CAUSE NO. CV-96-423

RONNIE AND NANCY HAESE, ET AL.,	)	**IN THE DISTRICT COURT FOR**
	)	
PLAINTIFFS,	)	**KLEBERG COUNTY, TEXAS**
	)	
vs.	)	
	)	**105TH JUDICIAL DISTRICT**
H&R BLOCK, INC., ET AL.,	)	
	)	
DEFENDANTS.	)	

FEDERAL TRADE COMMISSION'S MEMORANDUM OF POINTS AND AUTHORITIES AS AMICUS CURIAE REGARDING THE PROPOSED CLASS ACTION COUPON SETTLEMENT AND PETITION FOR AN AWARD OF ATTORNEYS' FEES

TABLE OF CONTENTS

The Federal Trade Commission ("Commission") submits this memorandum as *amicus curiae* to assist the Court in evaluating the class action coupon settlement proposed by class representatives Ronnie and Nancy Haese and H&R Block, Inc., H&R Block and Associates, L.P., H&R Block Tax Services, Inc., HRBO, Limited, H&R Block of South Texas, Inc., HRB-Delaware, Inc., H&R Block, Ltd., HRBOI, Ltd., HRBO III, Ltd., HRBOII, Inc., H&R Block of Dallas, Inc., H&R Block of Houston, Ltd., Houston Block, L.C., Block Management, Ltd., and STI-Block, L.C. (collectively, "H&R") and the petition for award of fees by counsel for the class.

I. INTRODUCTION

Courts and commentators alike have come to view class action coupon settlements with skepticism, and with good reason. Past experience shows some defendants promise to pay high attorneys' fees in exchange for counsel's willingness to accept a settlement consisting of coupons of dubious value that many, if not most, class members are unlikely to redeem. Although tasked with subjecting class action settlements to careful scrutiny to insure that they are fair, adequate, and reasonable and evaluating counsel's fees to insure that they are not excessive, courts are often bereft of any means to assess critically the actual benefits of settlement as compared to the expected trial outcome.

The coupon settlement proposed by H&R and class counsel in this consumer class action has some of the indicia that commentators cite as evidence of a collusive deal.[1] The settlement

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[1] Certain commentators view coupon settlements as indicative of collusion.

> Collusion within the class action context essentially requires an agreement - actual or implicit - by which the defendants receive a "cheaper" than arm's length settlement and the attorneys receive in some form an above-market attorney's fee. The mechanics of such an agreement varies with the litigation context. . . . In the mass tort and antitrust contexts, a variation on the nonpecuniary

trades plaintiffs' claims for coupons of uncertain value purportedly worth $262 million[2] and attorneys' fees in the amount of $49 million, without a penny to be paid to the injured class members. And, with it comes a proposition for the Court from class counsel, "approve our fees in full and we will pay $26 million to our clients, the class."

The value of the proposed coupon settlement is likely substantially lower than the purported $262 million face value of the coupons – the amount the settlement's proponents would have this Court find it provides to class members. The coupons for tax preparation and planning software, a book containing tax preparation and planning advice, and a rebate on tax preparation services (which garners "bonus sales" for H&R) are to a great extent redundant. The great bulk of the coupons are of questionable value to these class members who previously contracted for tax preparation services and are not likely to use the tax preparation and planning software and books directed to "do it yourselfers." Further, the purported settlement value assumes a 100% redemption rate that experience shows to be highly unlikely. See section III.B.1, *infra*. Even if

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> settlement (known informally as a "scrip settlement") has become popular, involving discount coupons for certificates granting the injured class the right to buy the defendant's product at a discount. Often the discount is no greater than what an individual plaintiff could receive for a volume purchase, or for a case sale, or for using a particular credit card, and typically restrictions are placed on its transferability.

John C. Coffee, *Class Wars: The Dilemma of the Mass Tort Class Action*, 95 COLUM. L. REV. 1343, 1367-68 (2000). *See also*, Jonathan R. Macey & Geoffrey P. Miller, *The Plaintiffs' Attorneys' Role in Class Action and Derivative Litigation: Economic Analysis and Recommendations for Reform*, 58 U. CHI. L. REV. 1, 45 n.10 (1991); John C. Coffee, *Understanding the Plaintiff's Attorney: The Implications of Economic Theory For Private Enforcement of Law Through Class and Derivative Actions*, 86 COLUM. L. REV. 669, 716 n.129 (1986).

[2] *See* n.17 and n.22, *infra*.

one were to consider the $26 million in fees offered to class members as part of the settlement – something to which H&R has objected – the amount of coupons that would have to be redeemed to support class counsel's $23 million fee award so far exceeds typical redemption rates as to be very unlikely.[3]

The analysis, however, does not end with the determination of the real value of the proposed coupon settlement. The Court must assess the adequacy and propriety of the settlement as a whole, including the strength of the plaintiffs' case on the merits and the settlement's provision for fee awards. Here, there is strong reason to conclude that the proposed settlement package is not fair or reasonable, regardless of the strength of plaintiffs' claims. If one assumes, in keeping with this Court's preliminary ruling, that plaintiffs are likely to prevail on the pertinent issues – i.e., that H&R owed a fiduciary duty to plaintiffs as a matter of law; that its violation was intentional, wilful and deliberate; and that plaintiffs are entitled not only to forfeiture of the license fees H&R received, but also the fees paid by plaintiffs to H&R – then the coupon settlement of uncertain and likely low value is inadequate. If by contrast, as H&R contends – and consistent with rulings it has obtained in other states – there is a substantial likelihood that this Court's rulings on the merits and as to damages would be overturned on appeal, the coupon settlement, albeit low in value, may nonetheless be adequate.

In either event, however, the apparent disparity between the modest value of the coupons to be provided to plaintiffs and the $49 million in fees to be paid to class counsel is fatal to the proposed settlement, assessed in its entirety. If the plaintiffs' claims are assumed to be strong, then class counsel has won them a poor litigation result yet is being generously awarded for that

[3] *See* n.38 *infra*.

result. If, on the other hand, one assumes that plaintiffs' claims are doubtful and that the coupon package adequately reflects the value of those claims, then the $49 million fee award is patently unjustified by the result achieved in this litigation. These fundamental flaws in the proposed settlement cannot be ameliorated, moreover, by class counsel's unorthodox suggestion that it should be permitted to disburse a portion of such fees to class members. That proposal raises a number of difficult questions, and the very fact that class counsel makes it betrays their own recognition of the inadequacy of the settlement or the excessiveness of the fees, as the settlement was negotiated. For the reasons stated below, the proposed class action coupon settlement appears not to be fair, reasonable, or adequate; the request for attorneys' fees should not be approved; and we ask that the Court suggest changes necessary for approval. Part III.E. contains suggestions for the Court's consideration.

