

A MARKET-BASED APPROACH TO COUPON SETTLEMENTS IN ANTITRUST AND CONSUMER CLASS ACTION LITIGATION

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Most litigation settles and class action litigation is no exception. A greater number of class action cases are being settled with coupon-based settlements in which a defendant eliminates its legal liability by paying the class members in coupons. Professor Leslie demonstrates how defendants structure settlement coupons to resemble promotional coupons, making the settlement worthless for many (and sometimes most) class members. Defendants impose restrictions on transferability, duration, aggregation, and redemption that serve the defendants' interests at the expense of the class members.

Agency cost theory explains why class counsel permit defendants to impose restrictions that significantly reduce the value of settlement coupons to the class: Because class counsel are paid in cash, the attorneys have insufficient interest in ensuring that the settlement coupons confer value on the class. Judges, too, provide insufficient protection for the class, generally approving coupon settlements even when the coupons are laden with value-reducing restrictions. As a result, class members can fall victim to collusive coupon-based settlements in which the defendant essentially pays the class counsel to accept worthless coupons for the class.

Properly structured settlement coupons could confer value, but plaintiffs' attorneys currently have insufficient incentive to negotiate beneficial coupon terms. Professor Leslie argues that the agency cost problem could be solved if judges required that class counsel be paid in the same currency as the class. Thus, if the class counsel negotiate a coupon-based settlement, then the attorneys should receive their contingency fee in settlement coupons, for example, 25 percent of the coupons. Only then will class counsel have sufficient incentive to insure that the settlement coupons provide real value to the class members. After analyzing several potential solutions, Professor Leslie concludes that requiring a common currency in payments to class and counsel is the most efficient way to protect class members from collusive settlements.

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INTRODUCTION

Innovation is the wellspring of competition. Successful sellers can innovate either with respect to product design or marketing. The C.W. Post Co. developed the most significant marketing innovation of the nineteenth century when it issued the nation's first coupon in 1895.¹ Since then, firms have used coupons to advertise, to attract new customers, and to generate additional sales. By the late twentieth century, American business—ever innovative—found a new, more lucrative function for coupons: wiping out hundreds of millions of dollars of potential legal liability. In an effort to facilitate settlements in class action litigation, business defendants and class counsel have structured settlements so that defendants eliminate their legal liability in exchange for issuing coupons to class members redeemable for savings on a subsequent purchase of the defendants' goods or services. Such a coupon-based settlement exists whenever a defendant pays the plaintiff class members, in whole or in part, with coupons as opposed to cash. In contrast to the class members, however, the class counsel are paid in cash.² This Article demonstrates how class action defendants structure settlement coupons to undermine the coupons' value to class members, explains why class counsel and trial judges allow defendants to issue overly restrictive settlement coupons, and proposes some innovative solutions to the problems created by coupon-based settlements.

Class action litigation is supposed to protect members of society by allowing them to aggregate claims that are too small to litigate individually. The class action device insures access to courts for all Americans so that even people with small injuries can receive due compensation. Class action litigation

1. See RUSSELL BOWMAN, COUPONING AND REBATES 2 (1980) (discussing the one-cent coupon for Grape Nuts Cereal).

2. See, e.g., *Ohio Pub. Interest Campaign v. Fisher Foods, Inc.*, 546 F. Supp. 1, 5 (N.D. Ohio 1982). In many coupon-based settlements, the defendant's cash outlays go exclusively to the class counsel. See, e.g., *Hanrahan v. Britt*, 174 F.R.D. 356, 360 (E.D. Pa. 1997); Sandra Nelson, *The Illinois Real Estate "Designated Agency Amendment": A Minefield for Brokers*, 27 J. MARSHALL L. REV. 953, 974 n.142 (1994) (discussing coupon settlement under which "the only actual money payment would be \$2.5 million to plaintiffs' attorneys").

should serve the public good, both by compensating individual class members and by disgorging ill-gotten gains from defendants. Unfortunately, the class action vehicle has been hijacked in many lawsuits. Defendants take advantage of the class action rules to eliminate future lawsuits while providing little, or no, meaningful compensation to the class members. Coupon-based settlements illustrate how defendants have structured class action settlements to maximize the gains for the corporate defendant while minimizing any compensation to the class. Indeed, given the restrictions imposed on settlement coupons, in some cases a coupon-based settlement may actually increase a defendant's net profits.

Coupon-based settlements take many forms. Such settlements go by several names: in-kind settlements, scrip settlements, and coupon settlements. Some class action settlements are paid exclusively in coupons, while others combine cash and coupons.³ Settlement coupons may resemble traditional promotional coupons, housing vouchers,⁴ or discount contracts.⁵ Settlement coupons are sometimes structured as an absolute dollar discount, or as a percentage off of the retail price.⁶ In some cases, class members receive coupons that may be redeemed for an amount of cash set lower than the face value of the coupon.⁷

The increasing popularity of coupon settlements is reflected in the escalating dollar value of settlements with a coupon component. From the mid-1970s to the mid-1980s, defendants issued almost \$200 million in settlement coupons.⁸ This aggregate value for early coupon-based settlements has since been bettered by some *individual* class action settlements, most notably the use of \$405 million in coupons to settle a major price-fixing suit against the airline industry.⁹

3. See, e.g., *In re Nat'l Media Corp. Sec. Litig.*, No. 90-7574, 1992 U.S. Dist. LEXIS 16589 (E.D. Pa. Sept. 15, 1992); *Plemister v. Harcourt Brace Jovanovich, Inc.*, 1984-2 Trade Cas. (CCH) ¶ 66,234 (N.D. Ill. Sept. 24, 1984); Emily Nelson, *Bausch Vows to Disburse Up to \$68 Million to Settle Lawsuit*, WALL ST. J., Aug. 2, 1996, at B10 (discussing the Bausch & Lomb class action settlement in which the company agreed to pay up to \$68 million to eligible consumers through cash and coupons).

4. See, e.g., *Davis v. N.Y. City Hous. Auth.*, 90 Civ. 0628 (PNL), 92 Civ. 4873 (PNL), 1992 U.S. Dist. LEXIS 19965 (S.D.N.Y. Dec. 30, 1992).

5. See generally Severin Borenstein, *Settling for Coupons: Discount Contracts as Compensation and Punishment in Antitrust Lawsuits*, 39 J.L. & ECON. 379 (1996).

6. See *id.* at 379; Fred Gramlich, *Scrip Damages in Antitrust Cases*, 31 ANTITRUST BULL. 261, 272-74 (1986) (discussing twenty scrip settlements between 1976 and 1986).

7. See Gramlich, *supra* note 6, at 273.

8. See *id.* at 262.

9. See *In re Domestic Air Transp. Antitrust Litig.*, 148 F.R.D. 297 (N.D. Ga. 1993). The court in *Domestic Air* approved the use of a coupon-based settlement which included \$50 million in cash and "discount travel certificates with a face value of \$408 million." *Id.* at 305; see also *Shaw v. Toshiba Am. Info. Sys., Inc.*, 91 F. Supp. 2d 942, 946 (E.D. Tex. 2000) (including settlement coupons with an aggregate face value over \$2 billion).

Coupon-based settlements most commonly appear in antitrust and consumer class actions. Within these categories, parties have turned to coupon-based settlements to resolve a wide range of disputes. For example, coupon-based settlements have been employed in antitrust class actions involving price-discrimination,¹⁰ price-fixing,¹¹ and other allegedly anti-competitive arrangements. State attorneys have used coupons to settle antitrust cases based on an alleged conspiracy to terminate double coupons.¹² Coupons have also provided the essential currency to settle a vast variety of consumer class actions.¹³ Coupon settlements appear to be increasing in popularity.¹⁴

Despite their rising popularity, coupon-based settlements have received scant academic attention.¹⁵ This is surprising given the clear potential for misuse—and cases of actual abuse—of the coupon instrument. Although coupon-based settlements may at first appear to be a reasonable mechanism to compensate class members, coupons are in fact often worthless despite their deceptively high face value. In many cases, the coupons are laden with restrictions intended to make redemption difficult. Class counsel do not prevent these value-reducing restrictions in settlement coupons because the attorneys are paid in cash, while judges usually focus on the face value of the coupons, not the restrictions on their use. Indeed, a coupon settlement may sometimes facilitate or indicate collusion between the class action defendant and the class counsel. In many cases, the class counsel appear to sell out the interests of the class in exchange for relatively generous attorneys' fees. While this represents a win-win scenario for the class counsel and the defendant, many class members are left uncompensated.

10. See, e.g., *Roberts v. Bausch & Lomb, Inc.*, No. CV-94-C-1144-W (N.D. Ala. Nov. 26, 1996).

11. See *In re Cuisinart Food Processor Antitrust Litig.*, 1983-2 Trade Cas. (CCH) ¶ 65,680 (D. Conn. Oct. 24, 1983) (involving resale price maintenance); *In re Ohio Pub. Interest Campaign v. Fisher Foods, Inc.*, 546 F. Supp. 1, 2 (N.D. Ohio 1982); *In re Montgomery County Real Estate Antitrust Litig.*, 83 F.R.D. 305 (D. Md. 1979) (involving conspiracy to fix real estate broker commission rates).

12. See *Connecticut ex rel. Lieberman v. Stop & Shop Cos.*, 1989-2 Trade Cas. (CCH) ¶ 67,796 (D. Conn. July 19, 1988); *Massachusetts v. First Nat'l Supermarkets*, 116 F.R.D. 357 (D. Mass. 1987).

13. See, e.g., *Shaw*, 91 F. Supp. 2d at 945 (addressing defective floppy-diskette controllers).

14. See John C. Coffee, Jr., *Rescuing the Private Attorney General: Why the Model of the Lawyer as Bounty Hunter Is Not Working*, 42 MD. L. REV. 215, 246 (1983) ("The future of nonpecuniary settlements seems depressingly bright.").

15. See Note, *In-Kind Class Action Settlements*, 109 HARV. L. REV. 810, 811 (1996). Two excellent studies have analyzed settlement coupons in antitrust cases. See Borenstein, *supra* note 5; Gramlich, *supra* note 6. Other impressive scholarship has discussed coupon settlements in the context of examining class actions overall, see, e.g., DEBORAH R. HENSLER ET AL., *CLASS ACTION DILEMMAS* 27, 488, 545 (2000), or nonpecuniary settlements, see Geoffrey P. Miller & Lori S. Singer, *Nonpecuniary Class Action Settlements*, LAW & CONTEMP. PROBS., Autumn 1997, at 97.

Part I of this Article examines the characteristics of traditional promotional coupons. Companies use promotional coupons to introduce new products and to attempt to increase product sales by decreasing the purchase price for those consumers who redeem coupons. These coupons create the risk that consumers who would have bought the product without the coupon will redeem it, which would decrease the manufacturer's profit on a sale that would have been made anyway. To offset that risk, sellers impose transferability restrictions and expiration dates in order to increase the likelihood that the coupon will induce new sales and not merely subsidize sales that would have occurred without a coupon.

Part II discusses why defendants in class action litigation pursue coupon settlements. Part II begins by presenting the different possible outcomes under a coupon settlement. Corporate defendants and class members have opposing preferences among these outcomes. However, because corporate defendants have great latitude in structuring the terms of settlement coupons, they design settlement coupons to increase the probability of achieving their preferred outcomes, which are disfavored by the class members. Defendants do so by imposing transferability restrictions, short expiration dates, aggregation restrictions, and product restrictions, among other limitations. In addition to the problems flowing from restrictive terms, coupon settlements raise serious concerns: Class members may feel compelled to purchase a product from a defendant-wrongdoer; defendants may be able to undermine any settlement value by increasing product price or decreasing product quality; and such settlements may facilitate price discrimination. Finally, coupon settlements neither adequately compensate most class members nor deter future misconduct by defendants. In most cases, coupons are not punishment; they are promotional. Settlement coupons are the economic equivalent of a court-supervised promotional campaign.

