NO. 16-364

IN THE

Supreme Court of the United States

JOSHUA BLACKMAN,
Petitioner,

v.

AMBER GASCHO, on behalf of herself and all others similarly situated, et al.,
Respondents.

On Petition for a Writ of Certiorari to the United States Court of Appeals for the Sixth Circuit

Brief of the Cato Institute as *Amicus Curiae* in Support of Petitioner

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QUESTION PRESENTED

Federal Rule of Civil Procedure 23(e)(2) requires that a settlement that binds class members be "fair, reasonable, and adequate." In this case, the Sixth Circuit upheld approval of a "claims-made" settlement that provided zero compensation for over ninety percent of class members. The court upheld the district court's decision to modify the fee award in a methodologically unsound way, choosing a participation rate half-way between the actual rate and full participation. Breaking with the Third, Seventh, and Ninth Circuits, the Sixth Circuit held that the district court was justified in using this ad hoc method to approve a fee award that comprised 60 percent of the total cash recovery of the settlement. The question presented is:

In a class action settlement providing relief only to class members who submit claims, do the Due Process Clause of the Fifth Amendment and Fed. R. Civ. P. 23(e)(2) provide any meaningful limitation on the ability of class counsel to enrich themselves without actual or expected benefit to absent class members who will be deprived of their legal claims?

TABLE OF CONTENTS

Page

QUESTION PRESENTED i

TABLE OF AUTHORITIES iii

INTEREST OF *AMICUS CURIAE* 1

SUMMARY OF ARGUMENT 1

ARGUMENT: WITHOUT MEANINGFUL JUDICIAL OVERSIGHT OF PROPOSED CLASS-ACTION SETTLEMENTS, CLASS MEMBERS ARE DEPRIVED OF THEIR LEGAL CLAIMS WITHOUT DUE PROCESS OF LAW 3

A. Present opt-out mechanisms for class-action participation result in effectively zero participation by class members 4

B. Without meaningful class participation, class actions are rife with principal-agent problems and conflicts of interest 6

C. Self-dealing will often take the form of collusion with defendants, to the detriment of class members 8

D. Rule 23(e)(2)'s "rigorous analysis" provides a bare-minimum check on class-counsel abuses 10

E. Courts should fulfill their Rule 23 duties and avoid due-process deprivations 11

CONCLUSION 15

TABLE OF AUTHORITIES

Page(s)

Cases

Arch v. American Tobacco Corporation, Inc.,
175 F.R.D. 469 (E.D. Pa. 1997)..... 8

Castaneda v. Partida,
430 U.S. 482 (1977)..... 13

Eubank v. Pella Corp.,
753 F.3d 718 (7th Cir. 2014)..... 12

Feinstein v. Firestone Tire and Rubber Co.,
535 F. Supp. 595 (S.D.N.Y. 1982)..... 8

Gascho v. Global Fitness,
822 F.3d 269 (6th Cir. 2016).....*passim*

Hansberry v. Lee,
311 U.S. 32 (1940)..... 6

Hazelwood School Dist. v. United States,
433 U.S. 299 (1977)..... 13

In re Bluetooth Headset Products Liab. Litig.,
654 F.3d 935 (9th Cir. 2011)..... 11

Kreuger v. Wyeth, Inc., No. 03-cv-2496,
2008 WL 481956 (S.D. Cal. Feb. 19, 2008). 8