II. BACKGROUND

A. Statement of the Case

In July 1996, the named plaintiffs filed suit against H&R on their own behalf and on behalf of other similarly situated Texans. The plaintiffs alleged that they, and other low income, largely uneducated, financially strapped individuals, were led to believe that they were obtaining a quick income tax refund through H&R, while in fact they were signing documents for a loan (a Refund Anticipation Loan or "RAL") at a very high interest rate and without proper disclosures. H&R allegedly failed to disclose the fact that H&R was receiving a "kick back" or commission from the lending bank for each RAL that H&R facilitated.[4] Plaintiffs alleged that H&R violated the

[4] The Commission has not independently evaluated the claims alleged and expresses no view on the merits of the case.

fiduciary duties it owed class members and the Texas Deceptive Trade Practices Act. According to the United States Court of Appeals for the Seventh Circuit, which rejected the proposed national class action settlement of similar claims against H&R, this suit was one of more than twenty class action suits brought against H&R and others on behalf of RAL borrowers. *Reynolds v. Beneficial Nat'l Bank*, 288 F.3d 277, 280 (7th Cir. 2002).[5]

B. Terms of the Settlement

1. The Settlement Class

The class the Court certified in this case consists of any individual in Texas, who, at any time, was a debtor on a RAL for which H&R acted as a facilitator. The parties seek settlement on behalf of a portion of the certified class consisting of all persons who: (1) obtained a RAL from H&R in the State of Texas during the period from 1992 through 1996; and (2) did not previously request exclusion from this suit.

2. Coupons

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[5] The issue of whether the proposed national class action settlement of similar claims against H&R and others was fair, reasonable, and adequate was remanded to Judge Bucklo by the Seventh Circuit pursuant to local Circuit Rule 36, after the Court of Appeals determined that facts suggesting that the class had been poorly represented by counsel "demanded closer scrutiny than the [previously assigned] district judge gave it." *Reynolds*, 288 F.3d at 283. On April 16, 2003, Judge Bucklo in *Reynolds v. Beneficial Nat'l Bank*, Nos. 96 C178, 98 C2550, 2003 U.S. Dist. LEXIS 6422 (N.D. Ill. Apr. 16, 2003), rejected the proposed settlement, which would have paid each class member who filed a claim a *pro rata* share of a $25 million claim fund, up to a maximum of $15 for claimants who obtained one RAL and $30 for claimants who had obtained more than one RAL. Under the terms of the settlement, class counsel would have received up to $4.25 million in fees. Of the national class, which included approximately 17 million people, only about 1 million filed claims and approximately 6,000 opted out of the settlement. Judge Bucklo rejected the settlement based on class counsel's inadequate representation of the class, discharging them from the case. She also chastised H&R's counsel for failing to provide information about the Texas class action settlement.

Pursuant to the terms of the settlement reached by class counsel with H&R, the benefit of the settlement to the plaintiff class consists solely of coupons. Each Class Member is entitled to redeem three coupons per year, between January 5 and April 15, over a five-consecutive-year period:

(1) a transferable coupon for H&R's TaxCut® platinum Federal Filing Edition tax preparation and planning package that currently has a suggested retail price of $39.95 or an equivalent product of equal retail value selected by H&R;

(2) a non-transferable coupon for a $20 rebate on tax preparation or electronic filing services provided in Texas; and

(3) a transferable coupon for a copy of H&R's Tax Planning Advisor book that currently has a suggested retail price of $14.95, or an equivalent product of equal retail value selected by H&R Block.

H&R will send all 15 coupons to class members at a time of its choosing some time after April 30th but before December 31st of the year prior to the first tax season to which this settlement is applicable after Court approval.

There is no cash payment by H&R to the plaintiff class under the terms of the settlement.

3. Attorneys' Fees

The settlement agreement provides that H&R will pay class counsel up to $49,000,000 in attorneys' fees and reimburse class counsel for expenses in an amount not to exceed $900,000, as approved by the Court.

4. Releases and Conditions to Distribution and Payment

In exchange for the above described coupons, class members must give broad releases

and meet a number of conditions precedent and conditions subsequent in order for H&R to have any obligation to distribute coupons to class members or pay class counsel's fees. The conditions are largely directed toward abating or dismissing other related actions against H&R. Class counsel have also agreed to limit H&R's liability for certain sanctions, regardless of whether the proposed settlement is approved or not.

The settlement agreement provides that upon its approval by the Court, the settlement class will release all claims (including federal claims) that plaintiffs asserted, may assert, or could have asserted arising out of or in any way related to: (1) the RALs or participation in RALs obtained by them at any time up to and through November 18, 2002; (2) H&R's use of the term "Rapid Refund;" and (3) any sanctions or contempt penalties that have or could have been sought against the Released Parties in this or other actions. Additionally, following Court approval, class members who do not timely opt out agree not to assert any claim, suit, demand, or cause of action against the released parties for the settled claims.

Several conditions must occur prior to H&R's obligation to make any coupon available to the Class or pay attorneys' fees. These conditions include, but are not limited to, several orders that this and other Courts must enter. The conditions reflect, among other things, class counsel's apparent abandonment of the claims of certain portions of the certified class, including the claims of class members who first obtained an RAL in or after 1997 and of those class members who only obtained RALs between 1988 and 1991.

For there to be a settlement at all, the Court must grant H&R's Motion to Compel Arbitration, which would dismiss the claims of those persons who were a part of the class as defined in the August 28, 1997 class certification order, who obtained a RAL for the first time in

1997 or thereafter. H&R contends that these class members were obligated to arbitrate their claims and therefore should have been dismissed from this action. The Court must also grant summary judgment for the claims of those who were part of the class as defined in the August 28, 1997 class certification order, who only obtained RALs between 1988 and 1991. H&R contends that these class members have no claim since H&R did not receive any commissions before 1992 and/or their claims are time-barred. If class members who first obtained a RAL from 1997 through 2002, or who only obtained a RAL during 1988 through 1991, file a request for exclusion by June 5, 2003, the Court will exclude them from the class. Those individuals who do not timely seek exclusion, will be entitled to object to dismissal at the June 24, 2003 settlement approval hearing, when the Court will make a final determination on whether they should be dismissed from the case for failure to arbitrate with respect to RALs obtained after 1996 and/or have summary judgment granted against them with respect to RALs obtained from 1988 through 1991. Finally, the Court must also grant summary judgment in favor of HRBO, Limited and HRBO III, Ltd.[6]

H&R has no obligation to distribute coupons to the class or pay class counsel until additional conditions subsequent to court approval, including: obtaining an order from this Court decertifying and non-suiting another related case pending before it, an order non-suiting the Martinez action pending against H&R in Neuces County, Texas and dismissal of the mandamus proceeding pending before the Texas Supreme Court. While awaiting approval of the settlement and final exhaustion of all appeals, the parties will jointly seek abatement of the related case

[6] H&R contends that these two entities were improperly named as defendants and requested summary judgment be entered to eliminate them from the case.

pending before this Court and the Martinez action.[7] H&R shall have no obligation to issue coupons to the class or pay class counsel their fees unless and until the orders are obtained.