Part III asks why, given these problems with coupon settlements, class counsel negotiate such settlements. The answer lies in the nature of agency costs. Although the class counsel is supposed to represent the class's interests and be compensated based on how well it does so, coupon settlements decouple the interests of the class and its counsel. When the class is paid in coupons, the attorneys can increase their compensation in attorneys' fees unrelated to any corresponding increase in the class recovery. Indeed, money to the class may deplete the defendant's available funds to pay the class counsel. In agreeing to allow the defendant to compensate the class with coupons, the class counsel may free up money for attorneys' fees. Rational defendants may be willing to pay more in attorneys' fees in exchange for giving the class scrip and eliminating liability. Finally, because actual coupon value is difficult for courts to calculate, coupon settlements afford class counsel an opportunity to con-

vince a reviewing judge that the settlement is more valuable than it actually is, and thereby increase the attorneys' fees awarded.

Part IV explains why, despite the fact that coupon settlements often fail to compensate class members adequately, judges routinely approve proposed coupon settlements. Federal and state rules require that any settlement of a class action lawsuit must be approved by a judge in order to be effective. Judges have a duty to investigate any proposed coupon settlements and to insure that the coupons actually provide value to the class. However, the true worth of a coupon is less than its face value; this prevents judges from determining whether the proposed settlement coupons confer actual benefits on the class. Judges rarely press the issue given the systemic pressure to approve settlements, the common deference to class counsel, and the difficulty of determining the actual value of settlement coupons.

Finally, Part V discusses four options that courts can consider to solve the problems caused by coupon settlements: ban coupon settlements, restructure settlement coupons, impose or encourage minimum redemption rates, and require that class counsel be paid in the same currency as the class. This last option means that when the class counsel negotiates a coupon settlement, the counsel should receive its fees in coupons as well. An examination of secondary markets demonstrates the wisdom of this approach. The best way to insure that settlement coupons have value is the creation of a competitive market for settlement coupons in which class members can sell their settlement coupons. While it would be unduly burdensome to have a court establish and monitor any such coupon market, judges can create proper incentives for class counsel to insure that settlement coupons are marketable by requiring that class counsel be paid in the same currency as class members. Requiring a "common currency" solves the agency cost problem by re-aligning the interests of the class and counsel; thus, the class counsel's own rational self-interest will motivate it to negotiate either a cash-based settlement or, in the event of a coupon settlement, marketable coupons that actually confer value on the class.

I. PROMOTIONAL COUPONS

Comprehending the dynamics of settlement coupons requires a thorough understanding of their immediate ancestor, promotional coupons. From orange juice to automobiles,¹⁶ manufacturers issue coupons that give consumers discounts ranging from a few cents to thousands of dollars in savings.¹⁷

16. Coupons have been issued for almost every product and service imaginable.

17. See Richard Turcsik, *True Value*, BRANDMARKETING, May 1999, at 45 (noting that one car dealership ran a newspaper ad with a \$2000 coupon).

American firms spend over \$6.5 billion each year on coupon promotions.¹⁸ Coupons are now the dominant method of promoting many products.¹⁹ The reason is simple: Coupons increase sales.²⁰

Coupons induce purchases for three related reasons. First, coupons have significant advertising value.²¹ They inform and remind consumers of a product's availability.²² The presence of a coupon increases the likelihood that a consumer will read an advertisement, maximizing the ad's promotional value.²³ Thus, even for those consumers who do not use coupons, manufacturers extract value from couponing.²⁴

Second, coupons decrease the price of a product, which basic micro-economic theory holds will increase consumption. In theory, each consumer has a reservation price, a price that she will not pay more than in order to purchase a given product. If a product's shelf price is greater than a consumer's reservation price, then she will not buy the product. Coupons represent a targeted mechanism for manipulating these relative prices, making the purchase price lower than the consumer's reservation price.²⁵ In addition to the actual decrease in price, coupons provide a psychological incentive to purchase a product because consumers perceive they are getting "a deal."²⁶ The reduction in

18. See Aradhna Krishna & Z. John Zhang, *Short- or Long-Duration Coupons: The Effect of the Expiration Date on the Profitability of Coupon Promotions*, 45 MGMT. SCI. 1041, 1041 (1999).

19. See Janet Poshtar, *Coupons Cut a Bigger Future*, MARKETING WK., Sept. 27, 1996, at 24-25 ("Coupons can be one of the most successful ways of promoting products, as they lead the consumer to make a choice before arriving at the store."); Turcsik, *supra* note 17, at 45; see also BOWMAN, *supra* note 1, at 7 (cataloging the growth of coupons as a percentage of advertising promotions); *id.* at 15-16 (documenting coupon growth in absolute numbers).

20. See Uri Ben-Zion et al., *The Optimal Face Value of a Discount Coupon*, 51 J. ECON. & BUS. 159, 159 (1999); Scott A. Neslin, *A Market Response Model for Coupon Promotions*, 9 MARKETING SCI. 125, 127 (1990).

21. See Robert P. Leone & Srini S. Srinivasan, *Coupon Face Value: Its Impact on Coupon Redemptions, Brand Sales, and Brand Profitability*, 72 J. RETAILING 273, 274 (1996).

22. See Ronald W. Ward & James E. Davis, *A Pooled Cross-Section Time Series Model of Coupon Promotions*, 60 AM. J. AGRIC. ECON. 393, 394 (1978) ("The informational value should yield additional increases in consumption primarily because the coupon is a tangible reminder of the availability of a particular product, i.e., the informational effect.").

23. See BOWMAN, *supra* note 1, at 66-68; *id.* at 137 ("[S]tudies have shown coupons tend to pull higher readership for a print advertisement.").

24. See generally Leone & Srinivasan, *supra* note 21.

25. See Robert M. Schindler, *A Coupon Is More Than a Low Price: Evidence from a Shopping-Simulation Study*, 9 PSYCHOL. & MARKETING 431, 432 (1992) (noting that a price promotion's effectiveness is a function of "creating in consumers' minds the perception that the promotional price is below their internal reference price"). Similarly, a price decrease may induce current customers to purchase a product in greater quantities. See DON E. SCHULTZ ET AL., SALES PROMOTION ESSENTIALS: THE 10 BASIC SALES PROMOTION TECHNIQUES . . . AND HOW TO USE THEM 58 (1993) ("Coupons may, in some cases, encourage consumers to purchase a larger size of the product than they might ordinarily.").

26. SCHULTZ ET AL., *supra* note 25, at 37 ("Unlike regular price cuts, coupons may make consumers feel that they are getting a good deal on a particular product, thereby causing them to

price and the informational value of coupons often work in tandem to induce consumers to increase consumption.²⁷

Third, in addition to creating short-term sales, coupons can cause consumers to switch brand loyalty. Manufacturers issue coupons to lure customers away from rival firms.²⁸ If the coupon can get consumers to break their purchasing habits in the short-term, this will make consumers more likely to sample competing brands in the future.²⁹ Coupons may induce consumers to try a new product,³⁰ some of whom may purchase it later at full price.³¹ Ideally, coupons can encourage noncurrent users to become repeat purchasers and, perhaps, even loyal customers.³²

Although it may seem that a manufacturer could increase sales simply by decreasing the sales price of its product, couponing boasts several significant advantages over a blanket reduction in price. First, coupons serve as a mechanism for price discrimination.³³ Unlike a general price reduction, a coupon can only be used once, and only by those consumers who affirmatively act upon the coupon.³⁴ Manufacturers would prefer that wealthy and willing consumers continue to pay full price; fortunately for these businesses, "many of the loyal full-price customers will not make use of the coupon because of the high costs of time, storage and effort involved."³⁵ Second, consumers know that the price decrease with a coupon is temporary.³⁶ This encourages consumers to buy the manufacturer's product quickly while the price is depressed. It also protects against protests of raising prices; the expiration of a coupon merely

increase consumption."); see also Schindler, *supra* note 25, at 433 ("[A]dvertised discount offers that explicitly state 'regular' prices have been found to create larger perceived discounts than similar advertised discount offers that do not explicitly state the product's regular price.").

27. See Ward & Davis, *supra* note 22, at 398.

28. See Joshua Levine, *Stealing the Right Shoppers*, FORBES, July 10, 1989, at 104.

29. See SCHULTZ ET AL., *supra* note 25, at 59.

30. See Schindler, *supra* note 25, at 440 (citing R.C. BLATTBERG & S.A. NESLIN, SALES PROMOTION: CONCEPTS, METHODS, AND STRATEGIES 268-69 (1990)).

31. See SCHULTZ ET AL., *supra* note 25, at 37.

32. See John W. Keon & Judy Bayer, *An Expert Approach to Sales Promotion Management*, J. ADVERTISING RES., June-July 1986, at 19.

33. See *infra* Part II.C.3.

34. Although some research indicates that temporary cuts can also function as price discrimination, see, e.g., Abel P. Jeuland & Chakravarthi Narasimhan, *Dealing—Temporary Price Cuts—by Seller as a Buyer Discrimination Mechanism*, 58 J. BUS. 295 (1985), conventional wisdom holds that couponing is a more effective price discrimination mechanism.

35. Ben-Zion et al., *supra* note 20, at 164. Although coupons have both promotional value and price discriminating characteristics, some scholars argue that the price discrimination effect of couponing contributes more to the profit-maximizing potential of coupons than the promotional effects. See, e.g., J. William Levedahl, *Profit Maximizing Pricing of Cents Off Coupons: Promotion or Price Discrimination?*, 25 Q.J. BUS. & ECON. 56 (1986).

36. See Poshtar, *supra* note 19, at 24-25 ("Coupons . . . are recognised by consumers as a short-term offer.").

restores the status quo ante and appears less like a price hike. Third, other manufacturers also recognize the temporary nature of the price reduction and, thus, couponing is less likely to start a price war.³⁷ Fourth, a temporary price decrease through couponing does not damage the product's brand image—making it appear “down market”—as would a general reduction in shelf price.³⁸ Furthermore, coupons also prevent a retailer from pocketing a promotional price discount. Research indicates that retailers sometimes pass along only one-third to one-half of a manufacturer's promotional price discounts to consumers as lower prices.³⁹ Because the price discount is given directly to the consumer, coupons essentially bypass the retailer and insure that the full price discount is given to the consumer.⁴⁰ In sum, couponing can be the cornerstone of a successful marketing scheme.⁴¹

Despite their popularity and apparent wide success, coupon programs create the risk that a consumer will use a coupon to purchase a product for which she would otherwise have paid the full, undiscounted price.⁴² Some studies estimate that between 50 and 60 percent of coupon sales would have occurred without the coupon;⁴³ others estimate the number to be as high as 80 percent.⁴⁴

In response to this risk, manufacturers try to structure coupons so as to induce new sales (particularly to new customers) and not merely to reduce the price on sales to loyal customers. Firms impose two primary restrictions on their coupons. First, most coupons are nontransferable.⁴⁵ Firms try to target

37. See *id.* (“Coupons have an important advantage over other forms of promotions. Cutting the price of a product on the supermarket shelf can lead to a price war with other brands, which can lead to a spiral of falling prices, without any player gaining an increase in market share.”).