Malchman v. Davis,
761 F.2d 893 (2d Cir. 1985) 10

Mirfasihi v. Fleet Mortg. Corp.,
356 F.3d 781 (7th Cir. 2004)..... 9

Oxford Health Plans LLC v. Sutter,
133 S. Ct. 2064 (2013)..... 5

Pearl v. Allied Corporation,
102 F.R.D. 921 (E.D. Pa. 1984)..... 8

Phillips Petroleum Co. v. Shutts,
472 U.S. 797 (1985).....2, 3, 4, 7

Richards v. Jefferson County, Ala.,
517 U.S. 793 (1996)..... 4

Standard Fire Ins. Co. v. Knowles,
133 S.Ct. 1345 (2013)..... 7

Sullivan v. DB Investments,
667 F.3d 273 (3d Cir. 2011) 9

Wal-Mart Stores, Inc. v. Dukes,
131 S.Ct. 2541 (2011).....2, 10

Constitutional Provisions

U.S. Const., amend. V..... 1, 3

Statutes & Regulations

Class Action Fairness Act of 2005,
Pub. L. No. 109-2, 119 Stat. 4 (2005). 7

Fed. R. Civ. P. 23(c)(2) 5

Fed. R. Civ. P. 23(e)(2)..... 3

Other Authorities

Christopher R. Leslie, *The Significance of Silence: Collective Action Problems and Class Action Settlements*, 59 Fla. L. Rev. 71 (2007)..... 5

Daniel Fisher, *Banner Ads Are a Joke in the Real World, But Not In Class-Action Land*,
Forbes (Sep. 15, 2016)..... 9

INTEREST OF *AMICUS CURIAE*[1]

The Cato Institute is a nonpartisan public policy research foundation dedicated to individual liberty, free markets, and limited government. Cato's Center for Constitutional Studies helps restore the principles of constitutional government that are the foundation of liberty. To those ends, Cato publishes books, studies, and the annual *Cato Supreme Court Review*, conducts conferences and forums, and files *amicus* briefs. This case concerns Cato because it involves a threat to the integrity of the adversarial legal system and thus to constitutional due process.

SUMMARY OF ARGUMENT

Depriving class members of their legal claims without compensation is a violation of their constitutional rights. Specifically, the Fifth Amendment's Due Process Clause protects class members' right both to adequate representation and to pursue their legal claims against the defendant. The nature of class action lawsuits may make it inevitable that some absent class members may have their legal claims disposed of without compensation or consent, but due process and the Federal Rules of Civil Procedure require a rigorous review by federal courts to minimize the risks of that deprivation.

The opt-out mechanism currently used to govern class actions results in minimal-to-no participation by class members. As a result of lax supervision by

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[1] Rule 37 Statement: All parties were timely notified of and have consented to the filing of this brief. No party's counsel authored this brief in whole or in part and no person or entity other than *amicus* funded its preparation or submission.

the class, class counsel are free to engage in self-dealing and collusion with defendants, selling class claims at a steep discount while maintaining high attorney fees. A "claims-made" settlement facilitates that collusion by allowing defendants to dispose of the claims of a broad class while only compensating the small percentage of class members who file the required paperwork. Class counsel also want a large class to justify a large fee award, even when they know that much of the class will not be compensated.

Class members' due-process rights are violated because the actions of class counsel fall short of the adequate representation guaranteed by the Constitution. *Phillips Petroleum Co. v. Shutts*, 472 U.S. 797, 812 (1985). These rights are also implicated by the judiciary's complicity in the deprivation of legitimate legal claims without compensation and without meaningful opportunity to consent. To remedy this unfortunate dynamic, courts must apply a "rigorous analysis" under Rule 23 to forestall a wholesale deprivation of class members' due-process rights. *Wal-Mart Stores, Inc. v. Dukes*, 131 S.Ct. 2541, 2552 (2011). In the context of a "claims-made" settlement, that rigorous analysis must include rejecting hypothetical full-participation assumptions and ad hoc, methodologically unsound decisions to establish a value for class recovery based on anything other than actual or expected participation.

Most importantly in the context of a cert. petition, the deprivation of all of these rights is not limited to this case—or even to the Sixth Circuit—but will be suffered by class members nationwide, as class counsel file claims in the jurisdiction that exercises the least scrutiny over potential self-dealing.

ARGUMENT

WITHOUT MEANINGFUL JUDICIAL OVERSIGHT OF PROPOSED CLASS-ACTION SETTLEMENTS, CLASS MEMBERS ARE DEPRIVED OF THEIR LEGAL CLAIMS WITHOUT DUE PROCESS OF LAW

The Fifth Amendment's Due Process clause protects the right of individuals to their liberty and property. Few forms of property are as crucial to a free society as the right to pursue legitimate legal claims, seeking a redress of wrongs. Similarly, while there is no right to counsel in civil litigation, the Court has said that due process includes the right of litigants to have their claims adequately represented by whatever counsel is bringing claims on their behalf. *Shutts*, 472 U.S. at 812.