Finally, class counsel apparently agreed on behalf of the class to limit H&R's liability for sanctions, whether or not this settlement is approved. The parties have agreed that if the settlement should fail due to non-approval by the Court or appellate reversal, sanctions sought or asserted against H&R in this case, the related case pending before this Court, or in the Martinez Action, collectively shall not exceed $10,000,000. Should the settlement fail for some reason other than judicial non-approval or reversal, and such failure is not caused by H&R, the sanctions collectively shall not exceed $20,000,000. It is hard to see how an agreement to limit H&R's liability for sanctions even if the settlement fails is in the interest of the class.

C. Class Counsel's Petition for the Release of Fees to the Class

Class counsel separately petitioned the Court to allow them to pay $26 million of their attorneys fees to the class, to be paid in the amount of $37.14 per class member.[8] This offer is

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[7] Although the settlement also obligates the parties to either take or not take certain action with regard to the national class action settlement pending before Judge Bucklo, those provisions may now be moot in light of the court's rejection of the settlement in that case. *See Reynolds*, 2003 U.S. Dist. LEXIS 6422.

[8] Class counsel envisioned sending checks, along with the coupons, to class members. They also asserted that they would attempt to skip trace those coupons and checks returned as undeliverable and resend them if a current address could be determined. In accordance with class counsel's proposal, the total amount of checks not cashed after 90 days or returned after being resent after skip tracing would be distributed among the identified members of the class who did cash their checks, less the cost of mailing and administration. In its response to Plaintiffs' Motion for the Release of Funds, H&R stated unequivocally that it had not agreed to pay any cash to the class in connection with the settlement, noting "Class Counsel's desire to give some of their attorneys' fees back to the class is not part of the settlement between H&R in [sic] the class. . . . " H&R objected to class counsel's proposal to the extent that H&R would be bound "to do anything or incur any expense, with respect to Class Counsel's plan . . . " In fact, H&R

contingent on the Court's approval of class counsel's fee request of $49 million. It is not clear that class counsel could be forced to pay the class, even if the Court were to grant the motion.[9]

III. ARGUMENT

A. This Court Stands as Fiduciary to the Class in Determining Whether the Proposed Settlement is Fair, Reasonable, and Adequate and Whether it was the Product of Arms-Length Negotiations

The Texas Supreme Court has recognized that, "class actions are extraordinary proceedings with extraordinary potential for abuse." *General Motors Corp. v. Bloyed,* 916 S.W.2d 949, 953 (Tex. 1996). As Judge Posner from the United States Court of Appeals for the Seventh Circuit has noted:

> the absence of a real client impairs the incentive of the lawyer for the class to press the suit to a successful conclusion. His earnings from the suit are determined by the legal fee he receives rather than the size of the judgment. No one has an economic stake in the size of the judgment except the defendant, who has an interest in minimizing it. The lawyer for the class will be tempted to offer to settle with the defendant for a small judgment and a large legal fee, and such an offer will be attractive to the defendant, provided the sum of the two figures is less than the defendant's net expected loss from going to trial. Although the judge must approve the settlement, the lawyers largely control his access to the information – about the merits of the claim, the amount of work done by the lawyer for the class, the likely damages if the case goes to trial, etc. – that is vital to determining the reasonableness of the settlement.

RICHARD A. POSNER, AN ECONOMIC ANALYSIS OF LAW 570 (4th ed. 1992).

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specifically requested that any order granting class counsel's motion include a direction that the checks be mailed separately from the coupons to avoid confusion as to the source of the check and that class counsel be ordered to bear all costs related to their proposal. Notwithstanding H&R's objections to class counsel's proposal to pay fees to the class, H&R apparently did not object to the class notice setting forth the proposal.

[9] *See* n.37 *infra* for a discussion of the enforceablity and the desirability of the Court's involvement in such an order.

This potential for abuse highlights the importance of the trial court's obligation to determine that the protective requirements of Texas Rule 42[10] are met when it approves a class action settlement.[11] *Bloyed*, 916 S.W.2d at 953-54. In assuming its role as guardian of the class[12], this Court must hold an evidentiary hearing[13] to "examine both the substantive and procedural aspects of the settlement [and determine]: (1) whether the terms of the settlement are fair, adequate, and reasonable; and (2) whether the settlement was the product of honest

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[10] This Court may look to federal case law interpreting Fed. R. Civ. P. 23 in considering whether to approve the proposed settlement. The Texas Supreme Court has held that analysis of Texas Rule of Civil Procedure 42 may be guided by analysis of Fed. R. Civ. P. 23, from which Rule 42 was derived. *Bloyed*, 916 S.W.2d at 954 n.1 (Tex. 1996).

[11] As the Supreme Court has often stated, the requirement of adequate representation in state court class actions has its roots in the Due Process Clause of the Fourteenth Amendment. *Phillips Petroleum Co. v. Shutts*, 472 U.S. 797, 812 (1985); *Hansberry v. Lee*, 311 U.S. 32, 42-43 (1940); *Matsushita Elec. Indus. Co. v. Epstein*, 516 U.S. 367, 396-97 (1996) Ginsburg, J., (concurring). The causes of action of absent class members are a form of property protected by state law. *Logan v. Zimmerman Brush Co.*, 455 U.S. 422, 428-29 (1982). They cannot be compromised unless the class has adequate representation. *Shutts*, 472 U.S. at 712.

[12] As Judge Posner stated in *Reynolds*, 288 F.3d at 279-80, in which the United States Court of Appeals for the Seventh Circuit reversed the trial court's approval of a nation-wide class action settlement of the same underlying claims as alleged against H&R here:

> We and other courts have gone so far as to term the district judge in the settlement phase of a class action suit a fiduciary of the class, who is subject therefore to the high duty of care that the law requires of fiduciaries.

[13] The Texas Supreme Court has held:

> Given the heightened responsibility of the trial court in approving class action settlements mandated by Rule 42(e), we think that a plenary hearing, with the opportunity for questioning by the court and vigorous cross-examination by counsel representing objecting class members, should be the general rule.

Bloyed, 916 S.W.2d at 958.

negotiations or of collusion." *Id*. at 955.[14] Moreover, as Judge Bucklo recently held in *Reynolds v. Beneficial National Bank*, Nos. 96 C178, 98 C2550, 2003 U.S. Dist. LEXIS 6422 at *8, in declining, upon remand, to approve a national class action settlement of similar claims brought against H&R and others, "[i]t is settled law that a class action settlement cannot be approved, regardless of objective fairness, if the requirements of Fed. R. Civ. P. 23, including adequacy of counsel, are not met. *Amchem Prod., Inc. v. Windsor*, 521 U.S. 591, 621-22 (1977); *Reynolds*, 288 F.3d at 284."

Despite the heavy burden they face in establishing this settlement's fairness, the settling parties have filed only a *pro forma* submission in support of their motion for preliminary settlement approval. It appears that the parties do not intend to file papers setting forth their arguments and evidence in support of the settlement until just before the fairness hearing, after the deadline for class members to file their objection and commentators to file their views. Not having had an opportunity to examine fully the proponents' evidence or arguments before submitting its views,[15] the Commission respectfully requests that the Court consider this filing as

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[14] The Texas Supreme Court has stated the factors the court should consider in making this determination: (1) whether the settlement was negotiated at arms' length or was a product of fraud or collusion; (2) the complexity, expense, and likely duration of the litigation; (3) the stage of the proceedings, including the status of discovery; (4) the factual and legal obstacles that could prevent the plaintiffs from prevailing on the merits; (5) the possible range of recovery and the certainty of damages, and (6) the respective opinions of the participants, including class counsel, class representatives, and the absent class members. *Bloyed*, 916 S.W.2d at 955.

