IN THE UNITED STATES COURT OF APPEALS
FOR THE SIXTH CIRCUIT

No. 14-3798
Consolidated with No. 14-3761

Amber GASCHO, *et al.*,

Plaintiffs-Appellees,

v.

GLOBAL FITNESS HOLDINGS, LLC

Defendant-Appellee,

Appeal of Joshua BLACKMAN,

Objector-Appellant.

On Appeal from the United States District Court
For the Southern District of Ohio, No. 2:11-cv-00436-GCS-NMK

Petition for Rehearing and Rehearing En Banc of Appellant Joshua Blackman

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As recognized by Judge Clay's dissent, the panel decision conflicts with *In re Dry Max Pampers Litigation*, 724 F.3d 713 (6th Cir. 2013), and *Rawlings v. Prudential-Bache Props., Inc.*, 9 F.3d 513 (6th Cir. 1993); consideration by the full court is therefore necessary to secure and maintain uniformity of the Court's decisions. Furthermore, the proceeding involves a question of exceptional importance because the panel decision conflicts with the authoritative decisions of the Fifth and Seventh Circuits that addressed the issue of whether to value the fairness of a claims-made settlement with the reality of the number of claims made, or the fiction of the hypothetical number of claims that could have been made but that no one expected to be made.

Introduction

Imagine a hypothetical class action settlement where the parties settle for a fraction of the total alleged liability, creating a $4 million settlement fund where class counsel gets 60% of the settlement fund ($2.4 million) and the 600,000 class members are left with only $1.6 million. Courts in the Sixth Circuit normally would not countenance such a result: class counsel cannot negotiate preferential and disproportionate treatment for itself under *Pampers* and *Rawlings*. *See also Vassalle v. Midland Funding LLC*, 708 F.3d 747 (6th Cir. 2013); *Williams v. Vukovich,* 720 F.2d 909, 923 (6th Cir. 1983). A court would and should reallocate the $4 million so that the class receives a proportionate share of the proceeds, restricting class counsel to at most one-third or one quarter of the settlement value. *Pearson v. NBTY, Inc.*, 772 F.3d 778, 782 (7th Cir. 2014) (Posner, J.).

Now imagine the same settlement, except now class counsel protects its

$2.4 million fee request with clear-sailing and "kicker" clauses to ensure that a district court could not reallocate the fee, clauses criticized as questionable by every court to consider the issue. Dissent 43-46. And instead of funding direct distributions, the settling parties agree to a claims-made process that ensures that over 90% of the class will receive nothing, with the defendant paying the same $1.6 million to the class as the first hypothetical settlement. This settlement is plainly worse for the class than the first settlement and fee request universally understood to be problematic. Yet the district court and a split panel of this Circuit held that such a settlement could be approved under Rule 23(e), despite class counsel's successful attempt to prevent reallocation to their putative clients. According to the majority, it was acceptable for the district court to assume that the $0 paid to over 90% of the class was "worth" $7 million (50% of what would have been paid if those class members had actually been paid). This contravenes *Pampers* and *Rawlings*, and rejects the reasoning of decisions of the Fifth, Seventh, and Ninth Circuits.

It is also wrong. The defendant would be indifferent between the two settlements: they each cost it $4 million. *Pampers*, 713 F.3d at 717. The class is clearly worse off: in the first settlement, a judge can fix the proposed disproportion and award the class its fair share; while in the second settlement, the class will be stuck with a smaller portion of the settlement. But class counsel's self-dealing has enriched themselves under the second settlement. Ensuring this disproportionality is a breach of class counsel's fiduciary duty, as noted by *Pampers,* but the majority opinion never once mentions that fiduciary duty. The majority's rule creates perverse incentives for class counsel to benefit themselves at the expense of the class, while also perversely

reducing deterrence of wrongdoing defendants. *See generally* Howard M. Erichson, *Aggregation as Disempowerment: Red Flags in Class Action Settlements*, 92 Notre Dame L. Rev – (forthcoming 2016), available at http://ssrn.com/abstract=2761912.