38. See *id.* (“[A] price reduction can be offered through coupons without damaging the product's brand values.”).

39. See Levedahl, *supra* note 35, at 69.

40. See *id.*

41. See Neslin, *supra* note 20, at 125 (“[T]here are many potential marketing objectives that can be served by coupons. These range from pre-empting a competitive new product, to attracting new triers, to acting as a price discrimination device.”); Poshtar, *supra* note 19, at 24–25.

42. See SCHULTZ ET AL., *supra* note 25, at 61 (“The most commonly cited problem in couponing is that discounts large enough to convince competitive users to try the brand are likely to be used to an even greater extent by loyalists who very well might have purchased the brand anyway.”). Large couponing programs can also require significant expenditures. The costs of coupon marketing include advertising costs, drop costs, and the administrative costs of dealing with and reimbursing retailers.

43. See Neslin, *supra* note 20, at 127 (citing Scott A. Neslin & Robert W. Shoemaker, *A Model for Evaluating the Profitability of Coupon Promotions*, 2 *MARKETING SCI.* 361 (1983)).

44. See Levine, *supra* note 28, at 104 (noting that some observers estimate that as many as 80 percent of coupons are redeemed in purchases that would have taken place without the coupon); see also Neslin, *supra* note 20, at 141 (“[L]oyal users were disproportionately attracted by the coupon.”).

45. Indeed, this is sufficiently common that in determining the optimal coupon face value, studies impose a constraint that coupons not be transferable. See, e.g., Ben-Zion et al., *supra* note 20, at 163.

coupon distributions to potential new customers,⁴⁶ and manufacturers limit the number of coupons per customer in order to prevent stockpiling by loyal customers who would otherwise purchase the product at full price.⁴⁷

Second, most coupons have expiration dates. Research reveals two trends regarding coupon expiration. First, more manufacturers are imposing expiration dates on their coupons. In 1987, of the billions of coupons issued, over one-quarter had no expiration date.⁴⁸ Four years later, over 99 percent of coupons were constrained by an expiration date.⁴⁹ To be precise, only 0.6 percent of currently issued coupons are unburdened by an expiration date.⁵⁰ Second, consumers have witnessed a steady constriction of coupon expiration periods. Redemption periods are getting shorter as expiration dates inch closer to the drop dates for many coupons,⁵¹ and trend analysis suggests a continuing contraction of the time period in which consumers may redeem coupons.⁵²

Manufacturers have reduced expiration periods based on the belief that shorter expiration periods attract new users.⁵³ Coupon redemption patterns show that expiration dates do indeed induce new sales. Consumers tend to redeem promotional coupons most during the initial period after the coupons are distributed.⁵⁴ Coupon redemption declines after a spike following the initial drop date.⁵⁵ Older economic and marketing models on coupon profitability assumed no expiration date and predicted coupon redemption becoming

46. See *id.* at 161 (noting that a goal in structuring coupons is to not give them to loyal customers).

47. See *id.* at 159.

48. See J. Jeffrey Inman & Leigh McAlister, *Do Coupon Expiration Dates Affect Consumer Behavior?*, 31 J. MARKETING RES. 423, 423 (1994).

49. See *id.* (citing Paul Martin, *Coupon Expiration Accelerates*, ADWEEK'S MARKETING WK., Nov. 1994, at 31).

50. See Krishna & Zhang, *supra* note 18, at 1050 (citing NCH data); see also SCHULTZ ET AL., *supra* note 25, at 57 (noting that the trend is greater imposition of expiration dates).

51. See Turcsik, *supra* note 17, at 45 ("[F]rom 1994 to 1998, expiration periods have decreased by more than 35 percent and, therefore, consumers have lost more than one-third of the time they had to redeem coupons.").

52. See also SCHULTZ ET AL., *supra* note 25, at 57 (noting that the trend is toward shorter expiration dates: "23 percent of all coupons distributed in 1985 had short expiration dates (less than three months), versus more than 43 percent in 1988").

53. See Krishna & Zhang, *supra* note 18, at 1041 ("Promotion 'experts' routinely advise their corporate clients to employ short-duration coupons for faster sales and long-duration coupons for higher total sales."); cf. Turcsik, *supra* note 17, at 45 (citing an expert who believes that this is a false assumption). Shorter redemption periods may also help marketing managers plan and evaluate their promotional activities. See SCHULTZ ET AL., *supra* note 25, at 58.

54. See BOWMAN, *supra* note 1 (arguing that coupon redemption starts off strong and declines monotonically thereafter); see also Ronald W. Ward & James E. Davis, *Coupon Redemption*, J. ADVERTISING RES., Aug. 1978, at 51 (arguing that empirically, "a calculation of the rate of redemption over time indicates that the maximum rate can be expected during the second month following the initial [coupon] drop").

55. See Inman & McAlister, *supra* note 48, at 423; Leone & Srinivasan, *supra* note 21, at 279.

essentially asymptotic in the long run.⁵⁶ But an expiration date can change this and force a spike of induced purchases immediately before a coupon expires.⁵⁷ Because these are induced purchases, manufacturers do not lose money on sales that would have taken place without the coupon.

Two related theories explain why expiration dates induce sales. First, an expiration date intuitively imposes time pressure on the consumer and forces a purchasing decision. This time pressure can be an effective weapon in competitive marketing campaigns.⁵⁸ Many sales are induced that would not have taken place absent the expiration date.⁵⁹

Second, according to regret theory, many consumers will redeem a coupon, not because of an informed calculus that compares their reservation price to the post-coupon price, but rather because consumers anticipate that they will feel regret if they forego an opportunity for the one-time discount.⁶⁰ Economists Jeffrey Inman and Leigh McAlister explain:

If consumers anticipate their feelings of regret in having missed an expired coupon's savings, the immediacy of anticipatory regret should increase as the coupon's expiration date draws closer, because after the coupon expires redemption no longer can be postponed to a subsequent period. Hence, when a coupon's expiration date approaches, consumers may become increasingly likely to redeem the coupon.⁶¹

Many consumers perceive the expiration of a coupon as a loss.⁶² As the expiration date approaches, the fear of incurring a perceived loss

56. See Ward & Davis, *supra* note 54, at 56.

57. See Inman & McAlister, *supra* note 48, at 426 ("Interestingly, even brands whose coupons are valid for a long period of time seem to experience an expiration date 'bump.'"). Heavy coupon users are particularly likely to redeem coupons as the expiration dates approach. See *id.* at 427 ("Interestingly, results of a binomial logit analysis suggest that heavier users of coupons are significantly more likely to redeem a coupon that is about to expire and to be bothered by allowing a coupon to expire unused.").

58. See Krishna & Zhang, *supra* note 18, at 1050.

59. See SCHULTZ ET AL., *supra* note 25, at 58 ("Limiting the amount of time during which coupons can be redeemed appears to make it more likely that people who redeem the coupons will be those who do not already buy the product, and who may continue to purchase it in the future even without the coupon.").

This strategy is particularly effective for firms with already high market share. See Krishna & Zhang, *supra* note 18, at 1042 ("[I]t is more profitable for large-share firms to offer short-duration coupons . . ."). As discussed later in this Article, most defendants in consumer and antitrust class actions that are settled with coupons appear to be well-established, high market-share firms, the type of businesses that benefit from short duration periods on their coupons.

60. For a general discussion of the role of anticipated regret in consumer decision-making, see Itamar Simonson, *The Influence of Anticipating Regret and Responsibility on Purchase Decisions*, 19 J. CONSUMER RES. 105 (1992). Itamar Simonson writes that "[c]onsumers can often anticipate how they would feel if their decisions yielded negative or less positive outcomes. The anticipated regret and responsibility can be incorporated into the evaluation of alternatives and influence the choices made." *Id.* at 1105.

61. Inman & McAlister, *supra* note 48, at 424.

62. See *id.*

increases.⁶³ In order to avoid that loss, such consumers will make a purchase with that about-to-expire coupon even though they would not have bought the product at that time absent the coupon. In short, manufacturers invest significant effort in establishing an expiration date that will induce purchases that would not otherwise occur.

Along with determination of the profit-maximizing expiration date, coupon issuers must set the face value.⁶⁴ The optimal coupon value is a function of consumer reservation prices.⁶⁵ Depending on reservation prices, shelf prices, and coupon values, some consumers will only purchase a product with a coupon. Manufacturers attempt to divine the coupon face value that will induce new sales while minimizing the expected loss from coupon redemption by loyal customers.⁶⁶ The manufacturer must set the face value of the coupon so as to bring the purchase price below the consumers' reservation price.⁶⁷ If a coupon has a low face value, then consumers have little incentive to redeem it.⁶⁸ A higher face value increases the redemption rate.⁶⁹ However, manufacturers care less about overall redemption rates than the profit impact of a couponing scheme. If the coupon's face value is too high, couponing may simultaneously increase a manufacturer's market share while decreasing its profitability.⁷⁰

63. See *id.* at 425 ("Per regret theory, as the expiration approaches, the potential loss of not redeeming the coupon increases.").

64. See Ben-Zion et al., *supra* note 20, at 162 ("The prime decision variable of a marketer administering couponing policy is the optimal coupon value.").

65. See *supra* note 25 and accompanying text.

66. See Ben-Zion et al., *supra* note 20, at 167 ("A marketer who is considering a high discount and who has a larger customer share of loyal customers may find that the potential gain from new customers may be lower than the decline in revenue from old customers. Thus, he chooses a lower face value for the coupon.").

67. Robert M. Schindler notes,

There have also been a number of analyses of purchase data that have provided evidence that a price decrease that puts a product's price below the consumer's internal reference price will lead to a greater sales increase than a price decrease that does not result in the price being below the consumer's internal reference price.

Schindler, *supra* note 25, at 433 (citing studies).

68. See Leone & Srinivasan, *supra* note 21, at 278. However, manufacturers can still achieve the informational value of coupons with low-value coupons. See Ward & Davis, *supra* note 22, at 399 ("[T]he couponer uses the larger value of coupons as a price-cutting device, because most of the informational effect could have been achieved with a smaller total value of coupons.").

69. See Neslin, *supra* note 20, at 133; see also BOWMAN, *supra* note 1, at 51-52.

70. See SCHULTZ ET AL., *supra* note 25, at 61 ("Marketers who are using high-value coupons to prompt trial by new users generally need to resign themselves to sacrificing profits (or, at best, breaking even), due to redemptions by current customers who would have purchased the brand anyway."); Sanjay K. Dhar et al., *The Effect of Package Coupons on Brand Choice: An Epilogue on Profits*, 15 *MARKETING SCI.* 192, 196 (1996); Leone & Srinivasan, *supra* note 21, at 274 ("If only consumers who would have bought the promoted brand anyway redeem coupons, then coupon redemptions would always result in lower profitability."); Neslin, *supra* note 20, at 141 ("The tentative conclusion is thus that while

In sum, manufacturers utilize coupons to increase product sales. To do so effectively, issuers manipulate coupon expiration dates and face values in order to induce new sales and not merely reward loyal customers. As Part II explains, businesses use these lessons from promotional coupons in order to convert class action lawsuits into profit-maximizing opportunities.

II. WHY DEFENDANTS PURSUE COUPON-BASED SETTLEMENTS

Defendants have driven the trend toward coupon-based settlements in class actions. In general, many defendants highly value class action settlements that eliminate liability to all potential plaintiffs in one action.⁷¹ However, different goals may motivate defendants to pursue a coupon settlement. Some defendants may plead insufficient cash flow to pay a traditional cash-based settlement.⁷² Other defendants may pursue coupon-based settlements to realize potential tax benefits.⁷³ However, the overriding motive behind coupon settlements is that defendants can minimize any monetary payment to the class while, theoretically, in some cases actually making out better off financially than if there had been no litigation.⁷⁴ In sum, all potential outcomes of a coupon settlement are better than a cash-based settlement for the settling defendant.