The current opt-out regime governing federal class actions raises serious due-process concerns by allowing named plaintiffs, class counsel, and defendants to dispose of the legal claims of absent class members without meaningful consent. The only bulwark against this deprivation of property in federal court is the requirement that district courts approve "proposals [that] would bind class members" only after determining that the settlement is "fair, reasonable, and adequate." Fed. R. Civ. P. 23(e)(2).

Approval of a "claims-made" settlement that awards attorneys' fees based on class-participation rates above actual or expected rates leaves class members' interests protected only by the good will of class counsel and defendants. Disregarding *actual* participation rates in favor of *hypothetical* full-participation assumptions or an ad hoc, splitting-the-

difference methodology also provides strong incentives for class counsel and defendants to collude to the detriment of absent class members.

A. Present opt-out mechanisms for class-action participation result in effectively zero participation by class members.

The evolution of class actions in U.S. courts has yielded a system where litigation is controlled by class counsel and defendants, bargaining over class-certification and settlement. Named plaintiffs are likely allowed to offer token input, as required by class counsel's professional obligation, but the vast majority of class members have no way of making their voices heard. This result is not surprising given the incentives faced by class counsel, but the typical lack of meaningful participation by absent class members suggests a systemic due-process problem.

The Court has stated that "due process requires at a minimum that an absent plaintiff be provided with an opportunity to remove himself from the class by executing and returning an 'opt out' or 'request for exclusion' form to the court." *Shutts*, 472 U.S. at 812. If due process protections are to be meaningful in this context, the absent plaintiffs' "opportunity" must be meaningful. The *Shutts* Court said as much as it described a Kansas opt-out statute and concluded that the opportunities afforded plaintiffs were "by no means *pro forma*" and that the Constitution required no more protection for plaintiffs who could be "presumed to consent to being a member of the class by his failure to [affirmatively opt out]." *Id.* at 813. See also *Richards v. Jefferson County, Ala.*, 517 U.S. 793, 799 (1996) ("the right to be heard ensured by the

guarantee of due process has little reality or worth unless one is informed that the matter is pending and can choose for himself whether to appear or default, acquiesce or contest").

Rule 23 provides that class members be notified of the lawsuit, ostensibly providing class members with an opportunity to become informed about their legal claims and participate meaningfully in legal proceedings. Fed. R. Civ. P. 23(c)(2). This rule is the theoretical foundation for concluding that class members can be presumed to have consented to being part of the class. That foundation falls apart, however, when subjected to a critical review under a practical lens. *See generally* Christopher R. Leslie, *The Significance of Silence: Collective Action Problems and Class Action Settlements*, 59 Fla. L. Rev. 71 (2007). *See also Oxford Health Plans LLC v. Sutter*, 133 S. Ct. 2064, 2071-72 (2013) (Alito, J., concurring) (inaction in response to a class arbitration opt-out form is not consent).

Having suffered relatively small injuries, class members have little incentive to learn of the existence of class actions in which they may have legal interests. Class counsel, meanwhile, having already assembled their named plaintiffs, have no incentive to provide meaningful notice to the rest of the class. As a result, when notices arrive at class members' homes, they resemble little more than the piles of junk mail that most people receive daily. (Anecdotally, undersigned counsel have experienced this phenomenon in our own households.) Most class members, not being on the lookout for class action "opportunities," will dispose of such notices without any comprehension of the fact that they have

forfeited their right to opt out. Class counsel are then able to proceed with the case unencumbered by an informed and participating class that could object to the uncompensated extinguishing of its legal claims.

B. Without meaningful class participation, class actions are rife with principal-agent problems and conflicts of interest.