[15] Given the incentives that class counsel may have to accept marginal settlements that maximize the amount of legal fees awarded, the Commission believes that class members need significant information about the status of the case and the state of the record in support of the class' claims to make an informed decision about whether to object to the settlement. The notice to class members here lacks information about the procedural posture of the case; whether the Court has issued any substantive rulings on motions to dismiss or motions for summary judgment; the evidence that would establish or negate either key allegations of the complaint or

suggestions regarding those areas of the proposed settlement and fee request that should be intensely scrutinized.

B. The Proposed Settlement May Not Be Fair, Adequate, Or Reasonable

To evaluate the fairness of a proposed settlement or fee award, the court must first assess the actual value of the settlement to the class. Coupon settlements have generated enhanced scrutiny because, unlike money settlements, they are hard to value. *See Note: In-Kind Class Action Settlements*, 109 HARVARD L. REV. 810, 816-18 (1996).[16] Because the value of the coupon is debatable, the settlement valuation question is more susceptible to manipulation by the settling defendants and class counsel, each of whom typically has great incentive to see that the settlement is approved. In fact, only in extremely unusual circumstances would it be appropriate to value the settlement, as the settling parties do here, based on the sum of the face value of all available coupons.[17] The face value may not represent real value to the class member when, as

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defenses; and the defendants' ability to pay and the risks of not settling. Nor does the notice state the estimated total value for the benefits offered by H&R to the class or the amount of the undisclosed fees allegedly paid to H&R for facilitating the loans.

Although the Commission contacted counsel of record in the case and obtained from them considerable information not set forth in the notice to the class or the settlement agreement, the Commission is not privy to the substance of all expert testimony the parties intend to present in support of the settlement. Most importantly, class members – those with the greatest interest in understanding the benefits that will accrue to them under the proposed settlement and the risks of going forward – most likely have not had access to even that information the Commission has obtained.

[16] For example, although a coupon or discount may have a face value of $5.00 and may be distributed to 1000 class members, the settlement is not worth $5,000.00 if none of the coupons will ever be redeemed.

[17] Although not set forth in the notice sent to class members, in their Motion for Preliminary Approval of Settlement at p. 2, class counsel state:

> The gross value to each 1992-1996 class member of the settlement

here, the coupon is difficult to redeem or convert to cash, connected to an item or series of items a substantial number of consumers are unlikely to need or want, or expires in a short amount of time.[18]

> is approximately $74.90 per year for five years. The parties believe the total number of class members is approximately 700,000. Thus, the proposed settlement has a total gross value to the 1992-1996 class of $262,150,000.

[18] In its comments filed with the Committee on Rules of Practice and Procedure of the Judicial Conference of the United States on the proposed Amendments to Fed. R. Civ. P. 23, the Commission noted a number of factors that would assist courts in determining whether a particular coupon settlement was fair and adequate:

> the history of the coupon redemption rates in similar situations;
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> whether the defendants will track and record data on redemption rates of coupons;
>
> whether all class members will be entitled to use coupons;
>
> whether the coupons are easily redeemed and are likely to be redeemed (without restrictions on use and without requiring expensive purchases);
>
> time restrictions on redemption (*i.e.*, how long consumer have to use the coupon);
>
> product restrictions on redemption (*i.e.*, whether it can be used for variety of products or just one);
>
> whether the defendant will be required to issue coupons until a minimum redemption level is reached or, in the alternative, to pay a minimum amount if the target redemption level is not reached within a fixed period of time;
>
> whether coupons benefit the defendant more than the class members (*i.e.*, whether they create bonus sales, thereby vitiating any deterrence component of the settlement);

1. Typically low coupon redemption rates should be taken into account when valuing coupon settlements

Empirical data showing low redemption rates for cash and coupon settlements underscore the need for careful determination of the real value of the settlement. A 1986 study of all antitrust class action settlements finalized during the 1975-84 period in which coupons were used for all or partial payment to the class makes this point quite clear.[19] Redemption rates for twelve of twenty cases for which the researchers had reliable data averaged 26.3%, with rates varying considerably and some as low as 1%. *Id*.

When data on redemption rates has been reported in the context of consumer class actions, the redemption rates are considerably lower. In a case involving defective heat coils in Renault, Encore and Alliance cars made in 1983-87, counsel for defendant Chrysler reported that only 1% of the 300,000 class members in that case ever used the $400 non-transferrable coupons good for the purchase of a Chrysler car. Barry Meier, *Fistfuls of Coupons: Millions for Class-Action Lawyers, Scrip for Plaintiffs*, N. Y. TIMES, May 26, 1995, available at LEXIS, News Library, New York Times File. In *Strong v. BellSouth Telecommunications, Inc.*, 173 F.R.D.

> whether significant restrictions are placed on the sale or transfer or coupons;
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> the face value of the coupons, relative to the total cost of the product; and
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> the mode of distribution of the coupons.

http://www.ftc.gov/os/2002/02/rule23letter.pdf.

[19] Fred Gramlich, *Scrip Damages in Antitrust Cases*, 31 ANTITRUST BULL. 261, 272-74 (1986).

167, 172 (W.D. La. 1997), *aff'd* 137 F.3d 844 (5th Cir 1998), the district court, in a settlement that provided class members with the option of either continuing under a plan or canceling and obtaining a credit, declared the purported $64 million settlement a phantom when there was only a 4.3% response rate to the settlement and the credit requests actually submitted by class members only amounted to $1,718,594.40. In *Buchet v. ITT Consumer Fin. Corp.*, 845 F. Supp. 684, 694-95, *modified*, 858 F. Supp. 944 (D. Minn. 1994), the court rejected a settlement involving a discount coupon worth as much as $39 for the purchase of property insurance or related products, citing actual redemption rates ranging from 0.002% to 0.11% for similar coupons.

For these reasons, a RAND study on class actions urges judges to (1) apply heightened scrutiny when coupons comprise a substantial portion of the settlement value and (2) require estimates of the rate of coupon redemption.[20] When the data exist, courts should insist on proof of the coupons' real value through redemption rates for coupons for the same or similar products or expert testimony regarding the real value of the coupons.[21]

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[20] DEBORAH R. HENSLER, ET AL., *Class Action Dilemmas, Pursuing Public Goals for Private Gain, Executive Summary*, 32 (1999).

[21] The National Association of Consumer Advocates ("NACA") views coupon settlements with such skepticism that NACA's Guidelines on Class Actions suggest that settlements involving certificates or coupons require a minimum level of redemption by class members within a reasonable period of time.

> In the event actual redemption does not meet this minimum level, the defendant should provide alternative relief in the form of a common fund. This requirement protects against the use of a meaningless certificate settlement that has little or no impact on a defendant, and little or no compensatory value to the plaintiff class.