A. The Potential Outcomes of Coupon-Based Settlements

Broadly speaking, when defendants pay class members in coupons, there are two possible outcomes for each issued coupon: Either a class member will use the coupon or she will not. Although the options (and consequently the payoffs for both a class member and the defendant) appear binary, the nature of the transaction in which the coupon is used significantly affects the ultimate pay-offs for both the class and the defendant. Breaking down the different scenarios for coupon use, four possible outcomes exist for each coupon: Non-Use

coupons seem to have a pronounced effect on the market share, the effect may not necessarily be large enough for couponing to be profitable.”); Ward & Davis, *supra* note 22, at 400.

71. See Richard B. Schmitt, *The Deal Makers: Some Firms Embrace the Widely Dreaded Class-Action Lawsuit*, WALL ST. J., July 18, 1996, at A1.

72. For example, in *Domestic Air*, “[f]rom the beginning of the negotiations, the airline defendants made clear that they did not have significant amounts of cash to pay in settlement and would discuss compromise only if the majority of the settlement fund consisted of travel certificates.” *In re Domestic Air Transp. Antitrust Litig.*, 148 F.R.D. 297, 310 (N.D. Ga. 1993).

73. See Gramlich, *supra* note 6, at 263. Fred Gramlich estimates that tax consequences represented the purpose for coupon-based settlements in 40 percent of the cases he reviewed. See *id.* at 264; see also *id.* at 276 (noting that defendants pursued coupon-based settlements in eight out of the twenty cases he analyzed based on their desire to avoid taxes).

74. See *infra* notes 245–256 and accompanying text.

Outcome; Induced-Purchase Outcome; Non-Induced-Purchase Outcome; and Transferred-Use Outcome.

1. Non-Use Outcome

First, the plaintiff might not use the coupon for any purpose (Non-Use Outcome). This can occur because the class member loses or forgets about the coupon,⁷⁵ has no need to purchase the product,⁷⁶ or chooses not to purchase that product from the defendant.⁷⁷ For example, a class member may simply wish to cease doing business with the company against whom the class litigation was brought.⁷⁸ Alternatively, the coupon may expire before the individual has the opportunity to redeem it.⁷⁹ In less typical cases, governmental regulations may preclude class members—such as purchasers who are units of a state government—from redeeming their settlement coupons.⁸⁰

If the class member does not use the coupon, she loses. The individual class member who receives only a coupon and who does not use that coupon receives absolutely no value from the settlement.⁸¹ From the class member's perspective, it is the equivalent of losing the class action litigation outright.

For the defendant, each Non-Use Outcome constitutes a win because the defendant pays nothing to that class member. Each member of the class who declines (or forgets) to use her coupon constitutes an individual whom the defendant does not have to compensate and, yet—because the settlement has res judicata effect—the class member is precluded from suing the defendant directly to remedy the underlying wrong. Taken to an extreme, if few class members redeem their coupons, then the defendant can eliminate

75. See, e.g., *Domestic Air*, 148 F.R.D. at 322 (“Some recipients of the certificates will forget about them or misplace the certificates and other class members will order the coupon and not redeem it during the redemption period.”).

76. This risk exists in the case of durable goods for which the coupon expires before the plaintiff has need for a replacement durable good. See *infra* notes 140–142 and accompanying text.

77. See *Dunk v. Ford Motor Co.*, 56 Cal. Rptr. 2d 483 (Ct. App. 1996). For example, in one coupon-based settlement, the special master concluded that the settlement coupons issued by Toyota had “real value” because 36 percent of Toyota owners exhibited “repurchase loyalty.” *Livingston v. Toyota Motor Sales USA, Inc.*, No. C-94-1377, No. C-94-1359, No. C-94-1960, 1995 U.S. Dist. LEXIS 21757, at *34 (N.D. Cal. May 30, 1995). However, this statistic would counsel against a finding of coupon value but for the fact that the settlement coupons were transferable.

78. See *Clement v. Am. Honda Fin. Corp.*, 176 F.R.D. 15, 27 (D. Conn. 1997).

79. See *infra* notes 134–142 and accompanying text.

80. See Brian Wolfman & Alan B. Morrison, *Representing the Unrepresented in Class Actions Seeking Monetary Relief*, 71 N.Y.U. L. REV. 439, 475 (1996) (discussing proposed and rejected settlement coupons in *In re General Motors Corp. Pickup Truck Fuel Tank Products Liability Litigation*, 846 F. Supp. 330, 340–41 (E.D. Pa. 1993), *rev'd*, 55 F.3d 768 (3d Cir. 1995)).

81. This assumes that the settlement includes no relevant injunctive relief.

liability without providing any settlement compensation to the majority of class members.

2. Induced-Purchase Outcome

Second, the class member can use the coupon for a purchase that she would not have made if she had not received the settlement coupon. If the consumer would not have purchased the defendant's product but for her possession of the settlement coupon, then the coupon has induced the class member to make the purchase (Induced-Purchase Outcome). This can occur because the coupon reduces the product's price below the consumer's reservation price (as a promotional coupon does)⁸² or simply because the consumer wants to avoid the Non-Use Outcome, under which she receives nothing.

From the class member's perspective, this can be characterized as either a win or a loss, depending on what motivates the purchase. It is a win for the class member to the extent that she voluntarily uses the coupon, and under traditional economic models she would not use a coupon to make a transaction that did not benefit her.⁸³ However, it can be characterized as a loss to the extent that the class member is induced to use a coupon to make a purchase that she may not truly want. This can happen because a class member fears she might later regret her decision not to redeem the settlement coupon,⁸⁴ or because a class member ignores transactions costs⁸⁵ and feels that she will receive no vindication in the class action litigation unless she uses the coupon.⁸⁶ Class members may be more likely to use their coupon out of ill-conceived spite; after all, if they do not redeem the

82. See *supra* note 25 and accompanying text. A settlement coupon induces a purchase when two conditions are satisfied. First, the shelf price (SP) is greater than the reservation price (RP): $SP > RP$. Second, the sum of the shelf price plus the transaction costs of acquiring and redeeming the coupon (TC) minus the coupon's face value (CFV) is less than the consumer's reservation price: $(SP + TC - CFV) < RP$.

83. The settlement coupon may bring the product's purchase below the class member's reservation price and therefore induce a sale that the consumer values. See *supra* note 25 and accompanying text. If the product's shelf price were already below the class member's reservation price, then the transaction is better characterized as a Non-Induced-Purchase Outcome. See *infra* Part II.A.3.

84. See *supra* notes 60–63 and accompanying text (discussing regret theory).

85. For example, a class member intent on redeeming the settlement coupon that she has "earned" may not take into account the cost of obtaining the coupon from the defendant or of making a trip to a seller that she otherwise would not.

86. See *In re Gen. Motors Corp. Pick-up Truck Fuel Tank Prods. Liab. Litig.*, 55 F.3d 768, 808 (3d Cir. 1995) (stating that some class members may use settlement coupons because they feel beholden to use them).

coupon, they get nothing from the litigation. This pressure is exacerbated by expiration dates that force the plaintiff to use the coupon or lose it.⁸⁷

In contrast, each Induced-Purchase Outcome is clearly a win for the defendant because it gets a sale that it would not have earned otherwise. Although the defendant receives a lower profit on purchases made with the coupon than on sales made at full price, the defendant sets the face value of the coupon at a level less than its marginal profit. Because the marginal profit on every sale made with a settlement coupon is still net positive,⁸⁸ every Induced-Purchase Outcome increases the defendant's overall profits.⁸⁹ This is precisely the calculation that firms make when issuing promotional coupons.⁹⁰ In short, this presents a scenario that is a solid win for the defendant and a debatable outcome for the class member.

3. Non-Induced-Purchase Outcome

Third, the class member may use the coupon for a purchase that she would have made anyway, even without the coupon (Non-Induced-Purchase Outcome). In most class action litigation, a consumer becomes a member of the class because she has purchased the defendant's product or service, usually during a defined window of time. Most class members probably have some continuing demand for the defendant's product.⁹¹ Assuming that the consumer does, in fact, demand the product irrespective of the availability of discounts, the coupon does not cause the consumer to buy the defendant's product. Any purchase with the coupon would represent a Non-Induced-Purchase Outcome.

In this scenario the class member wins and, in essence, receives a settlement worth the face value of the coupon. Because the consumer would have paid full price for the product, any discount off of the shelf price is the equivalent of giving the consumer a negotiable instrument that can be redeemed for cash.⁹²

87. See *supra* notes 48–63 and accompanying text.

88. See *supra* notes 64–70 and accompanying text; see also *General Motors*, 55 F.3d at 808.

89. See *infra* notes 244–245 and accompanying text.

90. See *supra* notes 64–70 and accompanying text.

91. This hypothesis is most reasonable for perishable or nondurable goods that consumers repeatedly purchase over time. Cf. *infra* notes 140–142 and accompanying text (discussing settlement coupons for durable goods).

92. For example, if a consumer is going to purchase a product for \$20, the rational consumer should be indifferent as to whether the manufacturer takes \$2 off the price by letting the consumer redeem a coupon or the manufacturer charges full price while giving the consumer \$2 in cash to settle class action litigation. This assumes the absence of other available discounts. See *infra* note 143 and accompanying text. Also, if there is a sales tax and the coupon transaction is

In contrast to the first two scenarios, each Non-Induced-Purchase Outcome represents a loss to the defendant. The defendant is making a sale at a discount that would have been made at full price but for the settlement coupon.⁹³ The defendant is still making a marginal profit on each sale.⁹⁴ Nevertheless, because the sale would have occurred even absent the settlement coupon, the defendant essentially loses money on each Non-Induced-Purchase Outcome since the defendant would have made more money on the transaction if the buyer had not redeemed a coupon.

4. Transferred-Use Outcome

Fourth, the class member can sell or otherwise transfer her coupon to a third party who redeems the coupon when purchasing the defendant's product (Transferred-Use Outcome). For example, a consumer planning to purchase a pick-up truck would rationally pay \$800 for a coupon to save \$1000 off the purchase price.⁹⁵

This scenario represents a win for the class member. The member gets a sum of money, which she negotiates with a third party, and this represents her monetary gain from the settlement.⁹⁶ If settlement coupons are fully transferable, then each class member can sell her coupon for whatever the market will bear. The market-clearing price will be less than the face value of the coupon, but represents a payment to the class member nonetheless.⁹⁷

Defendants generally disfavor the Transferred-Use Outcome because most transferred coupons will be used in Non-Induced Purchases.⁹⁸ Anyone in the market to purchase a settlement coupon for a given product is likely to purchase the product absent the coupon. When settlement coupons are sold on a market, they will not appreciably increase the demand for the product but will merely be used to offset the cost for purchases that would

taxed at net price, the class member would prefer the coupon option over the cash option. But this is quibbling.

93. This assumes that no other discounts—unrelated to the class action litigation—are available.

94. As with promotional coupons, rational defendants will impose a coupon face value that is less than the profit margin on each individual sale.

95. This assumes that the coupon is still valid after the transfer and that the transaction costs to acquire the coupon are less than \$200.

