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Sixth Circuit Rejects Class Settlement Over Excessive Payments to Class Counsel and Named Plaintiffs

The federal courts of appeals continue to scrutinize class-action settlements closely when the direct benefits to class members are overshadowed by the attorneys' fees that flow to plaintiffs' counsel. The most recent example is *Greenberg v. Procter & Gamble Co.* (pdf), No. 11-4156 (6th Cir. Aug. 2, 2013). In its decision, the Sixth Circuit provided guidance to practitioners regarding the fee awards and incentive payments to named plaintiffs.

The decision arises from a case involving Pampers "Dry Max" diapers. According to the court, in May 2010, "the Consumer Product Safety Commission began investigating whether Dry Max diapers tend to cause severe diaper rash." On the heels of the CPSC's announcement of its investigation, plaintiffs filed a dozen lawsuits against Procter & Gamble (which manufactures Pampers brand diapers); those cases were consolidated before a federal judge in Ohio.

Within a few months after the filing of the lawsuits, the CPSC "found ***no connection*** between the use of Dry Max diapers and diaper rash" after a review of thousands of incident reports. (Emphasis added). Although that would seem to present an enormous problem for the plaintiffs' lawsuit, their intrepid lawyers did not drop the case.

Faced with the prospect of continuing litigation, the parties negotiated a settlement under Rule 23(b)(2), which applies when plaintiffs primarily seek injunctive or other equitable relief, and does not authorize class members to opt out of the settlement. The settlement called for the company to make changes to its diaper box labeling and its web site, to reinstate an earlier program allowing customers to seek a refund with proof of purchase, and to make charitable donations of about $400,000. The agreement did not provide for money damages to absent class members. The settlement provided that the named plaintiffs (who are parents) would receive $1,000 per affected child, and that class counsel would receive $2.73 million in attorneys' fees. The district court approved the settlement over the objection of some class members.

The Sixth Circuit reversed by a 2-1 vote. The court began by making the general point that class-action settlements are special:

> Class-action settlements are different from other settlements. . . . [They] affect not only the interests of the parties and counsel who negotiate them, but also the interests of unnamed class members who by definition are not present during the negotiations. And thus there is always the danger that the parties and counsel will bargain away the interests of unnamed class members in order to maximize their own.

The court noted that one concern with class settlements is that "the adversarial process . . . extends only to the amount the defendant will pay, not the manner in which that amount is allocated between the class representatives, class

counsel, and unnamed class members." And, the court explained, because defendants have no economic incentive to worry about that allocation, "the law relies upon the 'fiduciary obligation[s]' of the class representatives and, especially, class counsel, to protect those interests."

The Sixth Circuit held that those obligations had not been satisfied in this case. The court contrasted the "medley of injunctive relief" afforded to "unnamed class members under the settlement" with the handsome proposed fee award to class counsel of "$2.73 million—this, in a case where counsel did not take a single deposition, serve a single request for written discovery, or even file a response to P&G's motion to dismiss." The court considered the refund program to be "negligible," chiefly because most class members "have already had access to it" when the company previously had offered the equivalent program. And the court characterized the proposed labeling and web-site disclosures as providing largely "common sense" information to consumers—making those disclosures "of limited value to them." The court clearly viewed the proposed attorneys' fees award to be outsized in comparison to what it termed the "illusory" benefits to absent class members: "one fact . . . is concrete and indisputable: $2.73 million is $2.73 million." Because "this settlement gives 'preferential treatment' to class counsel 'while only perfunctory relief to unnamed class members,'" the court held that the settlement is "not fair" as required by Rule 23(e).