En banc review is necessary to preserve this Circuit's precedents and to resolve the circuit split with courts that protect the interests of absent class members against self-dealing class counsel. Uniformity is especially critical in the class-action context because, in class actions with a national class, class counsel and the defendant can agree to forum-shop a settlement by filing and settling a new complaint in the federal court that provides the least protection to the class. *Smentek v. Dart*, 683 F.3d 373, 376 (7th Cir. 2012); *cf. Krafsur v. Davenport*, 736 F.3d 1032, 1040 (6th Cir. 2013) (uniform national rule discourages forum shopping).

Summary of Relevant Facts

The material facts are not in dispute. Plaintiffs brought a number of class actions against Global Fitness alleging consumer fraud and other violations of state law over their billing and refund practices for their gyms. The parties settled the claims of approximately 606,000 class members. Slip op. 3. Though the class was ascertainable (over 90% of the class received direct individualized notice, *id.* at 5), and there was no dispute over what the settlement entitled individual class members to, class counsel chose not to structure the settlement to directly pay class members, but instead used a "claims made" process. Class member would file claims, those claims would be paid, and the class members who did not file claims would waive their rights and receive nothing. Such a procedure virtually guarantees that over 90% of the class

will go unpaid, *id.* at 27, and the same was true here: only 8% of the class (49,000 class members) made valid claims for a total of $1.6 million. (The majority opinion praises the simplicity of the claims process, *id.* at 24-27, but over 10% of the relatively affluent class members attempting to submit claim forms failed to do so successfully. *Id.* at 5.) Class counsel does not claim to be surprised by this low claims rate: they put forward testimony that the 8% claims rate was within the range they expected. *Id.* at 7; *see also* Dissent 39-40. Class counsel, meanwhile, negotiated for a separate fund for themselves of $2.4 million: the defendant agreed not to challenge class counsel's fee request for that amount ("clear sailing"), while receiving the benefit of any reduction the district court made (the "kicker"). *Id.* at 4; Dissent 43-45.

Class member Joshua Blackman, represented *pro bono* by non-profit counsel, objected to the structure of the settlement that paid class counsel 60% of the total proceeds, especially in conjunction with the clear-sailing and kicker clauses that precluded reallocation of the settlement funds to the class. *Id.* at 5. Under *Pampers*, which prohibited "preferential treatment" to the attorneys, Blackman argued, it was *per se* unfair for a settlement to pay the attorneys more than the class when the class was so drastically compromising their claims that over 90% would go unpaid. The district court nevertheless approved the settlement: though the class received only $1.6 million, it *could have* received $15.5 million if everyone made a claim, and the district court held that the settlement was worth the midpoint of the two figures, $8.5 million. *Id.* at 6-7; Dissent 39. Compared to that $8.5 million figure, the $2.4 million fee request was reasonable. Blackman appealed; while the appeal was pending, the Seventh Circuit decided *Pearson v. NBTY*, adopting Blackman's proposed rule of

decision here and rejecting the idea that a district court should credit unpaid claims as having any value to the class. 772 F.3d 778. Nevertheless, a split panel affirmed the district court decision, rejecting *Pearson*, distinguishing *Pampers*, and approving the district court's approach. Judge Clay, writing in dissent, would have reversed under *Pampers*, *Rawlings*, and *Pearson*. The dissent is correct.