96. Minus her own transaction costs to facilitate the transfer.

97. See *infra* Part V.B.

98. However, some could be Induced Purchases because the coupon—which is sold at a discount from its face value—can lower the overall cost for some marginal consumers and thus be the equivalent of a demand-increasing price reduction.

happen otherwise.⁹⁹ However, under certain conditions, a transferred use can represent an induced purchase.¹⁰⁰ A transferable settlement coupon could increase demand when the cost of the coupon plus transactions costs are less than retail price, such that the consumer sees a meaningful price reduction. In other words, if the face value of the coupon is sufficiently greater than the purchase price of the settlement coupon, then some consumers may be induced to purchase the defendant's product. In the end though, the reason why the transferee is purchasing the settlement coupon is because the transferee would presumably have purchased the defendant's product without the settlement coupon in hand.¹⁰¹

B. Ordering the Outcomes

Each of the four possible outcomes for a settlement coupon affects the class members and defendants differently. Each group has its own utility function. If either group were left to its own devices, it would structure the settlement coupons so as to maximize the likelihood of different outcomes occurring. This part discusses the relative rankings of each of the four outcomes for the class and the defendant, respectively.

1. Class Preferences

Assuming that the parties settle a class action with coupons,¹⁰² from an individual class member's perspective the best outcome is the Non-Induced-Purchase Outcome. In such a case, the coupon's face value reflects its actual value to its holder. A class member should prefer a Non-Induced-Purchase Outcome over an Induced-Purchase Outcome.¹⁰³ Whether a coupon is used

99. In contrast, if the coupons are not transferable, they may be sufficient to increase demand at the margin in some cases and thereby increase output. See Gramlich, *supra* note 6, at 267–68.

100. A Transferred Use represents an Induced Purchase if two conditions are satisfied. First, the shelf price (SP) is greater than the reservation price (RP): $SP > RP$. Second, the sum of the shelf price plus the price of the settlement coupon (P_c) plus the transaction costs of acquiring and redeeming the coupon (TC) minus the coupon's face value (CFV) is less than the consumer's reservation price: $(SP + P_c - CFV + TC) < RP$.

101. Assuming an equal distribution of reservation prices between coupon holders and non-holders, the transferred coupons are less likely to be used in an Induced Purchase because non-class members are not seeing the price reduction as class members because the former must bear the additional cost of purchasing the settlement coupon.

102. This assumption is made explicitly because the class members' preferred outcome would normally be a cash payment.

103. In general, consumers receive greater value from a Non-Induced Purchase than an Induced Purchase. When used for a Non-Induced Purchase, the class member receives compensation that is equivalent to the coupon's face value. However, when used for an Induced Purchase, the value of the coupon will vary within the range of greater than zero and

for an Induced or Non-Induced Purchase helps determine the actual value of the coupon to the class member.¹⁰⁴ If the consumer would have purchased the product without the coupon, then she receives a higher utility from the coupon than if the purchase were induced by the coupon.¹⁰⁵

Although the class member receives some cash under the Transferred-Use Outcome, the typical class member prefers the Non-Induced-Purchase Outcome. Under a Non-Induced-Purchase Outcome, a class member would purchase the product without the coupon and, thus, the face value of coupon approximates the actual value of the coupon for that consumer. As a result, if a consumer is set to purchase the defendant's product at full price, then a \$20 coupon is worth \$20 to the consumer. In contrast, if the class member sells the settlement coupon, he presumably must do so at a discount from the face value.¹⁰⁶ Thus, the Non-Induced-Purchase Outcome confers greater value on the class member than the Transferred-Use Outcome.

The Transferred-Use Outcome is arguably preferable to the Induced-Purchase Outcome. The Transferred-Use Outcome does not require the

less than the coupon's face value. The actual value will be a function of each class member's individual reservation price. For example, if a product's noncoupon price (that is, its shelf price) were \$100 and a settlement coupon had a face value of \$10, then a class member with a reservation price of \$91 would receive \$1 in value. Without the coupon, she would not purchase the product because its shelf price is greater than her reservation price. With the coupon, she purchases for \$90 a product that she values at \$91, and thus achieves a surplus of \$1. In contrast, that same coupon would confer \$9 of value on the consumer with a reservation price of \$99 because she valued the product at \$99 but only had to pay \$90. This example demonstrates that the higher an individual's reservation price, the greater the value that that consumer receives from using the coupon for an Induced Purchase. However, if the class member's reservation price were greater than the noncoupon price of the product, then the transaction in which the coupon is redeemed should be characterized as a Non-Induced Purchase.

104. In evaluating a proposed coupon settlement, one court noted that "the true value of the certificates to the class depends on when the certificates will be used, how they will be used, and who will be using them." *In re Domestic Air Transp. Antitrust Litig.*, 148 F.R.D. 297, 322 (N.D. Ga. 1993).

105. If the coupon induced the sale, then the consumer has a lower reservation price. Consumers with a higher reservation price will necessarily receive greater surplus from a coupon because someone willing to pay full price who uses a coupon receives additional surplus equal to the full amount of the coupon's face value. The additional surplus is equal to shelf price minus price after coupon. (Total surplus on the sale is reservation price minus price after coupon.) In contrast, a consumer who is induced by the coupon to make the purchase necessarily was not willing to pay the full price. The additional surplus for this consumer is reservation price (which is less than shelf price) minus price after coupon. Thus, consumers using settlement coupons to make Non-Induced Purchases receive more surplus than class members using the same coupons for an Induced Purchase.

106. Given the transaction costs of acquiring and redeeming the coupon, it is unlikely that another consumer would purchase the settlement coupon at its face value. Even absent transactions costs, it seems unlikely that someone would pay \$20 for a \$20 coupon. The purchaser gains nothing from the transaction. It is possible that a friend or family member may purchase the ticket, which could decrease the transactions costs significantly.

class member to make any additional purchase, especially of a product that the consumer would not otherwise buy. If the coupon is transferable, the class member has options: she can redeem the coupon herself or sell it to someone else who will redeem it.¹⁰⁷ Because transferability creates options, a class member should prefer transferable coupons, whether or not she ultimately sells her coupon. The consumer would not transfer the coupon unless she maximized her utility by transferring the coupon as opposed to using it herself or letting it expire.

The Non-Use Outcome is the class member's least preferred outcome because if a class member does not redeem her coupon, she receives nothing.¹⁰⁸ All of the other outcomes are better for the coupon holder than Non-Use. Another option could be worse only if it entailed a net loss to a class member.¹⁰⁹

These rankings of class members' preferences for the outcome of their settlement coupon are summarized in Figure 1:

	Non-Use Outcome	Induced-Purchase Outcome	Non-Induced-Purchase Outcome	Transferred-Use Outcome
Class Members' Rankings (1 being best)	4	3	1	2

Figure 1

2. Defendant's Preferences

Not surprisingly, a class action defendant would rank the four possible outcomes for any given coupon differently than would the average class member. Whereas a class member prefers the Non-Induced-Purchase

107. If the settlement coupon is transferable, one can presumably gage an individual's preferences by seeing whether she redeems or sells the coupons.

108. An argument can be constructed that a Non-Use Outcome is better than an Induced-Purchase Outcome if the class member makes a purchase—lest the settlement coupon expires—and ultimately regrets the purchase. However, rational choice theory suggests if the consumer uses the coupon, then she values the Induced Purchase greater than Non-Use. But Non-Use can be the result of nondecision, such as losing or forgetting about the settlement coupon. The Non-Use Outcome may be the natural result of no decision being made at all. In contrast, the consumer cannot absentmindedly use the coupon. Thus, while the Induced Purchase is a function of deliberate decision-making, many versions of Non-Use are not.

109. Some class action settlements have sometimes created a net loss for class members. See, e.g., *Kamilewicz v. Bank of Boston Corp.*, 100 F.3d 1348 (7th Cir. 1996) (Easterbrook, J., dissenting from denial of rehearing en banc).

Outcome, the highest-utility outcome of each coupon for the defendant is an induced purchase. If the settlement coupon induces the class member to purchase the defendant's product, then the settlement coupon has the same payoff as a promotional coupon. The defendant is not merely minimizing its loss under this outcome; the defendant is actually better off. If every class member were induced to make a purchase that she otherwise would not have made, then the defendant can potentially be better off than if the class action litigation had never been filed.¹¹⁰

The defendant's second-most-favored outcome is the Non-Use Outcome. At the extreme, if every coupon results in this outcome, then no class member uses a coupon and the defendant is out nothing but attorneys' fees and costs as agreed upon in the proposed settlement. In essence, the defendant has paid the class counsel to simply drop the litigation.¹¹¹ The defendant would prefer the Non-Use Outcome for every class member that does not make an Induced Purchase. Although it would appear that the defendant would prefer a Non-Induced Purchase over a Non-Use because the former generates a profit while the latter does not, that is not the proper comparison. While the defendant receives no money under the Non-Use Outcome, the defendant actually loses money under the Non-Induced-Purchase Outcome because the sale would have occurred anyway. The rational defendant would rather not have a settlement coupon used at all (the Non-Use Outcome) than have that coupon used in a transaction that would have taken place at full price without the coupon (the Non-Induced-Purchase Outcome).¹¹²

110. See *infra* notes 244–253 and accompanying text. If extra profits from these induced sales are greater than the defendant's payments to the class counsel and the defendant's own litigation costs, the defendant is made better off for having (allegedly) violated the law.

111. The only monetary hit for the antitrust defendant is the payment of the plaintiffs' attorneys' fees (and its own litigation costs). So long as these costs are less than the antitrust defendant got in gains from price-fixing, for example, the defendant has profited for having violated the antitrust laws.

112. Nevertheless, each Non-Induced-Purchase Outcome is still preferable to a cash-based settlement. First, the defendant is not out of a large amount of cash all at once. (The only bulk payment of cash is to the attorneys representing the class. But in terms of the payment to the class members, the defendant still makes a marginal profit from each transaction for which a coupon is used. See *infra* note 244 and accompanying text.) The cost is spread out as class members redeem over time. By paying money out over time, instead of one lump-sum payment, the coupon settlement has a lower net present value for the class as a whole compared to a cash-based settlement, even if all of the class members eventually use their coupons. Defendants clearly understand discount rates and they would structure coupon redemption to take advantage of the time value of money. Second, structured properly, the defendant does not become unprofitable as a result of the class settlement coupons; rather, the defendant merely suffers a reduction in its profitability. The defendant still makes a marginal profit on each transaction, albeit a smaller profit than she would have made had the purchaser not used the settlement coupon. The rational defendant will set the face value of the coupon and can set the coupon value so that the net price (after the coupon is used by the class member) is still greater than the defendant's cost. See *infra*

The worst outcome for defendants is for a settlement coupon to be used for a transaction that would have occurred anyway. This occurs by definition in the Non-Induced-Purchase Outcome. (It is also likely to occur with the Transferred-Use Outcome because a transferable coupon is likely to be purchased by a buyer who was already planning to purchase the defendant's product without a coupon; this represents a Non-Induced Purchase by a non-class member.) With either form of Non-Induced Purchase, the defendant effectively loses money on each sale in which a coupon is used if that sale would have taken place without the coupon. The marginal loss is equal to the face value of the coupon because, given our assumptions, the consumer would have paid full price for the item. The defendant's payoff is higher if no coupon is redeemed at all than if the coupon is used for a sale that is a given, which is why the defendant prefers the Non-Use Outcome over these. Although all Non-Induced Purchases are equally bad for the defendant,¹¹³ the defendant prefers a Transferred-Use Outcome over a Non-Induced Purchase by a class member because at least some of the Transferred-Use redemptions by third parties will reflect Induced Purchases,¹¹⁴ which the defendant prefers.