National Association of Consumer Advocates' Standards and Guildelines for Litigating and Settling Consumer Class Actions, 176 F.R.D. 375, 384 (1997).

2. The value of the coupon settlement to class members is very uncertain and likely far less than the face value of the coupons

a. A substantial number of class members are not likely to want the coupons offered

A substantial number of the estimated 700,000 class members will not likely benefit from this proposed settlement. First, each of the three coupons offered by H&R for each of five tax seasons is to a great extent redundant. Whether by person, software or book, all three items redeemable or discounted by coupon offer guidance on the filing of one's taxes. The likelihood that class members would use all three coupons in a single tax year is extremely remote.[22] For example, a class member who uses the software or book to prepare and file a tax return would not have any use for the tax preparation discount coupon. As a result, the value of the coupons cannot be determined by simply adding up the retail value of each as the settling parties' estimated value of the settlement suggests is appropriate.[23] Second, two of the coupons – for the tax

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[22] Apparently even H&R admitted this to be the case to the Wall Street Journal:

> The settlement, in which Block denied liability, provides, among other things, a five-year package of $20 coupons that class members can use to obtain services from Block. If every potential rebate coupon and benefit were redeemed – which Block called 'not a realistic scenario' – the value of the settlement would be $262.2 million.

Joseph T. Hallinan, *H&R Block Will Settle Suit, Take a $41.7 Million Charge*, WALL ST. J. ¶ 3 (Nov. 20, 2002) *available at* http://online, wjs.com/article/0,,SB1037713876367814068,00.html.

[23] In addition, the face value of the coupons is misleading. The time value of money requires that the coupons be discounted to net present value. Moreover, class members can currently purchase H&R's Tax Planning Advisor book for $10.47 on Amazon.com, a $4.48 discount to the suggested retail price upon which the proponents believe this settlement should be valued. *See* http://www.amazon.com.

preparation and planning software and H&R's Tax Planning Advisor – may be of little interest to these particular class members. Each member of the class contracted with H&R for personal tax preparation services. Given this fact, it would appear unlikely that many class members would choose to use either H&R's software or written tax preparation and planning materials in the future.[24] Some class members may object to doing any business with H&R again.

The coupon class members are most likely to use is the $20 rebate off future H&R tax preparation or electronic filing services, which is not transferable. This coupon would provide a real benefit to the many class members who return to H&R Block each year to purchase tax preparation services, provided they mail in the coupon and proof of purchase as instructed to receive the rebate. Perhaps not surprisingly, the biggest winner on this aspect of the settlement may be H&R. The $20 rebate coupons could serve as an effective bonus sales program for H&R.[25] *See In re GMC Pick-Up Truck Fuel Tank Prod. Liability Litig.*, 55 F.3d 768 (3d Cir.),

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[24] United States District Judge Bucklo, who recently declined to approve the proposed settlement in the national class action against H&R, described the class as being comprised of "persons who are unsophisticated, of limited education, and financially strapped, and sometimes elderly. . . . " *Reynolds*, 2003 U.S. Dist. LEXIS 6422, at *5-6. Plaintiffs in this case charged H&R with targeting poor, uneducated immigrants, many of whom did not speak English. It is highly unlikely that these class members would be interested in or have the need for the higher value computer software offered by H&R.

[25] The company may benefit immensely as a result of scrip settlements, as the coupons are effectively "soft money" that may increase product sales. Entirely apart from litigation, many companies offer coupons as a proven means of enhancing profits. In fact, H&R's press release on this proposed settlement sought to reassure investors on the real costs of the deal:

> The cost to the company of this aspect of the settlement is expected to be minimal over the five-year life of the program, due in part to the offsetting effect of additional revenues as class members return to H&R Block.

Press Release, H&R Block, *H&R Block Announces Settlement in Texas Litigation* (Nov. 19,

cert. denied, 516 U.S. 824 (1995) (holding that trial judge erred in approving a coupon settlement providing class members with $1000 coupons for the purchase of new trucks, the Third Circuit expressed concern about the low percentage value of the coupon, the restrictions on its transfer, the infrequency of purchases by most class members, conflicts among class members and the fact that the settlement would benefit GM through increased sales).[26]

b. The transferability of the coupons may have little value

Normally, transferability enhances the value of coupons, but the Court should satisfy itself that the coupons are not only deemed transferable but that they are in fact transferable as a practical matter.[27] Although the coupons for tax software (current suggested retail price of

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2002) available at www.hrblock.com/presscenter/pressreleases/pressRelease.jsp?PRESS_RELEASE_ID=1001.

[26] H&R may benefit from this settlement in other ways too. Without having to pay a penny to class members and having projected that it will incur minimal costs, H&R has obtained incredibly broad releases and other concessions, at least some of which, according to the terms of the settlement, will stand regardless of whether the settlement is approved. Through this settlement, H&R may hope to establish a low floor for the settlement of other outstanding class action cases pending in other courts. Objectors to the proposed and recently rejected settlement in the federal court national class action against H&R urged the Court of Appeals for the Seventh Circuit to reject the settlement as the product of a "reverse auction." *Reynolds*, 288 F.3d. at 282-83. In a reverse auction situation, defendants play class counsel in different jurisdictions with overlapping class actions against one another, attempting to negotiate a settlement with those who will accept the lowest amount of damages and attorneys' fees combined and to cut off the others' claims. *See* John C. Coffee, Jr., *Class Wars: The Dilemma of the Mass Tort Class Action*, 95 COLUM. L. REV. at 1370-73.

[27] *See* Note, *In-Kind Class Action Settlements*, 109 HARV. L. REV. at 824:

> In analyzing such provisions, courts generally focus on several issues: whether all class members will be able to use the scrip; whether the settlement plan erects formidable procedural hurdles to scrip use; whether the coupons are transferable; and, if so, whether a secondary market for the coupons is likely to provide an active outlet for those class members seeking to trade or sell their scrip.

$39.95) and the Tax Planning Advisor book (current suggested retail price of $14.95) here are denoted by the terms of the settlement to be transferable, whether class members actually are able to realize any value from these coupons is largely dependent on the availability of and easy access by class members to a market maker for these products. For every class member who seeks to benefit from the settlement by transferring his coupon, there must be a willing buyer who intends to redeem it. The availability of bulk or high volume purchasers will increase the number of coupons class members are able to sell and the price they will be able to get. Absent evidence that there will be a viable market for these coupons, it is difficult to assess the value of their transferability. Without a market, many class members would likely be left with worthless coupons.

c. The terms of the settlement will likely result in many coupons not being redeemed

Although the $20 coupon, the most valuable of the three, may bring class members through the door to obtain H&R services, the fact that it is a rebate, as opposed to a discount coupon, will likely lead to many class members not ultimately reaping its benefits.[28] In addition to having to pay for additional services from H&R to obtain any benefit from the settlement, class members must send in their coupon, along with proof of payment for the services obtained, to

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See also In re General Motors Corp. Pick-up Truck Fuel Tank Prod Liab. Litig., 55 F.3d at 809 (district court erred "when it presumed development of a liquid market for these transfer certificates with very little support in the record for it.")