The attorney-client relationship is a classic case of the principal-agent relationship. As with all such relationships, the most difficult task is to constrain the agent's self-interest, especially where the agent has a significant informational advantage over the principal. Standards of professional ethics, enforced by state bar associations, provide some constraint on lawyers' tendencies to enrich themselves at the expense of their clients but, as shown by the number of disciplinary actions commenced each month, are often not enough. As unfortunate as this truth is, the situation becomes even more problematic when the agent (class counsel) is aware that the vast majority of the principals (class members) are not monitoring his actions. Indeed, most of these "principals" are unaware of the existence of the "agent" or the fact that he is acting in their names and binding them.

Because class counsel need not worry about class members' involving themselves in the litigation, they are largely free to pursue their own interests, even when doing so prejudices the interests of absent class members. The Court has previously stated that due process is violated when the named plaintiffs' interests are in line with those of the defendant, rather than the absent class members. *Hansberry v. Lee*, 311 U.S. 32, 45-46 (1940). Self-dealing by class

counsel, especially in collusion with defendants, violates the due-process rights of absent class members in precisely the same way.

Self-dealing on the part of class counsel could take a number of forms, including advancement of a political agenda, but it typically takes the form of pursuing larger attorney fees. One way that class counsel can inflate fee awards is to be over-inclusive when identifying the class. A larger class means more aggregated damages and thus larger fees.

Of course, the existence of incentives to engage in self-dealing does not mean that class counsel will do so, but there is plentiful evidence that class counsel engage in self-dealing, thereby failing to provide adequate representation to absent class members as required by due process. *Shutts*, 472 U.S. at 812. The Court has recently dealt with two such examples of self-dealing by class counsel. In *Dukes*, for example, the Court rejected an attempt to limit damages to back-pay claims in order to make the class action mandatory. *Dukes*, 131 S.Ct. at 2559. The Court rejected this self-interested attempt by class counsel because it would have precluded class members' compensatory damages claim. In *Standard Fire Ins. Co. v. Knowles*, 133 S.Ct. 1345, 1348-49 (2013), class counsel attempted to stipulate to less than $5 million in damages, in order to avoid federal jurisdiction under the Class Action Fairness Act of 2005, Pub. L. No. 109-2, 119 Stat. 4 (2005). While the Court decided the case on other grounds, it acknowledged that the attempted stipulation would have reduced the value of class members' claims. *Knowles*, 133 S.Ct. at 1349. Lower courts have also rejected selective pleading, waiver, or abandonment of claims

in order to achieve class certification, even though doing so would impair class members' ability to raise abandoned claims later. *See*, *e.g.*, *Arch v. American Tobacco Corp., Inc.*, 175 F.R.D. 469, 479-80 (E.D. Pa. 1997); *Pearl v. Allied Corporation*, 102 F.R.D. 921, 922-23 (E.D. Pa. 1984); *Feinstein v. Firestone Tire & Rubber Co.*, 535 F. Supp. 595, 602 (S.D.N.Y. 1982); *Kreuger v. Wyeth, Inc.*, No. 03-cv-2496, 2008 WL 481956, at *2-4 (S.D. Cal. Feb. 19, 2008).

Not every principal-agent problem or conflict of interest that arises in the class-action context is the result of class counsel's nefarious motives. For example, it is impossible to effectively communicate with the entire class, which will inevitably lead to some class members being disadvantaged. Courts should be aware of the strong potential for self-dealing by class counsel, however, and should refuse to condone it by certifying classes and approving settlements that appear self-serving. By reviewing class-certification requests and settlements with a skeptical eye, courts will be better able to protect the rights of class members to adequate representation.

C. Self-dealing will often take the form of collusion with defendants, to the detriment of class members.

The danger of self-dealing is greater when there is an opportunity for class counsel to collude with defendants in reaching a settlement. Class counsel are motivated primarily by a desire to increase the size of their fee awards, while defendants want to minimize both the payout to the class and future legal exposure. The incentives of class counsel and defendants align in increasing the size of the class,

most of whom will see their legal claims disposed of without compensation. *See Mirfasihi v. Fleet Mortg. Corp.*, 356 F.3d 781, 785 (7th Cir. 2004) (Posner, J.) ("Would it be too cynical to speculate that what may be going on here is that class counsel wanted a settlement that would give them a generous fee and Fleet wanted a settlement that would extinguish 1.4 million claims against it at no cost to itself?").