In short, of the four potential outcomes in a coupon settlement, the defendant strongly disfavors the Non-Induced-Purchase and (many) Transferred-Use Outcomes. These have the lowest utility for the defendant. The rankings of a defendant's preference for the outcome of each settlement coupon are summarized in Figure 2:

	Non-Use Outcome	Induced-Purchase Outcome	Non-Induced-Purchase Outcome	Transferred-Use Outcome
Defendant's Rankings (1 being best)	2	1	4	3

Figure 2

notes 199-210 and accompanying text (discussing how defendants adjust shelf price in light of settlement coupons). Class counsel will grant great latitude to the defendant to structure the coupon because class counsel has little incentive to haggle.

113. However, even under these outcomes, the rational defendant still makes a profit on each sale, albeit a smaller marginal profit than would have been achieved in the absence of a coupon. In any case, each transaction in which the consumer uses a settlement coupon increases the defendant's profits; the only question concerns by how much the defendant's profits are increased compared to what the profits would have been without the settlement coupons in circulation. This is in stark contrast to a traditional monetary settlement, in which the defendant suffers a direct pecuniary loss.

114. See *supra* notes 100-101 and accompanying text.

3. Comparing the Relative Payoff

Discussing each possible outcome individually illustrates several lessons. First, on balance, defendants are better off with coupon settlements than with cash-based settlements. In a world where the class member can neither sell nor transfer her coupons, the defendant wins in all cases except those in which a class member uses a coupon for a purchase that she would have made even without a coupon. Yet, even in these cases, a class member's redemption of a settlement coupon merely decreases, but does not eliminate, a defendant's profit margin on a given sale. More importantly, from the defendant's perspective, the settlement coupons may encourage additional sales and thereby increase the defendant's net profits.

Second, both the defendant and the class members have two preferred outcomes and two disfavored outcomes. The class has two outcomes under which the member receives some cash (if she sells her coupon in the Transferred-Use Outcome) or cash equivalent (if she uses the coupon to make a purchase that she would have made otherwise under the Non-Induced-Purchase Outcome). Each class member also has two less-favored outcomes, which require the class member to expend money (the Induced-Purchase Outcome) or not receive anything from the settlement (the Non-Use Outcome). In contrast, the defendant has two preferred outcomes that increase its profits (Induced-Purchase Outcome) or require no payment (Non-Use Outcome), and two less-favored outcomes under which the defendant is likely to suffer a hit in its marginal profits (Transferred-Use and Non-Induced-Purchase Outcomes).

Figure 3 summarizes the relative payoffs for each of the four possible outcomes for the class members and the defendant.

	Non-Use Outcome	Induced-Purchase Outcome	Non-Induced-Purchase Outcome	Transferred-Use Outcome
Class Members' Rankings (1 being best)	4	3	1	2
Defendant's Rankings (1 being best)	2	1	4	3

Figure 3

Figure 3 illustrates that the outcomes favored by the defendant are disfavored by the class and vice versa. The rational profit-maximizing defendant will structure a coupon settlement to increase the likelihood of the two

outcomes that it prefers and that, necessarily, the class members disfavor. The following part illustrates how class defendants structure coupons to increase their expected value for themselves and, consequently, decrease coupon utility for class members.

C. Defendants Structure Coupon-Based Settlements to Diminish Coupon Value

Given the rankings of the four outcomes, defendants have a strong incentive to attempt to increase the probability of Induced-Purchase and Non-Use Outcomes for each coupon, while simultaneously diminishing the likelihood of the Non-Induced-Purchase and Transferred-Use Outcomes for each coupon. This part discusses how defendants impose restrictions on settlement coupons in order to manipulate the outcome distribution probabilities. Each of the restrictions imposed on the use of settlement coupons appears designed for one of three reasons: to make the coupons less likely to be used at all, to make the coupons less likely to be used for a transaction that would have occurred even without the coupon, or to minimize the value of the coupon when used. The first category of restrictions facilitates the Non-Use Outcome. The second category of restrictions attempts to create new sales through coupons, thus increasing the number of Induced-Purchase Outcomes. The third category of restrictions attempts to decrease the defendant's costs associated with the Non-Induced-Purchase and Transferred-Use Outcomes.

1. Limits on Transferability

Of the four possible outcomes, the Non-Induced-Purchase and Transferred-Use Outcomes are the least desirable from the defendants' perspective.¹¹⁵ Yet defendants can easily diminish or eliminate the probability of the Transferred-Use Outcome by imposing restrictions on transferability. Nontransferable (or restricted-transfer) coupons also significantly increase the likelihood of the Non-Use Outcome.¹¹⁶

A settlement coupon can be fully transferable,¹¹⁷ transferable under restricted conditions, or not transferable at all. Fully transferable coupons¹¹⁸

115. See *supra* notes 110–114 and accompanying text.

116. See Wolfman & Morrison, *supra* note 80, at 476 n.73 (noting that nontransferable settlement coupons issued by Chrysler had a 1 percent redemption rate).

117. See, e.g., Hanrahan v. Britt, 174 F.R.D. 356, 360 (E.D. Pa. 1997); Weiss v. Mercedes-Benz of N. Am., Inc., 899 F. Supp. 1297, 1300 (D.N.J. 1995); New York v. Nintendo of Am., Inc., 775 F. Supp. 676, 681 (S.D.N.Y. 1991).

118. "Fully transferable" means that a coupon is transferable without any penalty. Some settlement coupons have restrictions that limit, but do not outright prohibit, transferability.

increase the likelihood of a Transferred-Use Outcome,¹¹⁹ which defendants disfavor. To decrease this probability, defendants impose transferability restrictions on settlement coupons. In extreme cases, settlement coupons are nontransferable.¹²⁰ Imposing an outright prohibition on transfers eliminates any possibility of Transferred-Use Outcomes: The class member must purchase the product herself or receive absolutely nothing from the class action settlement. While this would seem to be the defendant's preferred solution, most defendants simply impose restrictions on the transferability of settlement coupons rather than banning transfers completely.¹²¹

Examples of transferability restrictions short of an outright prohibition include limitations on the type of recipients, number of transfers, and terms of transfers. Attempts to limit the type of recipients who can use a transferred coupon include restricting transfers only to members of the coupon holder's household.¹²² Such intra-household transfer restrictions can significantly undermine the value of settlement coupons for many class members. First, the restriction makes the coupon essentially nontransferable for those class members without individuals in their household who desire to purchase the defendant's product. Second, intra-household restrictions undermine coupon value for businesses that belong in the class due to bulk purchases.¹²³

119. See *Weiss*, 899 F. Supp. at 1304.

120. See Gramlich, *supra* note 6, at 278 (discussing examples of nontransferable settlement coupons).

121. An outright ban on transfers may look suspicious to a reviewing court. It is much more difficult for a judge to navigate her way through the thicket of transferability restrictions that may (or may not) lead to a similar result. See *infra* Part IV.B and accompanying text (explaining how coupons create noise).

In the twenty cases studied by Gramlich, the coupons were transferable in the majority of cases. See Gramlich, *supra* note 6, at 273; see also *In re Superior Beverage/Glass Container Consol. Pretrial*, 133 F.R.D. 119, 122 (N.D. Ill. 1990) ("The certificates are transferable under certain limited circumstances."); *In re Cuisinart Food Processor Antitrust Litig.*, 1983-2 Trade Cas. (CCH) ¶ 65,680, at 65,680 (D. Conn. Oct. 24, 1983) (noting that coupons were "subject to certain specified conditions" but neglecting to articulate the restrictions).

122. See, e.g., *Clement v. Am. Honda Fin. Corp.*, 176 F.R.D. 15, 21 (D. Conn. 1997) (rejecting proposal coupon settlement where coupons were "not transferable to any third party other than a 'household member,' defined as an individual living in the same household as the class member"); *In re Domestic Air Transp. Antitrust Litig.*, 148 F.R.D. 297, 305 (N.D. Ga. 1993) (imposing variant of intra-household transfer restriction).

123. In *In re General Motors Corp. Pick-up Truck Fuel Tank Products Liability Litigation*, 55 F.3d 768 (3d Cir. 1995), the class and defendant proposed a coupon settlement under which, in order to settle class litigation alleging product design and construction flaws in General Motors (GM) trucks, the defendant would give each class member a \$1000 coupon toward the purchase of a new GM pick-up truck. See *id.* at 780. Despite the fact that the trial judge approved the settlement, the Third Circuit recognized that the settlement contained "substantial impediments to fleet owners' using these certificates" because the fleet owners could not exercise "the intra-household transfer option, intended specifically for the benefit of individual owners." *Id.* at 801;

Other defendants limit the number of times that a settlement coupon can be transferred.¹²⁴ For example, in *In re Domestic Air Transportation Antitrust Litigation*,¹²⁵ the court's analysis illustrates the limits on reasonable transferability: "While each certificate may be used only by the party to whom the certificate is issued or members of that person's immediate family, class members who are natural persons may, at the time of filing a claim, designate another natural person to receive their certificates."¹²⁶ In other words, the coupon is transferable if the transfer is made in the filing forms and the class member specifies the transferee at that time. This means that a coupon can only be transferred once, at most. This effectively eliminates the development of a market maker who purchases settlement coupons, advertises them, and markets them to potential buyers.¹²⁷

Finally, defendants can structure the settlement coupon terms so that transfers reduce the coupons' value.¹²⁸ For the coupons proposed to settle the *In re General Motors Corp. Pick-up Truck Fuel Tank Products Liability Litigation*¹²⁹ class action litigation,¹³⁰ if the class member transferred her \$1000 coupon, the transferee would only receive a \$500 coupon.¹³¹ Furthermore, this reduced-value coupon could only be used to purchase a full-sized General Motors truck, whereas the original class member could use her \$1000 coupon

see *infra* notes 417-424 and accompanying text (discussing the Third Circuit's condemnation of the proposed coupon settlement in the case).

124. See, e.g., *In re Montgomery County Real Estate Antitrust Litig.*, 83 F.R.D. 305, 312 (D. Md. 1979) (limiting the number of transfers to "two successive assignees").

125. 148 F.R.D. 297 (N.D. Ga. 1993).

126. *Domestic Air*, 148 F.R.D. at 309.

127. See *infra* Part V.B (discussing the creation of a market for settlement coupons). The court in *Domestic Air* held that the coupons were "reasonably transferable" because the class members were

free to give certificates to their family members at any time or, in the case of a business, to any of its employees or partners. Moreover, if a class member does not anticipate that she or any family member will fly in the next four years, she can designate any other person (including a non-family member) to receive her certificates for value when filing her claim. Although the certificates are not universally transferable at all times, the terms of transferability are reasonable and virtually identical to those approved by Judge Greene in the settlement of *In re North Atlantic Air Travel Antitrust Litig.*

Domestic Air, 148 F.R.D. at 331.

128. See *In re Mid-Atl. Toyota Antitrust Litig.*, 564 F. Supp. 1379, 1382 (D. Md. 1983) ("While the certificates are freely negotiable for redemption in cash, only the initial recipient of the certificate may exercise the goods, services or trade-in allowance option.").

129. 55 F.3d 768 (3d Cir. 1995).

130. See *infra* notes 417-424 and accompanying text (discussing *General Motors*).

131. See *Livingston v. Toyota Motor Sales USA, Inc.*, No. C-94-1377, No. C-94-1359, No. C-94-1960, 1995 U.S. Dist. LEXIS 21757, at *37 (N.D. Cal. May 30, 1995) (discussing other transferability restrictions in *General Motors*); Wolfman & Morrison, *supra* note 80, at 473.

for the purchase of less expensive trucks and vans.¹³² Both restrictions drastically reduced the attractiveness of the transfer option.