[28] *See* Howard Millman, *Customers Tire of Excuses for Rebates That Never Arrive*, N.Y. TIMES, April 17, 2003, at G9 (According to Peter Kostner, an analyst with the Aberdeen Group, "approximately 60 percent of purchasers never get a rebate.");*see also* Jane Spencer, *Rejected: Rebates Get Harder to Collect*, WALL ST. J., June 11, 2002, at D1 ("claim rates rise with the value of the rebate, but even on electronics, redemption rates average only 40 percent, according to BDS Marketing.").

obtain their $20. This is an unnecessary procedure.

In sum, the real value of the coupons to class members is uncertain and it seems likely that the purported face value of the coupons ($262,150,000) wildly exaggerates the true value of the settlement to class members.

C. The Court Must be Able to Justify the Settlement Value When Compared to the Likely Recovery in this Case

The Texas Supreme Court has stated that, "'the strength of the plaintiff's case on the merits balanced against the amount offered' is the crucial factor in evaluating the fairness of the settlement." *Bloyed*, 916 S.W.2d at 956 (*quoting, In re General Motors Corp. Engine Interchange Litig*., 594 F.2d 1106, 1132 n. 44 (7th Cir.), *cert. denied*, 444 U.S. 870 (1979). Although this Court has made a preliminary ruling on the merits of plaintiffs' claims, it must consider, in assessing the propriety of the settlement proposed, the full range of still-possible outcomes, taking into account the prospect of appeal and the rulings of other courts on comparable claims.

By letter dated November 6, 2002, this Court requested that the parties prepare an appropriate order and judgment reflecting the Court's findings. The letter followed discovery and motions for summary judgment, and a trial date had been set. The Court's letter stated:

> I will deny Defendants' Motion for Summary Judgment, Supplemental Motion for Summary Judgment and Second Motion for Summary Judgment.
>
> I will grant Plaintiffs' Motion for Partial Summary Judgment and hold that Plaintiffs are entitled to summary judgment that Defendants owed a fiduciary duty to Plaintiffs as a matter of law and that Defendants breached that duty. On these issues I find that no factual disputes exist that must be decided by a jury. I further find that Defendants committed a clear and serious violation of duty and that forfeiture is appropriate. I further find that the misconduct occurred in each instance in which an RAL transaction occurred when Defendants failed to disclose

> the "kickback" or "license fee." I further find that such conduct was intentional, willful and deliberate. I further find that forfeiture is necessary to satisfy the public's interest in protecting the preparer-taxpayer relationship. Accordingly, I find that Defendants must forfeit all fees for 1992 - 1996, inclusive, which amount has been agreed to and stipulated by the parties. My findings are based on the summary judgment evidence presented. All Defendants' objections are overruled.

This ruling encompasses a number of distinct legal and factual propositions: that tax preparers owe clients a fiduciary duty; that the failure of a tax preparer to reveal receipt of a license fee from a refund loan lender breaches that duty; that the conduct of the defendant in the present case was intentional and willful; and that the appropriate remedy for such conduct is forfeiture of the entire fee collected by the preparer and the license fee the bank paid to H&R, rather than forfeiture of the license fee alone or a measure of the plaintiffs' actual economic loss. If all of these propositions are likely to be upheld on appeal, then the apparent value of plaintiffs' claims is substantial,[29] and the proposed coupon settlement may well be inadequate.[30]

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[29] Judge Bucklo characterized the status of this litigation as follows:

> In November, the trial judge granted summary judgment in favor of plaintiffs on the breach of fiduciary duty claim, and awarded damages in the amount of $74,900,000.

Reynolds, 2003 U.S. Dist. LEXIS 6422 at *36.

[30] In *Green v. H & R Block, Inc.*, 735 A.2d 1039 (Md. Ct. App. 1999), the Maryland Court of Appeals held that the facts alleged by the class, if proven, would establish that H&R acted as its customers' agent in preparing tax returns and that the relationship extended to the process of obtaining RALs. U.S. District Court Judge Bucklo indicated that she might reconsider the earlier assigned Judge's decision dismissing the fiduciary duty claim in the national class action case now pending before her against H&R. Significantly, Judge Bucklo points to the settlement in this litigation in support of her conclusion that proponents of the $25 million national class action settlement undervalued the breach of fiduciary duty claims. She noted:

> The value of the Texas settlement to Texas class members is unclear at this point. . . . The allocation of attorneys fees to plaintiff is not in the final settlement agreement. There appear to be two

Nevertheless, a realistic assessment of the present settlement must acknowledge that the propositions upon which this Court's preliminary ruling was based are subject to serious question. State courts in Pennsylvania, New York and Illinois, for example, have held that there was no agency relationship between H&R and its customers. *Basile v. H & R Block, Inc.*, 761 A.2d 1115 (Pa. 2000); *Carnegie v. H & R Block, Inc.*, 269 A.D.2d 145 (N.Y. 2000); *Beckett v. H & R Block, Inc.*, 714 N.E.2d 1040 (1st Dist. 1999). Moreover, even if the Texas courts were to reject such rulings and conclude that there is fiduciary duty, they may well question whether the refund of the entire amount of the fees plaintiffs paid to H&R is an appropriate remedy, or is instead an excessive windfall in light of the possibility that plaintiffs' actual economic loss (if any) may be substantially less.[31] For all these reasons, it is entirely possible that the coupon settlement adequately compensates plaintiffs for their claims, despite its likely low value.

In assessing the adequacy and propriety of the settlement, however, the Court must take into consideration all aspects of the settlement – including, of course, its provisions for attorneys' fees. In the present case, the proposed $49 million award of fees is arguably the dominant feature

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> possible scenarios: the Texas class was settled for almost $50,000,000 in attorneys' fees, with the class to receive nothing more than coupons of probably little value to at least most plaintiffs, or in fact the class - just one portion of the class in the present case - is itself to receive more than the entire settlement in the case before me but counsel are attempting to hide this fact until the present settlement is approved.

Reynolds, 2003 U.S. Dist. LEXIS 6422 at *40 n.10.

[31] We are unaware, for example, of any showing in the present case that consumers were harmed in the sense that they could have obtained loans in anticipation of their tax refunds under more favorable terms, had H&R not received license fees from lenders. Moreover, it is possible that the appellate courts would disallow damages in excess of the amount of the license fee, which would cut the amount of any possible award substantially.

of the settlement package, comprising the *only* cash relief being provided to anyone. As discussed further below, this fee award is not only excessive, but shows that the entire settlement taken as a whole cannot be justified, regardless of how one values the plaintiffs' claims.