I. The majority decision conflicts with *Pampers*.

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." *Pampers*, 724 F.3d at 717; *accord Redman v. RadioShack Corp.*, 768 F.3d 622, 629 (7th Cir. 2014) (Posner, J.) (arm's-length negotiations "are consistent with a conflict of interest on the part of one of the negotiators—class counsel—that may warp the outcome of the negotiations"). A settlement can be unfair without collusion if class counsel self-deals to make itself the primary beneficiary of the settlement, because, as *Pampers* recognized, "the economic reality [is] that a settling defendant is concerned only with its total liability" and "the allocation between the class payment and the attorneys' fees is of little or no interest to the defense." 724 F.3d at 717 (internal quotation and citation omitted; brackets in original). Under *Pampers,* class counsel has "fiduciary obligations" to the class, and cannot structure a settlement to provide it "preferential treatment." *Id.* at 718. A district court must "carefully scrutinize whether those obligations have been met"; a settlement cannot "benefit[] class counsel vastly more than then it does the consumers who comprise the class." *Id.* at 718, 721. Rather, the settlement value—measured in "reality [rather] than on fiction," must be "commensurate" with the fees. *Id.* at 720-21.

As the dissent notes, the majority contravenes *Pampers* in multiple ways.

First, it fails to apply the *Pampers* test: courts must "consider the allocation of relief between class counsel and the class." Dissent 42-43. This settlement benefits the attorneys much more than the class. The "disparity was so great" that "it should have so flunked a fairness inquiry… under Rule 23(e)." Dissent 46.

Second, the majority gets around *Pampers* by crediting the district court's decision to credit class counsel millions of dollars for claims that were never made. As the dissent points out, "no Circuit in the country approved of such a methodology," and it runs afoul of *Pampers*' command that settlements be based on reality, not "fiction" and *Rawlings*' command that fees be based on the "results achieved." Dissent 39. The majority says that *Pampers* "does not discuss how to value cash benefits for a class that are secured by the work of class counsel but go unclaimed," slip op. at 9, but this is incorrect. *Pampers* rejected the settling parties' argument that the refund program was value that justified the settlement, expressly valued the unclaimed diaper refunds as "illusory," 724 F.3d at 721, and called the value of the entire refund program "negligible." *Id.* at 719. It could only do that by correctly valuing the unclaimed refunds as zero, rather than as half or all their face value.

Third, *Pampers* imposes fiduciary obligations upon class counsel. Dissent 46; *cf. also Pearson,* 772 F.3d at 784 (noting how less selfish class counsel could have improved class recovery). But the majority never analyzes or even mentions those fiduciary obligations. The majority holds that *Pampers* was distinguishable because here the claims process was not "unduly burdensome." Slip Op. at 23. Contrary to the majority's characterization, *Pampers* did not reject the settlement for the *subjective*

reason that it had a burdensome claims process. It rejected the settlement for the *objective* reason that the allocation was disproportionate and class counsel benefited more than the class. 724 F.3d at 721. Had the settling parties been able to meet their burden with evidence to demonstrate that the class actually benefited from the refund program rather than simply asserting it without disclosing evidence in their possession, the settlement approval could have been affirmed if the benefits were proportional. 724 F.3d at 719. But under the majority's view, *Pampers* could have been affirmed if the district court had simply treated each class member in that case as recovering half the price of a box of diapers, far outstripping the $2.73 million fee, regardless of the actual recovery.

The majority reasons that Blackman incorrectly "assum[es] that class counsel 'structured the settlement to withhold benefit from 92% of the class.'" Slip op. at 27. But settling parties intend the foreseeable consequences of their notice and claims procedure.[1] Just as it was certain that less than 1% of the class would make claims in *Pampers*, it was thoroughly predictable that less than 10% of the class would make claims here, and the majority concedes this in the very next paragraph when it cites plaintiffs' own witness. *Id.* So what if many "cases employ[] claims processes similar to this one"? *Id.* Many cases employ claims processes similar to *Pampers*; in cases without individualized notice, claims rates are well under 1% even without the burdens imposed by *Pampers*. Daniel Fisher, *Odds Of A Payoff In Consumer Class Action? Less Than*

[1] Moreover, the claims process here shared features *Pearson* criticized as reducing the claims rate, such as a demand that claims be verified under penalty of perjury. *Compare* slip op. 5 *with* 772 F.3d at 783.

A Straight Flush, Forbes.com (May 8, 2014).[2] "Everybody does it" at the district-court level is a cry for reform of systematic abuses, not for appellate acquiescence to attorney self-dealing.