The aggregate effect of these restrictions can significantly limit meaningful transferability and, consequently, diminish the market value of the coupons. First, these restrictions limit the pool of potential buyers of the coupons. Any restriction that disqualifies would-be purchasers effectively reduces the demand for settlement coupons and, thus, reduces the price at which class members can sell their coupons. Second, restrictions increase the transaction costs of redeeming the coupons. The greater the transaction costs, the lower the purchase price for the coupon.¹³³ In short, if the coupon has restricted transferability, the coupon's resale price decreases, as does the compensation to the class member.

In sum, defendants can increase their expected utility from coupon-based settlements by limiting the coupons' transferability. With the probability of the Transferred-Use Outcome diminished by transfer restrictions, defendants can focus on structuring the settlement coupons so as to increase the probability of the Non-Use and Induced-Purchase Outcomes and to decrease the probability of the Non-Induced-Purchase Outcome.

2. Coupon Expiration

Class action defendants increase the likelihood of the Non-Use and Induced-Purchase Outcomes by imposing expiration dates on settlement coupons. Expiration dates create a win-win situation for the defendant: Either the coupon expires, thus eliminating any payout, or the short window forces the class member to make a purchase that otherwise would not have occurred. If a coupon expires, the class member cannot use it and the Non-Use Outcome is achieved. Alternatively, if a coupon has not been used and the expiration date is fast approaching, the class member may feel compelled to make a purchase she otherwise would not make using her settlement coupon, lest she receive nothing from her participation (albeit passive) in the class action litigation.¹³⁴ If the class member is thus motivated to use the coupon to prevent it from expiring, the defendant succeeds in achieving the Induced-Purchase Outcome.

132. See *In re Gen. Motors Corp. Pickup Truck Fuel Tank Prods. Liab. Litig.*, 846 F. Supp. 330, 339 (E.D. Pa. 1993) (discussing the availability of "light-duty" pick-up trucks).

133. At an extreme, if the transaction costs were greater than a coupon's face value, then a coupon holder could not give her coupon away because the buyer would have to spend more to acquire and redeem the coupon than the coupon was worth.

134. See *supra* notes 60-63 and accompanying text.

In general, defendants desire an early expiration date. The shorter the redemption period, the greater the likelihood of both the Non-Use and Induced-Purchase Outcomes, which are the highest-value outcomes for the defendant. Take an extreme example: If settlement coupons expired a day after the court approved the settlement, each class member would either use her coupon immediately or not at all.¹³⁵ Most class members would be forced into the Non-Use or Induced-Purchase Outcomes. Conversely, a longer redemption period (or no expiration date at all)¹³⁶ increases the probability that the coupon will be used for a purchase that would have occurred anyway, a Non-Induced Purchase, which reflects the defendant's lowest-value outcome.

While the imposition of some expiration date appears reasonable, a review of actual settlement coupons reveals a tendency by many defendants to impose unreasonable expiration schedules.¹³⁷ For some coupons, defendants have set expiration dates as short as 120 days from the date of the issuance.¹³⁸ Failure to redeem the coupon within the defined period means that the class member receives nothing of value under the settlement.¹³⁹

This problem is especially acute for coupon settlements involving durable products. Proposed coupon settlements often require class members to purchase a durable good, such as a vehicle or a house.¹⁴⁰ Even an expiration date measured in years can force an Induced-Purchase Outcome, so long as the expiration date occurs before the class member's desired date of next purchase. For durable goods, the expiration date should of course be much further off.¹⁴¹ For example, in at least two cases involving settlements of

135. Furthermore, if the expiration date is short, then there is less time to develop a market for the coupons and market makers would be unlikely to create a market in any product that was so perishable that it would become worthless in a short amount of time.

136. Historically, many coupons have had no expiration dates. See *supra* note 48 and accompanying text.

137. See Borenstein, *supra* note 5, at 382 ("In many of the recent antitrust settlements that involved prospective discounts, coupons have been issued with expiration dates that make it very likely that not all coupons would be used if recipients continued to make their usual purchases.").

138. See *In re Cuisinart Food Processor Antitrust Litig.*, 1983-2 Trade Cas. (CCH) ¶ 65,680, at 69,470 (D. Conn. Oct. 24, 1983). As noted below, the coupons in *Cuisinart* could not be used for food processors, so class members had to buy something from Cuisinart—not a food processor—within 120 days or they would receive nothing from the settlement. In the twenty cases studied by Gramlich, the average redemption period for the coupons was three years from the date of settlement. See Gramlich, *supra* note 6, at 273. While this may seem appropriate, for durable goods this is a relatively short time period. See *infra* notes 191–192 and accompanying text.

139. While technically the class member has received the option to make a purchase with the settlement coupon, this is of no practical value to most class members who fail to redeem their coupons.

140. See *infra* notes 191–192 and accompanying text.

141. In *In re General Motors Corp. Pick-up Truck Fuel Tank Products Liability Litigation*, 55 F.3d 768 (3d Cir. 1995), the proposed settlement coupons expired in fifteen months. See *id.* at 780.

antitrust violations arising in the real estate market, the coupons were set to expire before most homeowners would be prepared to sell their homes; yet the coupons were nontransferable.¹⁴² This creates a classic instance in which a coupon either expires (and the defendant therefore pays no penalty to these injured class members) or the class member is forced to sell her home in order to participate in the coupon-based settlement. As a result, the real estate brokers receive a significant windfall by inducing the sale of a home, receiving a commission for this compelled sale, and then returning a negligible amount of their commission to the class member.

In sum, whether a product is durable or not, rational defendants will set the expiration date at a point before the class member would next want to purchase the product absent a settlement coupon. Coupon settlements present an opportunity for defendants to manipulate the expiration dates of settlement coupons. This ability to force class members to choose between Non-Use and Induced-Purchase Outcomes guarantees a favorable resolution for the defendant at the expense of class members.

3. Restrictions on Coupon Aggregation

Class action defendants further attempt to reduce Non-Induced Purchases by preventing class members from aggregating coupons. Coupon aggregation can take one of two forms: A coupon holder may wish to combine multiple settlement coupons in a single purchase or may want to use a settlement coupon in conjunction with other nonsettlement coupons or discounts. Most defendants disfavor aggregable coupons because the aggregation of coupons for a single purchase decreases the per unit revenue.¹⁴³

The functional redemption period was even shorter because the class members had to first acquire the coupons; thus, their fifteen-month window began before they could possibly exercise their coupons. In contrast, the certificates issued by Mercedes-Benz to settle its class action litigation had an expiration date of four years. See *Weiss v. Mercedes-Benz of N. Am., Inc.*, 899 F. Supp. 1297, 1300, 1303 (D.N.J. 1995) (contrasting the four-year window with the shorter time horizon in *General Motors*' proposed settlement coupons). Given that truck owners normally keep their vehicles for several years, those consumers who had recently purchased their defective pick-up trucks would be compelled to make a high-cost purchase for a product they otherwise would not want at all (let alone from this defendant). The problem is magnified for large-fleet owners; thus, in *General Motors*, "state and local government fleet owners would not be able to redeem all of their certificates" because of budgetary constraints and the lack of need of replacing an entire fleet of vehicles. *Gen. Motors*, 55 F.3d at 781; see also *Clement v. Am. Honda Fin. Corp.*, 176 F.R.D. 15, 21 (D. Conn. 1997) (rejecting proposal coupon settlement for vehicles where expiration varied between two or three years depending on class member's circumstances).

142. See Gramlich, *supra* note 6, at 278.

143. Depending on the level of coupon aggregation, the coupons' face value, and the defendant's profit margin per sale, a sale with multiple coupons could represent a net loss for the defendant-seller.

Defendants often impose restrictions that preclude a class member from using multiple settlement coupons in a single purchase. Because defendants want to maximize both sales volume and revenue per sale, defendants routinely impose restrictions on settlement coupon aggregation. For example, when one publisher settled antitrust class action litigation by issuing coupons redeemable for money off of selected books, the settlement precluded class members from using the coupons for more than 50 percent of a book's full retail price.¹⁴⁴ This restriction insured that the publisher would still make a profit on every sale consummated with a settlement coupon.¹⁴⁵ Furthermore, many class members would be forced to pay more than the current market price for many books.¹⁴⁶ Some defendants prevent aggregation by issuing each class member multiple settlement coupons that are each valid in a separate time frame.¹⁴⁷

Defendants also commonly proscribe class members from redeeming settlement coupons in conjunction with promotional coupons or any other available discount.¹⁴⁸ Many class members may already hold (or easily obtain) promotional coupons or other discounts unrelated to the settlement coupon. If so, most consumers would like to redeem both coupons in a single purchase in order to reduce the purchase price more than through use of either coupon alone.

From a class member's perspective, aggregation restrictions can eliminate all value from the settlement. If a consumer who plans to make one purchase possesses both a promotional coupon for \$25 and a settlement coupon for \$25 but cannot aggregate the coupons for use in a single purchase, the settlement coupon is worthless.¹⁴⁹ For those consumers who regularly use promotional coupons,¹⁵⁰ nonsettlement coupons are often likely

144. See *Phemister v. Harcourt Brace Jovanovich, Inc.*, 1984-2 Trade Cas. (CCH) ¶ 66,234 at 66,987 (N.D. Ill. Sept. 24, 1984).

145. Similarly, the *Domestic Air* settlement coupons could not be used for more than 10 percent of the purchase price, thus insuring that every trip made with a settlement coupon remained profitable for the defendant airline. See *In re Domestic Air Transp. Antitrust Litig.*, 148 F.R.D. 297, 332 (N.D. Ga. 1993); see also *Hanrahan v. Britt*, 174 F.R.D. 356, 360 (E.D. Pa. 1997) (granting a 35 percent discount off of suggested retail price).

146. Although many books had been bestsellers, the publisher limited the settlement coupons' validity to hardcover versions, which were—or would likely soon be—available in remainder bins at deep discounts, prices generally lower than the class members' post-coupon price.

147. See *infra* notes 163–165 and accompanying text.

148. See, e.g., *Livingston v. Toyota Motor Sales USA, Inc.*, No. C-94-1377, No. C-94-1359, No. C-94-1960, 1995 U.S. Dist. LEXIS 21757, at *63 (N.D. Cal. May 30, 1995); *In re Cuisinart Food Processor Antitrust Litig.*, 1983-2 Trade Cas. (CCH) ¶ 65,680 (D. Conn. Oct. 24, 1983).

149. This assumes that neither coupon is fully transferable, which is generally a reasonable assumption.

150. It seems probable that class members who fill out the class action claims forms to receive settlement coupons are more likely to be coupon users in general.

already available; nonaggregable settlement coupons therefore provide no additional value. Thus, when defendants preclude class members from using generally available discounts and rebates in conjunction with a settlement coupon, the coupon may lose all of its value and leave many class members "no better off than the general public."¹⁵¹

Despite the fact that aggregation restrictions can significantly diminish the value of settlement coupons to the class, many courts have given insufficient attention to this form of restriction.¹⁵² For example, the *Domestic Air* court reasoned that

[w]hile objectors have complained that certificates may not be used in conjunction with other bonuses and award certificates, revenues generated from tickets sold on fares that are not published amount to only 5% of total revenue, and the settlement agreement explicitly provides that no carrier is prohibited from offering additional promotions in combination or conjunction with the certificates. The issue is simply left to each individual carrier in the context of the competitive market.¹⁵³

The court's reasoning is, at a minimum, unpersuasive. The court claimed to be unconcerned that the certificates may not be used in conjunction with other traditional coupons because the settlement does not prohibit the individual defendants from allowing such use in the future.¹⁵⁴ This completely misses the point. Under the terms of the settlement, the class members could not use a settlement coupon in conjunction with other coupons that they already had or with discounts offered to the public at large.¹⁵⁵ Even if the settlement coupons have fewer restrictions on their usage (for example, longer redemption periods) than available promotional coupons, the settlement coupon may still confer no benefit in the absence of aggregation.¹⁵⁶ Because

151. *In re Gen. Motors Corp. Pick-up Truck Fuel Tank Prods. Liab. Litig.*, 55 F.3d 768, 809 (3d Cir. 1995); see also Wolfman & Morrison, *supra* note 80, at 473 n.64.