D. Class Counsel's Fee Request is Excessive Given the Likely Low Value of the Settlement and Calls Into Question the Adequacy of Counsel's Representation

1. Class counsel's fee request is excessive when viewed as a percentage of the likely real value of the settlement; it also must be tested against the lodestar method of fee calculation

Generally, there are two methods for calculating fees in class actions in Texas: the percentage of recovery method and the lodestar method,[32] which calculates fees by multiplying the number of hours expended by an appropriate hourly rate determined by a variety of factors, including the benefits obtained for the class, the complexity of the issues presented, the expertise of counsel, the preclusion of other legal work due to acceptance of the class action suit, and the hourly rate customarily charged in the area for similar legal work. *See Johnson v. Georgia Highway Express, Inc.*, 488 F.2d 714, 717-19 (5th Cir. 1974). The notice sent to class members regarding the proposed settlement asserts that class counsel will seek approval of their $49 million fee request pursuant to the percentage of recovery method and that their fee constitutes only 18% of the benefits obtained by the class.[33] This percentage calculation is premised on the full face

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[32] *Bloyed*, 916 S.W.2d at 960-01.

[33] In *Shaw v. Toshiba Am. Info. Sys., Inc.*, 91 F. Supp. 2d 924, 972 (E.D. Tex. 2000), the United States District Court for the Eastern District of Texas noted that based on opinions of other courts and available studies of class actions attorneys' fee awards, under the percentage of recovery common fund approach, attorneys' fees routinely range from 25% to 33.34%.

value of the coupons class counsel garnered on behalf of the class, many of which will likely never be redeemed or monetized. In the event the Court decides to use the percentage of recovery method of fee calculation, the analysis must be premised on the real value of the settlement and not the face value of the coupons provided. The Court must make a reasonable assessment of the settlement's true value and determine the precise percentage represented by the attorneys' fees.[34]

The Texas Supreme Court, moreover, has noted that when, as here, the court is presented with a non-monetary settlement and the attorney fees are calculated based on a percentage of the recovery for the class, the fee request must also be tested against the lodestar method to insure that the award is not grossly excessive:

> Regardless of the method by which attorney's fees are calculated, the terms of the nonmonetary settlement in this case raise additional concerns about the conflicting interests of class counsel and class members, because the value of the settlement can only be roughly estimated. . . . At a minimum, we think that on remand any

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[34] A number of courts have held back large portions of fee requests or denied them altogether where the fee request was based on a percentage of recovery and the actual value of the settlement was uncertain. *See, e.g.*, *Bussie v. Allmerica Fin. Corp.* 1999 U.S. Dist. LEXIS 7793 *9-10 (D. Mass. 1999)(staging fee award, preserving the right to adjust the award in light of actual experience under the settlement); *Duhaime v. John Hancock Mut. Life. Ins. Co.*, 989 F. Supp. 375, 379-80 (D. Mass. 1997)(staging fee award); *Strong v. BellSouth Telecommunications, Inc.*, 173 F.R.D. at 172 (denying fee petition because actual value of settlement fund based on credits claimed by class members was approximately $2 million, as opposed to class counsel's prior estimate of $64.5 million); *Bowling v. Pfizer, Inc.*, 922 F. Supp. 1261, 1283-84 (S.D. Ohio), *aff'd*, 102 F.3d 777 (6th Cir. 1996) (holding back large portion of fee award until additional "future" benefits to class were actually paid into class fund); *Voege v. Ackerman*, 67 F.R.D. 432, 436-37 (S.D.N.Y. 1975)(reserving fee determination until all claims of shareholders entitled to participate had been filed and determined since settlement's benefits to class could not be determined with any certainty beforehand); NACA Guidelines, 176 F.R.D. at 399 (in cases involving certificates and no minimum settlement level, class counsel should not request a percentage fee "until such time as the court can accurately assess the actual value of the settlement (i.e., after the deadline for class member claims [or] after the certificates expire).").

> fee awarded on a percentage basis should be tested against the lodestar approach to prevent grossly excessive attorney's fee awards and to minimize the inherent conflict between class counsel and the class members.

Bloyed, 916 S.W.2d at 961.

The Commission urges the Court to require that class counsel file their fee petition, including any argument and factual information to support their fees under the lodestar method, sufficiently in advance of the deadline for class members to object. At present, based on the likely low value of the coupon settlement presented here, there is no basis upon which to conclude class counsel's fee is anything but excessive.

2. The amount of the fee request when compared to the likely low settlement value to class members suggests the settlement may not have been the product of arms-length negotiation

The Texas Supreme Court has stated that, "the potential conflict between absent class members and class counsel is one of the serious problems with class action settlements." *Bloyed*, 916 S.W.2d at 957. As stated by the United States Court of Appeals for the Third Circuit in *In re GMC Pick-Up Truck Fuel Tank Prod. Liability Litig.*, 55 F.3d at 801-02:

> Beyond their ethical obligations to their clients, class attorneys, purporting to represent a class, also owe the entire class a fiduciary duty once the class complaint is filed. [citations omitted]. The large fees garnered by some class lawyers can create the impression of an ethical violation since it may appear that the lawyer has an economic stake in their clients' case. . . . Economic models have shown how conventional methods of calculating class action fee awards give class counsel incentives to act earlier than their clients would deem optimal. See Coffee, Understanding the Plaintiff's Attorney, 86 COLUM. L. REV. at 688. . . . Coffee also blames the principal-agent problem endemic to class actions for creating a situation where the defendants and plaintiffs can collusively settle litigation in a manner that is adverse to the class's interest: "At its worst, the settlement process may amount to a covert exchange of a cheap settlement for a high award of attorney's fees. Although courts have long recognized this danger and have developed some procedural safeguards intended to prevent collusive settlements, these reforms are far from adequate to the task." Id. at 714 n.121 (citing cases).

> A number of commentators have identified settlements that afford only nonpecuniary relief to the class as prime suspects of these cheap settlements. See Coffee, Understanding the Plaintiff's Attorney, 86 COLUM. L. REV. at 716 n.129; JONATHAN R. MACEY & GEOFFREY P. MILLER, The Plaintiffs' attorney Role in Class Action and Derivative Litigation: Economic Analysis and Recommendations for Reform, 58 U. CHI. L. REV.1, 45 n.10 (1991); Nancy Morawetz, Bargaining, Class Representation, and Fairness, 54 OHIO ST. L. J., 5 n.40 (1993).

The agreement by H&R to pay class counsel up to $49 million in attorneys fees,[35] and up to an additional $900,000 in costs, in the face of this uncertain but likely low value coupon settlement for class members raises questions about whether the settlement was the result of collusion.[36]

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[35] H&R did not even reserve the right to object to the fee application. *See Duhaime v. John Hancock Mut. Life Ins. Co*., 989 F. Supp. at 376-77 (wherein court noted that "clear-sailing" fee arrangements where the party paying the fee agrees not to contest the amount to be awarded by the court so long as the award falls below a negotiated ceiling are subject to close judicial scrutiny because "there is a danger 'lawyers might urge a class settlement at a low figure or on less-than-optimal basis in exchange for red-carpet treatment on fees.'" (citations omitted)).