Finally, the majority was impressed that the fee award was consistent with a lodestar award assuming adequate billing records had been submitted, and suggested there was nothing wrong with class counsel receiving more than the class. Slip op. 13-15. But that reasoning is also inconsistent with *Pampers*, which rejected a below-lodestar fee award[3] disproportionate to class recovery. And as the dissent notes, the fee award is inconsistent with *Rawlings* as well. Dissent 37, 39.

Rehearing is necessary to reconcile the inconsistent holdings between this case and *Pampers* and *Rawlings*.

II. The majority's application of *Boeing* conflicts with *Pearson* and *Strong*.

Pearson holds it error to value a settlement using "the maximum *potential* payment that class members could receive" "based on the contrary-to-fact assumption" that each class member would file a claim. 772 F.3d at 780-81 (emphasis in original). The

> "ratio that is relevant … is the ratio of (1) the fee to (2) the fee

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[2] Contrary to the majority's characterization, the *Pampers* settlement, though purporting to be a "Rule 23(b)(2) injunctive-relief class," released class members' claims for equitable disgorgement monetary recovery and enjoined class members' rights to bring Rule 23(b)(3) class claims for monetary damages. *Compare* slip op. 9-10 *with* 724 F.3d at 716.

[3] *In re Dry Max Pampers Litig.*, No. 1:10-cv-00301 (S.D. Ohio 2011), Dkt. 76 at 35.

> plus what the class members received. Basing the award of attorneys' fees on this ratio, which shows how the aggregate value of the settlement is being split between class counsel and the class, gives class counsel an incentive to design the claims process in such a way as will maximize the settlement benefits actually received by the class, rather than to connive with the defendant in formulating claims-filing procedures that discourage filing and so reduce the benefit to the class."

772 F.3d at 781 (internal quotation and citation to *Redman* omitted); *see also id.* at 783-84; *accord* Dissent 40-41. Separate negotiation of fees and relief does not protect the class from this evil. *Pearson,* 772 F.3d at 786-87; *accord* Dissent 44. The majority wholly rejected these premises. Slip op. 20-21.

The majority relies upon *Boeing v. Van Gemert*, 444 U.S. 472 (1980), for the proposition that fees should be awarded based on the total fund available to the class rather than the amount actually recovered. But as the dissent notes, it is a non sequitur to then apply *Boeing* to the question of whether the settlement has a fair allocation.

As *Pearson* would hold, *Boeing* is distinguishable from this case because *Boeing* 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; *Boeing* was a class action litigated to judgment, not a settlement. *Boeing* is not applicable where "[t]here is no fund… and no litigated judgment, and there was no reasonable expectation in advance of the deadline for filing claims that more members of the class would submit claims than did." *Pearson,* 772 F.3d at 782. Nor is *Boeing* a case involving a self-serving clear-sailing agreement and kicker where class counsel negotiated a settlement with a claims-made procedure. Thus, even if *Boeing* permitted

such a disproportionate fee when a defendant litigates over what it will pay class counsel, it does not consider or speak about the Rule 23(e) fairness of a settlement where class members have complained about *Pampers* allocational fairness, the clear-sailing clause, and the kicker. *Pampers* and *Pearson* show that an illusory "amount available" does not create settlement fairness: fact, not fiction, is what matters in evaluating a settlement.[4]

Boeing applies only to cases with an actual non-reversionary 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