The Sixth Circuit also held that the district court abused its discretion in certifying the class for settlement purposes because "the named plaintiffs are inadequate representatives of the class under Rule 23(a)(4)." The court held that, in "consider[ing] the alignment of interests and incentives" between the named plaintiffs and absent class members, the fact that the named plaintiffs would "receive an award of $1000 per child" (the incentive payments) while the class members "receive nothing but illusory injunctive relief" created a "conflict" that eliminated the interest of the named plaintiffs "'in vigorously prosecuting'" claims on behalf of the absent class members. The court rejected class counsel's argument that "incentive awards are common in class litigation." While declining "to lay down a categorical rule one way or the other as to whether incentive payments are permissible," the court suggested a sliding scale for assessing such payments:

The propriety of incentive payments is arguably at its height when the award represents a fraction of a class representative's likely damages; for in that case the class representative is left to recover the remainder of his damages by means of the same mechanisms that unnamed class members must recover theirs. The members' incentives are thus aligned. But we should be most dubious of incentive payments when they make the class representatives whole, or (as here) even more than whole; for in that case the class representatives have no reason to care whether the mechanisms available to unnamed class members can provide adequate relief.

The decision in *Greenberg* is a significant one for class-action practitioners—both on the plaintiffs' and on the defense side. From my perspective, there are several key takeaways:

First, it is hard to criticize defendants for seeking closure when facing the high costs of defending a class action—especially when the lawsuit lacks merit. Any class action that survives the pleading stage brings with it the asymmetrical costs of discovery (especially e-discovery): The documents that named plaintiffs typically turn over in a class action often fit in a manila folder, while defendants routinely must preserve, review, and sometimes disclose hundreds of thousands—if not millions—of e-mails, documents, and the like, often costing millions of dollars (win or lose). And the attorneys' fees that defendants must pay also add up. It is not surprising that companies—which are thought of as rational economic

actors—are often willing to settle whenever the anticipated settlement costs are less than the often-enormous costs of defense.

Second, plaintiffs' counsel should recognize that the federal courts are scrutinizing class settlements more closely, and thus should consider less "ambitious" attorneys' fees awards. For example, I do not know how much time the plaintiffs' attorneys expended in this case, but it is clear that the Sixth Circuit did not believe that they had put in $2.73 million worth of time (or that if they had, such an amount of effort would be reasonable). Perhaps a smaller request for attorneys' fees—or one that was more closely tied to the value of the settlement to class members—would not have drawn an objection, or at least would not have triggered the concerns that animated the panel majority.

Third, class counsel should give up on cases that aren't going anywhere on the merits. The dissenting opinion in Greenberg highlights the issue. As Judge Cole put it, "[a]lthough the relief offered to the unnamed class members may not be worth much, their claims appear to be worth even less. Nobody disputes that the class's claims in this case had ***little to no merit***. In the absence of this settlement, class members would almost certainly have gotten nothing." (Emphasis added). Judge Cole's point appears to be that when a plaintiff presents weak (or even entirely meritless) claims, courts should have no problem approving low-value settlements. But the better question is: Why should we want claims of minimal (or no) merit to be brought at all?

Fourth, the court's discussion of incentive awards for named plaintiffs is perhaps the most novel aspect of the decision. As the opinion recognizes—and as all class-action practitioners know—it is routine to provide named plaintiffs in class-action settlements with incentive awards that are usually much greater than what a class member will recover from a settlement or than what would fully compensate the plaintiff for his or her claims. *Greenberg* questions the prevalence of incentive awards with a colorful metaphor: "to the extent that incentive awards are common, they are like dandelions on an unmowed lawn—present more by inattention than by design." While I think the majority makes good points about the lack of alignment of incentives between the class representatives and absent class members, the roots of that problem have little to do with incentive payments and much more to do with how most class actions are brought. In reality, class actions frequently originate in the minds of plaintiffs' lawyers themselves; they identify the claims first and the claimants second. (Sometimes they do not have to look that far: We have seen many cases where the named plaintiff is a relative, law partner, or employee of the class counsel.) When (as is common) named plaintiffs are not clients in the typical sense, they are unlikely to do an adequate job supervising their lawyers. If named plaintiffs actually fulfilled that role, a greater incentive payment might be justified. On the other hand, I find it hard to agree with Judge Cole's concern in dissent that, when "claims are worth very little . . ., even a recovery in the full amount may not be enough to induce anyone to serve as a named plaintiff." Again, my reaction is that if extraordinary inducements are needed to convince someone to play the part of a named plaintiff, perhaps the lawsuit is not worth bringing.

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