[36] As noted in Note, *In-Kind Class Action Settlements*, 109 HARV. L. REV. at 817-18:

> Commentators often question whether class action counsel have colluded with a defendant and thereby deprived the plaintiff class of value. Many fear that class attorneys will accept a suspect in-kind settlement in exchange for the defendant's commitment, implicit or explicit, to pay higher attorney's fees. The use of scrip only heightens this fear. Particularly if a defendant believes that the class members ultimately will not redeem a large amount of the issued scrip, the defendant may be willing to settle for a high face value in certificates, along with a correspondingly high cash fee to the plaintiffs' attorneys, secure in the expectation that, in the end, the defendant will pay only the fee plus some nominal amount. With respect to scrip settlements, as the General Motors court noted, there can be the "sense that counsel may have pursued a deal with the defendants separate from, and perhaps competing for the defendant's resources with, the deal negotiated on behalf of the class."

(footnotes omitted).

This Court should scrutinize this settlement to determine whether the deal was negotiated at arms length and consider whether class counsel provided adequate representation.

3. The excessive amount of the fee award shows that the settlement as a whole is improper and contrary to the public interest

The ultimate question for the Court's consideration is whether the proposed settlement is "fundamentally fair, adequate, and reasonable." *Bloyed v. General Motors Corp.*, 881 S.W.2d 422, 428 (Tex.App.- Texarkana 1994), *aff'd*, 916 S.W.2d 949 (Tex. 1996). In the present case, the proposed combination of coupon relief to plaintiffs and excessive award of fees to class counsel shows that the proposed settlement fails to meet this test, *regardless* of how one assesses the merits of plaintiffs' claim. The settlement is manifestly against the public interest, and should be rejected.

As discussed above, the merits of plaintiffs' claims are subject to serious debate, as the range of legal rulings to date from various courts reflects. One need not arrive at a firm assessment of those claims, however, to conclude that the present settlement is fundamentally flawed. That is because its flaws are apparent, whether plaintiffs' claims are meritorious or not. If one assumes, in keeping with this Court's preliminary ruling, that plaintiffs have a strong claim for relief that includes a refund of the entire amount of the fees that they paid to H&R, then the proposed relief to plaintiffs is inadequate for the reasons stated above. In the face of such inadequate relief, the proposed fee award is plainly excessive in relationship to the value of the coupons, and unjustified in light of the poor result achieved.

If, on the other hand, one assumes that a realistic value of plaintiffs' claims is substantially lower, then the settlement is also flawed, albeit for somewhat different reasons. Under this

assumption, it is entirely possible that the likely modest value of the coupon package being offered to plaintiffs here is a reasonable reflection of the value of plaintiffs' claims, discounted for all uncertainties. If that is the case, however, then the amount of the attorney fees is even more unreasonable. A case of modest claims and modest recovery cannot justify the payment of $49 million in legal fees. While the uncertainties of litigation may make this a plausible business decision for H&R, such an excessive fee award is inimical to the public interest. Whether the burden of such a large and unwarranted fee award is borne by H&R shareholders or future H&R customers, it constitutes a substantial economic loss that cannot be justified by any substantive results achieved in this litigation.

4. Class counsel's offer to divert a portion of their fees to the class raises concerns that warrant the Court's scrutiny

Class counsel's proposition to the Court that if it approves their fee petition in full, they will agree to pay approximately $26 million of their fees to their clients raises even more questions that should be examined. This "after the fact" attempt to increase the value of the settlement, no matter how well intended, is not part of the settlement and does not constitute consideration paid by Defendants for the rights the class has relinquished. The amount of fees volunteered by class counsel to be diverted to their clients was not the result of arms-length bargaining between adversaries regarding the value of the plaintiffs' claim.

The proposal presents other difficulties as well. Putting aside whether it is prudent for the Court to approve contractual arrangements between class counsel and their clients, it is not clear

that its order would be enforceable.[37] Class counsel have not offered to pay $26 million or any other amount to the class in the event the Court approves fees in an amount greater than $26 million but less than $49 million. In addition, in light of the likely low value of the coupon settlement, it appears that even with a payment of $26 million to the class, a fee in the amount of $23 million to class counsel may be excessive.[38]

E. Suggestions for Reformation of the Settlement if the Court Concludes that its Findings Would Likely be Upheld on Appeal

The Commission recognizes that this Court is not empowered to remake the parties agreement, *Evans v. Jeff D.*, 475 U.S. 717, 726-27 (1986), but it can reject the present agreement and suggest what changes would be necessary for approval. *See Id.* at 726; *Bowling v. Pfizer*, 143 F.R.D. 138 (S.D. Ohio 1992)(court suggested changes later incorporated in *Bowling v. Pfizer*, 143 F.R.D. 141 (S.D. Ohio 1992)). We urge the Court to do so.

Urging the parties to commit to a fixed payment amount, paid on a *pro rata* basis or

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[37] Plaintiffs' counsel's motion for permission to pay a portion of their fees to the class in essence seeks an advisory opinion from the Court. The Court's ruling on such a motion in no way relates to any justiciable claim pending before this Court. Accordingly, even if the Court were to enter an order requiring plaintiffs' counsel to pay fees to the class, it is not clear that it would be enforceable.

[38] Under this proposal, class counsel would retain $23 million in fees ($49 million less the $26 million to be diverted to the class). Assuming that one were willing to award class counsel fees in the amount of $23 million, based on one-third the total amount of a $69 million settlement, a settlement providing $26 million in cash would also need to provide coupons with an actual value of $43 million. In this case, the $20 rebate coupons, for reasons explained earlier, are the ones most likely to be of interest to the class members. These coupons have a face value of $70 million ($20 for each of 5 years for 700,000 class members). To have an actual value of $43 million, 61 percent of the $20 rebate coupons would have to be redeemed. This is a very unlikely scenario in light of typical coupon and rebate redemption (as noted earlier, in one study of coupon settlements the redemption rate averaged 26.3%, with rates varying considerably and some as low as 1%).

through a supplementary *cy pres* payout after all responding class members have been compensated would bring certitude to the value of the settlement to the class. Payment of attorneys' fees out of the common fund obtained on behalf of class members would insure that the amount of attorneys fees paid as a percentage of the recovery is discernible, and hopefully reasonable, and that any monies not paid to counsel in fees remains in the hands of class members.

Finally, in the event the Court approves this coupon settlement or any settlement with a coupon component, we urge the Court to require that counsel for the parties submit detailed information about the number and percentage of coupons redeemed, the rate of redemption, and the number of coupons transferred during the life of the coupons. This data, which is of great interest to courts, legislators, various government enforcement agencies, legal scholars and the community at large, will assist all in assessing the efficacy of nonpecuniary coupon settlements. The Commission recognizes that class counsel have devoted years to litigating this case. Nevertheless, in light of the uncertainty of the true value of this proposed coupon settlement, if nonetheless approved, we urge the Court to adopt the approach taken by others and stage class counsel's fees so that their ultimate compensation is tied to and reflective of the actual benefit received by the class members under the settlement. Tracking actual redemption experience, of course, would be critical to implementing this approach to fee approval, as well.

IV. CONCLUSION

The Court should not approve the settlement and the attorney fees. If the claims of the class have a high value, then the coupon settlement of uncertain and likely low value is inadequate. If the claims of the class have a low value, the coupon settlement may be adequate. In either

event, however, the proposed $49 million in attorney fees is excessive.

Dated: June 4, 2003

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