comprised of 30,245 claimants—or one-fourth of one percent of the total class size). Judge Posner reiterated that the relevant valuation is the actual value to the class, not "the maximum potential payment that class members could receive." To that end, Judge Posner not only found the $1.13 million in cy pres to be worthless to the class, but found that there was no merit to the award to begin with because "a cy pres award is supposed to be limited to money that can't feasibly be awarded to the . . . class members." Using the*Radioshack* ratio, Judge Posner calculated it to be 69% and concluded it was "outlandish." He suggested that the proper ratio "should not exceed a third or at most half of the total amount of money going to class members and their counsel." Like in *Pella*, the parties agreed to a kicker clause, to which Judge Posner again took exception.

Second, Judge Posner was also critical of the claims process, which he found "discourage[ed] the filing of claims." Specifically, the claims form "required the claimant to list cash register receipts or other documentation indicating the date and place at which he or she had bought the product," included a warning that false claims might be subject to prosecution, and required claimants to certify his or her claim under penalty of perjury—all this to receive $3 to $5 per bottle of pills purchased.

Few courts have yet to apply *Pella*, *Radioshack*, or *NBTY*. One court—*Myles v. AlliedBurton Security Services, LLC*, No. 12-cv-05761, 2014 WL 6065602 (N.D. Cal Nov. 12, 2014)—has taken to heart Judge Posner's holding that administration fees are not a benefit to the class and should not be considered in determining a reasonable attorney's fee. And a second court—*Fritzinger v. Angie's List, Inc.*, No. 12-cv-01118, 2014 WL 4680898 (S.D. Ind. Sept. 22, 2014)—expended considerable effort calculating the actual benefit of the settlement to the class in approving a fee award equal to a 24% *Radioshack*ratio.

While these rulings will no doubt cause many in the class action bar to rethink ongoing and future settlement negotiations, it remains to be seen whether these opinions are taken as gospel, or whether they are taken as broader guiding principles. That said, the overarching theme of these opinions is clear: maximize value to the class and minimize the appearance of attorney collusion (i.e., no clear sailing or kicker clauses). From this theme, a few general lessons stand out for future settlements in the Seventh Circuit. First, class notice will need to be as robust as possible (and the costs for such efforts should not be borne by the claimants) and the claims process will need to trend towards simplification. Second, counsel will likely need to provide the court a detailed valuation of the benefit the settlement provides the class, which may be helped in some instances by an independent expert and non-reversionary funds, to support class counsel's fees. Third, cy pres awards should be limited to circumstances in which the money cannot feasibly be awarded to the class members. And fourth, class counsel may have to be prepared to settle for a more modest fee, given that notice and administration costs are not to be considered value to the class, not to mention the fact that the Posner ratio will examine the reasonableness of the fee request based on the claimed value (not the potential value). These considerations may factor into plaintiffs' counsel decision to bring and to litigate consumer class action cases where the individual recovery is fairly modest as their ability to recover their time and cost expenditures may be more limited; as Judge Posner noted in *Radioshack*, "some cases should not be brought, because the litigation costs will exceed the stakes."