Few circumstances present such obvious threat of collusion as a "claims-made" settlement. In such a settlement, the defendant obtains a release of all class claims while only making payment to class members who successfully manage the process of filing the necessary claim paperwork. Fisher, *Banner Ads Are a Joke in The Real World, But Not in Class-Action Land,* Forbes (Sep. 16, 2016). It is well-known that very few class members will even attempt to obtain claims, *Sullivan v. DB Investments*, 667 F.3d 273, 329 n.60 (3d Cir. 2011) (en banc) (finding that response rates "rarely exceed seven percent"); *Gascho v. Global Fitness Holdings, LLC*, 822 F.3d 269, 296 (6th Cir. 2016) (Clay, J., dissenting) ("the median response rate in a study of consumer class actions was 5-8%"), and even fewer will be approved.

Defendants can agree to the settlement knowing that they will only pay a small fraction of the total claims. More importantly, defendants will push for a much larger class, knowing that they will likely pay less than 10 percent of all additional claims. Class counsel will also prefer to enlarge the class in order to justify a higher fee award. Their collusion will often be formalized in the settlement agreement, as in this case, with defendants agreeing not to object to class counsel's request for fees, *Id.* at 274, and any

reduction in fees reverting to the benefit of the defendant, rather than being distributed to the class. *Id. See also Malchman v. Davis*, 761 F.2d 893, 908 (2d Cir. 1985) (Newman, J., concurring) (finding that a clear sailing provisions "creates the likelihood that plaintiffs' counsel, in obtaining the defendant's agreement not to challenge a fee request within a stated ceiling, will bargain away something of value to the plaintiff class.").

D. Rule 23(e)(2)'s "rigorous analysis" provides a bare-minimum check on class-counsel abuses.

Our current class-action regime raises significant due-process concerns, but it also contains a safeguard against actual due process violations, by requiring the trial court to engage in a "rigorous analysis" of the plaintiffs' claims. *Dukes*, 131 S.Ct. at 2552 ("Rule 23 does not set forth a mere pleading standard . . . certification is proper only if the trial court is satisfied, after a rigorous analysis, that the prerequisites of Rule 23(a) have been satisfied") (internal quotation marks omitted). While the Court in *Dukes* only needed to address the due-process requirements of the certification process, due-process violations are possible at all points in class-action litigation—and especially in the settlement context. The Court should therefore apply its "rigorous analysis" standard to the entirety of Rule 23.

A trial court that ignores its responsibilities under Rule 23, engaging in no review—or only cursory review—of class counsel's actions will further erode any remaining incentives for that counsel to consider and protect the due process rights of absent

class members. A trial court that takes its responsibilities under Rule 23 seriously will be alert for those areas where self-dealing by class counsel is likely, and will be better able to protect the interests of those most vulnerable in this context: those absent class members whose liberty and property interests are now in the hands of class counsel.

E. Courts should fulfill their Rule 23 duties and avoid due-process deprivations.

The lower court, in its decision to uphold approval of the settlement agreement, barely acknowledged its responsibilities under Rule 23. *Gascho*, 822 F.3d at 276. While it played lip service to the requirement that the settlement be fair, reasonable, and adequate, it neglected even to mention the "rigorous analysis" requirement. *Id.* The Sixth Circuit applied its own multi-factor test, which includes such considerations as "the risk of fraud or collusion," yet failed to consider the real danger of self-dealing and collusion present with a "claims-made" settlement.

As the dissent below correctly noted, this was a settlement that fails to protect the interest of class members and "unduly enriches class counsel at the expense of their clients." *Id.* at 294-95 (Clay, J., dissenting). The clear-sailing and kicker clauses have been recognized by the Ninth Circuit as just the type of self-dealing and collusion that courts must police. *In re Bluetooth Headset Products Liab. Litig.*, 654 F.3d 935, 947 (9th Cir. 2011). Most importantly, the fee award was justified on grounds that would not have survived even a cursory glance by a court that took its Rule 23 responsibilities seriously.