[4] Contrary to the majority opinion, a "latent claim against unclaimed money in the judgment fund" (slip op. 21) as in *Boeing* is not the equivalent of a claims-made settlement with reversion to the defendant. A district court gets to decide what to do with unclaimed money in a judgment, including making additional attempts at class distribution or, when appropriate, a *cy pres* award. *Ira Holtzman, C.P.A. & Assocs. v. Turza*, 728 F.3d 682, 688-89 (7th Cir. 2013); *Six Mexican Workers v. Az. Citrus Growers*, 904 F.2d 1301, 1307 (9th Cir. 1990). Even in *Masters v. Wilhelmina Model Agency, Inc.*, cited by the majority (slip op. 17-18), the settlement permitted additional distribution of unclaimed money to the class, and the unclaimed moneys eventually went to *cy pres* at the judge's discretion. 473 F.3d 423, 435 (2d Cir. 2007). *Masters* did not involve a challenge to Rule 23(e) settlement fairness, but was plaintiffs' challenge to the district court's fee order. *Masters* conflicts with *Pearson* in that *Pearson* does not consider *cy pres* a class benefit, a question not at issue here, but there is no conflict with *Pearson* on the application of *Boeing* to the issue of Rule 23(e) allocational fairness.

852. *Strong* explained that in *Boeing*, the district court had ordered the judgment to be deposited into "escrow at a commercial bank." *Id.* Each 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 $18 million escrowed fund waiting to be divvied up among class members and the attorneys. Like *Strong*, class counsel should not be awarded based on this $15.5 million "phantom" fund but on the actual amounts distributed to class members.

The majority distinguished *Strong* because the relief there was "coupon-like," slip op. 19-20, but how is that different from a claims-made settlement? The problem with coupons is that class members will leave them unredeemed, costing the defendant nothing, and thus should be substantially discounted from face value. *In re HP Inkjet Printer Litig.*, 716 F.3d 1173, 1179 (9th Cir. 2013). That's exactly what happened with the claims process here: the value of a potential claim is substantially less than its face value, because over 90% of potential claims will go unredeemed.

The claim that potential class benefits should be treated as identical to—or even be averaged with—actual class receipts leads to absurd results. We have already seen this in the example of *Pampers*, where a district court could have approved the

settlement under the majority's "split the baby" approach. A hypothetical further demonstrates the problem: imagine two possible settlements of the fictional class action *Coyote v. Acme Products*:

***Acme* Settlement One**	***Acme* Settlement Two**
Acme Products hand-delivers a $6 check to each of one million class members who purchased their mail-order rocket roller skates. Acme pays $6 million to the class and $2 million to class counsel.	A simple claim form is provided for one million class members. Class members with valid claim forms receive $15. As the majority here acknowledges is typical and expected (slip op. 27), only 8% of the class submits claim forms, and Acme pays them a total of $1,200,000, and pays $3 million to class counsel.

The defendant prefers Settlement Two; it pays much less. Class counsel prefers Settlement Two; it receives much more. The only ones worse off are 92% of the class—and non-claiming class members will, on average, be less educated and less wealthy than claiming class members. What's remarkable is that, according to the majority, a district court can decide that Settlement Two is preferable because it is "worth" $8.1 million to the class (the midpoint between $1.2 million actual claims and $15 million potential claims), and is a "better" settlement than Settlement One, which "only" pays out $6 million. But under the majority's rule, why would class counsel even bother attempting to win more for the class? The perverse incentives are obvious, as *Pearson* recognized, 772 F.3d at 781, but the majority disregards them.

Even if, as the majority posited, class actions are to be used solely for deterrence rather than compensating the class, slip op. 23, the *Pearson* rule that prefers Settlement One to Settlement Two does a better job of deterring wrongful behavior

by defendants by precluding them from using illusory relief to settle valuable claims.[5] The majority's rule incentivizes class counsel to tacitly agree with defendants to let meritorious claims more softly off the hook to maximize their own fee. The majority's circuit split adopts a rule that is inferior both in protecting absent class members from self-dealing counsel and in promoting deterrence of alleged wrongdoing.[6]

III. The majority's endorsement of a kicker conflicts with *Bluetooth* and *Pearson*.

Pearson recognized the evils of the combination of clear sailing and a "kicker":

> "Our final concern is the reversion, or kicker, clause in the settlement agreement. This is the clause that provides that if the judge reduces the amount of fees that the proposed settlement awards to class counsel, the savings shall enure not to the class