The lower court held that the award was fair

based on the lodestar method, yet the district court took the testimony of plaintiffs' counsel at face value, disdaining the substantial evidentiary requirements traditionally demanded by courts. *Gascho*, 822 F.3d at 281; *id.* at 297 (Clay, J., dissenting). Alternatively, the Sixth Circuit held that the district court was justified in determining the benefit to the class by simply determining the midpoint between the benefit actually received by class members and the hypothetical benefit that would have been received at full participation. *Id.* at 288. Neither analysis constitutes the "rigorous analysis" required by this Court—they were superficial and perfunctory—and they fall short of that required by Rule 23.

Indeed, fee awards are a primary motivation for class-action settlement. *Eubank v. Pella Corp.*, 753 F.3d 718, 720 (7th Cir. 2014) ("From the selfish standpoint of class counsel and the defendant, . . . the optimal settlement is one modest in overall amount but heavily tilted toward attorneys' fees"). If the fee is justified on the basis of the hypothetical—and factually false—premise of full class participation, the incentives for self-dealing will be strong. The district court's "midpoint" standard may present slightly weaker incentives, but those incentives are still unacceptably high. Moreover, the standard is methodologically unsound from a statistical perspective.

A sounder methodology exists, but it would require additional analysis, something the court below seemed determined to avoid. It is to treat the defendant as a rational actor who engages in cost-benefit analysis regarding class-action settlements. The Sixth Circuit appears to have adopted the view

that the "benefit to the class" is the value of concessions extracted from the defendant, the "harvest of the suit" as represented in the fund at full participation. *Gascho*, 822 F.3d at 282. It is likely true that the overall value of the settlement to the class is the cost to the defendant—but when the defendant agrees to settle, the cost is properly measured by the *expected* value, calculated by multiplying the likely participation rate by the hypothetical value at full participation.

This Court is no stranger to expected values, having utilized them for decades in the context of employment discrimination, *Hazelwood School Dist. v. United States*, 433 U.S. 299, 308 n.14 (1977) (estimating the expected minority employment, given the percentage of qualified minorities and the minority population), and habeas relief, *Castaneda v. Partida*, 430 U.S. 482, 496 n.17 (1977) (discussing expected grand-jury participation by Mexican-Americans). Rational defendants, in negotiating a settlement, would anticipate paying the expected value, plus or minus the standard deviation. *Id.* ("The measure of the predicted fluctuations from the expected value is the standard deviation"). They would never anticipate paying the *hypothetical* amount at full participation, so reliance on that number as the value of the class benefit is nonsensical. Similarly, no defendant would expect to pay according to the district court's "midpoint" standard, so it cannot justify a fee award either.

Use of the expected value is not only methodologically sound, but it also weakens the incentives for defendants to collude with class counsel. Class counsel will still want to artificially

inflate class numbers to justify large fee awards and defendants will still want to inflate class numbers to eliminate those claims and limit future legal exposure, but both goals will require some actual compensation of individual class members. Requiring an expected-value calculation will, at the margin, restore some measure of the adversarial relationship and increase protection for absent class members.

The lower court's errors appear to derive from its refusal to acknowledge the due-process risks of class actions generally and a willful blindness to the possibility of collusion between class counsel and defendants. That collusion would indicate that class counsel was not adequately representing class interests, thereby violating their due-process rights. The Sixth Circuit approved a method of valuing the benefit to the class that had never been accepted by any of its sister circuits, *Gascho*, 822 F.3d at 288 (Clay, J., dissenting), and that is methodologically unsound. It did so for the same reason that so many other courts approve settlements that enrich class counsel and defendants at the expense of class members: acting otherwise takes time and effort, not to mention a willingness to refrain from enriching political allies. That this Court has refused to enforce its rigorous-analysis requirement in any meaningful way has emboldened such lower-court lawlessness.

If allowed to stand, this decision will lead to greater levels of self-dealing by class counsel and greater levels of collusion between class counsel and defendants, aided by a methodologically unsound standard. These deprivations of due process will not be limited to those living in the Sixth Circuit, however, because class counsel nationwide will

choose to file claims in whichever forum has exhibited the least desire to police self-dealing.

CONCLUSION

The petition should be granted.

Respectfully submitted,

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