[5] The majority justifies its holding in part by citing to Brian Fitzpatrick, *Do Class Action Lawyers Make Too Little?*, 158 U. Pa. L. Rev. 2043, 2047 (2010). Slip op. 23 n.7. Fitzpatrick argues that attorneys should be entitled to 100% of the proceeds of class-action settlements without regard to compensating their putative clients to incentivize them to deter wrongdoing defendants through litigation. Fitzpatrick's argument would imply *Pampers* and *Vassalle* were wrongly decided. Leaving aside the merits of the dubious normative argument Fitzpatrick makes, it is quite clear that it is entirely divorced from the positive law of the U.S. Constitution (which requires as a matter of due process adequate representation of class members), Rule 23 (which requires settlements be fair to class members), and legal ethics (which imposes fiduciary duties to clients upon lawyers). *Cf. also United States ex rel. Taxpayers Against Fraud v. Gen. Elec. Co.*, 41 F.3d 1032, 1047 (6th Cir. 1994). Contrary to the majority's premises, "Class counsel are fiduciaries of the class, not of the public at large." Dissent 46.

[6] Indeed, on remand, *Pearson* class counsel negotiated a new settlement that will pay class members approximately $5 million, instead of under $1 million. They are even requesting a higher fee than the $2.1 million they received the first time around.

> but to the defendant. This is a gimmick for defeating objectors. If the class cannot benefit from the reduction in the award of attorneys' fees, then the objector, as a member of the class, would not have standing to object, for he would have no stake in the outcome of the dispute. The simple and obvious way for the judge to correct an excessive attorney's fee for a class action lawyer is 'to increase the share of the settlement received by the class, at the expense of class counsel.' *Redman v. RadioShack Corp., supra*, 768 F.3d at 632. This route is barred unless the judge invalidates the kicker clause."

772 F.3d at 786. If kickers are allowed, then because class members cannot benefit from a reduction in attorneys' fees, they will not have standing to appeal an excessive fee by itself, nor will they have any rights to collect fees for benefiting the class should they successfully challenge the fees in the district court. Thus, the Ninth Circuit called clear sailing and kicker clauses red flags of self-dealing. *In re Bluetooth Headset Prod. Liab. Litig.*, 654 F.3d 935, 947-49 (9th Cir. 2011).[7]

[7] 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 a red flag by itself, as suggested by the Federal Judicial Center. *Managing Class Action Litigation* 19-20 (3d ed. 2010) ("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 (when used in lieu of feasible direct distributions to identifiable class members), like coupons or *cy pres* or injunctive relief that no class members can actually take advantage of, is precisely the sort of settlement term that creates the illusion of relief without actual relief to the vast majority of class members. Erichson, *supra.* Note that this is not an argument that a settlement with a low claims rate can never be approved. Perhaps a case has low litigation value so that a compromise of a settlement procedure with a low claims rate or with coupons is necessary to reflect that low litigation value. The

The majority opinion holds that a kicker is not problematic if a district court finds the settlement fair. Slip op. 28-29. But this means that a kicker by itself cannot ever cause rejection of a settlement, which means that settling parties have no incentive to ever eschew self-dealing through kickers. As the dissent notes, this is wrong, and creates a circuit split. Dissent 43-46. *En banc* rehearing is needed to resolve this independent important question.

Conclusion

Blackman therefore requests *en banc* review.

Dated: May 27, 2016

Respectfully submitted,

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question is one of allocation: has class counsel has put the class's or its own interests first? So long as the requested fee is proportional to the actual value of the class's recovery, it might be appropriate to approve a settlement with claims rates even lower than the 8% here. But the best practice is plainly a structure with a clean, rather than constructive, common fund, with the fee to be awarded from that fund.

Proof of Service

I hereby certify that on May 27, 2016, I electronically filed the foregoing with the Clerk of the United States Court of Appeals for the Sixth Circuit using the CM/ECF system, which will provide notification of such filing to all counsel of record.

/s/ Theodore H. Frank
Theodore H. Frank