152. Courts have discounted such arguments. See, e.g., *Cuisinart*, 1983-2 Trade Cas. (CCH) at 69,473.

153. *In re Domestic Air Transp. Antitrust Litig.*, 148 F.R.D. 297, 331 (N.D. Ga. 1993).

154. See *id.*

155. See *id.* at 30.

156. The court in *Domestic Air* asserted that the coupons would "have substantially greater usefulness than other promotional coupons sometimes distributed by the defendant airlines." *Id.* at 321. But the court engaged in no meaningful analysis of this. True, the settlement coupons may have had fewer restrictions than promotional coupons in that the promotional coupons could have no transferability whereas the settlement coupons could be transferred to a family member, and the settlement coupons may have had a longer redemption period than traditional coupons. But this ignores the fact that on any given flight a class member who has a traditional coupon as well as a settlement coupon will be in a situation in which the settlement coupon may provide absolutely no economic value because the class member can use the traditional coupon for that flight. Coupons cannot be compared in a vacuum; rather, the court must consider whether for any

many class members may already have suitable coupons, aggregation restrictions increase the probability of the Non-Use Outcome.

4. Making Coupon Redemption Administratively Difficult

While expiration dates and aggregation restrictions increase the likelihood of either the Non-Use or Induced-Purchase Outcomes, other restrictions exist to encourage the Non-Use Outcome alone. In many cases, in an apparent effort to deter the use of coupons, defendants structure the settlement coupons to be overly burdensome.¹⁵⁷ For example, in a case involving real estate services,¹⁵⁸ the coupon holder was required to have both the original closing statement from a prior home sale and a notarized affidavit in order to pay with her coupon.¹⁵⁹ As with promotional coupons, complicated coupon redemption schemes attract fewer users.¹⁶⁰ Furthermore, administrative burdens reduce the effective redemption period, which reduces redemption rates and increases the probability of the Non-Use Outcome.¹⁶¹

Some coupon-based settlements are not actually coupons, but more complicated rebate programs.¹⁶² Rebates are generally more administratively difficult than coupons because they require the consumer to mail additional paperwork to the manufacturer and to cash a rebate check. This increases the administrative burden on class members and, thus, increases the likelihood of the Non-Use Outcome.

Defendants also increase administrative difficulty by requiring multiple purchases. In some cases, class members have been required to redeem several settlement coupons consistently over a period of years in order to receive the full value of the settlement. For example, approving a coupon settlement in *In re Superior Beverage/Glass Container Consolidated Pretrial*,¹⁶³ the court noted that “[t]he bulk of the settlement consists of discount certificates

given transaction in which a settlement coupon was used a traditional coupon that was also available could have been used such that the settlement coupon is in fact valueless.

157. See, e.g., Amy Hunt, *Assault on the Airline Industry: Private Antitrust Litigation and the Problem of Settlement*, 59 J. AIR L. & COM. 983, 999 (1994) (criticizing the coupon settlement in *Domestic Air* as overly complex).

158. See *Davis v. Northside Realty Assocs.*, 95 F.R.D. 39 (N.D. Ga. 1982).

159. See Gramlich, *supra* note 6, at 278.

160. See Turcsik, *supra* note 17, at 45.

161. See Wolfman & Morrison, *supra* note 80, at 473 n.63 (noting experts' opinion in *General Motors* that the process of obtaining settlement coupons “effectively reduce[d] the redemption period from the nominal 15-month period to about one year”).

162. See *In re Superior Beverage/Glass Container Consol. Pretrial*, 133 F.R.D. 119, 122 (N.D. Ill. 1990).

163. 133 F.R.D. 119 (N.D. Ill. 1990).

utilizable in 40 quarterly installments over the next ten years."¹⁶⁴ Any class member who neglects to redeem her certificate in any quarter over a ten-year period is denied the full value of the settlement. Similarly, in a class action settlement involving supermarket price-fixing, each class member received \$1 food coupons that could only be redeemed at a rate of two coupons in each of ten consecutive six-month periods.¹⁶⁵

In sum, by making settlement coupons more difficult to redeem, defendants can increase the probability of the Non-Use Outcome, a preferred result for the defendant that significantly undermines the value of the settlement to the class.

5. Product Restrictions

Given the defendant's goal of preventing class members from using settlement coupons for a Non-Induced Purchase, defendants often structure coupons so that consumers cannot use them for more desirable or popular purchases that would have taken place anyway. Some defendants achieve this result by limiting the coupons' use to inferior goods, for which there is significant lower demand.

In many cases, the settlement coupons have not been valid for the actual product that sparked the class action litigation in the first place. For example, coupons offered by Bausch & Lomb to settle litigation arising from its deceptive pricing practices in selling contact lenses were not valid for the purchase of contact lenses.¹⁶⁶ The coupons were redeemable instead for such disparate items as sunscreen and Ray-Ban sunglasses.¹⁶⁷ Some of these product restrictions seem to be a clear attempt to move a defendant's less popular product lines. When Cuisinart settled class action litigation based on the company's alleged illegal resale price maintenance of its food processors, the defendant issued coupons that could not be used for food processors.¹⁶⁸ From the class members' perspective, the restriction diminished some of the coupons' value.¹⁶⁹ From the defendant's perspective, the restriction represented

164. *Id.* at 132.

165. *See* Ohio Pub. Interest Campaign v. Fisher Foods, Inc., 546 F. Supp. 1, 5 (N.D. Ohio 1982); *cf.* Petruzzi's, Inc. v. Darling-Del. Co., 880 F. Supp. 292, 295 (M.D. Pa. 1995) (rejecting coupon settlement in which each class member was to receive six certificates redeemable in six successive six-month periods).

166. *See* HENSLER ET AL., *supra* note 15, at 161.

167. *See id.* Bausch & Lomb claimed that coupons could not be redeemed for lenses because these were dispensed by practitioners. *See id.*

168. *See In re Cuisinart Food Processor Antitrust Litig.*, 1983-2 Trade Cas. (CCH) ¶ 65,680 (D. Conn. Oct. 24, 1983).

169. Some class members may have wished to purchase a second food processor. For example, although the class members may presumably have already possessed a food processor, many

a clear attempt to force an Induced-Purchase Outcome. Cuisinart would sell food processors in any case; the company simply did not need the assistance of settlement coupons to induce sales of food processors.

Perhaps the clearest example of restricting settlement coupons to inferior goods is the imposition of blackout dates on the airline coupons issued to settle *Domestic Air*.¹⁷⁰ To settle an antitrust class action based on airlines' alleged price-fixing, the defendants issued coupons redeemable for savings on future flights. However, the coupons were burdened by several blackout dates: Class members could not use the settlement coupons for air travel on the days surrounding the Thanksgiving, Christmas, and New Year holidays.¹⁷¹ These are the same restrictions that airlines impose on promotional coupons.

Airline tickets with blackout dates are inferior products. The defendant airlines proposed the blackout periods since these were dates that would sell out regardless of the existence of settlement coupons and the airlines did not want to lose profits for flights on those days. Use of a settlement coupon during a high-traffic period would constitute a Non-Induced-Purchase Outcome, the defendants' least-preferred result. If the settlement could induce the class members to fly when they otherwise might not, then the defendants could achieve an Induced-Purchase Outcome, their most-preferred outcome.

The blackout dates significantly reduced the coupons' value to the average class member. Plaintiff class members who would have cause to use a coupon likely want to fly on the blackout dates. After all, dates are blacked out because they are popular. Because coupons cannot be used when they would do the class members the greatest good, their compensation value is diminished.

Despite the relatively obvious problems with the blackout dates, the reviewing court approved the coupon settlement. The court in *Domestic Air* mentioned the holiday blackout period, but did not specifically analyze the effect of this restriction on nonbusiness travelers. Although the judge attempted to justify the blackout dates, his analysis is strained. First, the judge argued that the "few 'blackout' days represent a period of heavy travel during which the industry is unable to meet full consumer demand."¹⁷² But this simply proves that consumers desire this product and that any coupon redemption for flights during the blackout period would

class members may have purchased the initial food processor as a gift or may wish to purchase another food processor as a gift.

170. *In re Domestic Air Transp. Antitrust Litig.*, 148 F.R.D. 297, 320–21 (N.D. Ga. 1993).

171. *See id.*

172. *Id.* at 331 n.40.

most likely represent a Non-Induced Purchase, an outcome strongly favored by class members and disfavored by defendants. High demand merely shows that this is the most desirable product that the airlines offer—travel during holiday periods. Restricted-use settlement coupons provided a way for airlines to attempt to create demand in those times when consumers would not otherwise demand the product up to its capacity. This suggests that the coupons resemble a marketing technique to encourage consumers to purchase the defendant's product when they otherwise would not. If coupons were redeemable for travel during high-traffic periods, this would constitute a Non-Induced-Purchase Outcome. But the airlines wanted to encourage additional sales, an Induced-Purchase Outcome, so the coupons were limited to inferior goods: non-holiday travel. Thus, the defendants effectively issued coupons that were only available for an inferior product. This forced some consumers to choose between a Non-Use and an Induced-Purchase Outcome; either way, the defendant wins.

Second, the court took comfort in the estimate that airline tickets sold during these blackout dates represented "no more than approximately 3–4% of all domestic tickets."¹⁷³ This figure ignores the fact that most air travel is for business. For those class members that are nonbusiness travelers, the blackout dates represent a significantly higher percentage of the relevant travel dates.¹⁷⁴ The court mishandled the issue of fairness to holiday travelers by asserting

that individuals who are members of the class based on the purchase of tickets for flight during the holiday season receive the same benefit in settlement as all other travelers: the use of discount certificates on the purchase of almost all tickets issued by all defendants for flights taking place any time during a four-year period, with the exception of certain peak holiday travel time.¹⁷⁵

The judge missed the point: People who only became members of the class by purchasing tickets for air travel during the holidays received coupons that they could not use for the same product that they had purchased in the past and would most likely desire in the future. This makes them different than other class members who acquired their class status by traveling during non-holiday periods and who would have use for coupons during non-holiday periods.

173. *Id.*

174. One of the plaintiffs' experts did assert that "the average nonbusiness traveler will take more than sufficient flights to redeem all of the base fund certificates, even considering the holiday blackout period." *Id.* At most this suggests that *average* class members will have an opportunity to use their coupons; a significant minority may never travel enough to use their coupons.

175. *Id.* at 333.

Third, the court incorrectly implied that the problem of blackout dates was solved by the fact that the coupons were interchangeable among the defendant airlines.¹⁷⁶ Yet such interchangeability was meaningless. All of the airlines' settlement coupons shared similar blackout dates, such as Christmas Eve.¹⁷⁷ Thus, class members could not simply use their coupons for travel on another airline because all airline-defendants adopted similar blackout dates.

Blackout dates are only one example of product restrictions—others abound.¹⁷⁸ In *In re Chicken Antitrust Litigation*,¹⁷⁹ settlement coupons were valid only for products that were off-season. This restriction had the same effect as a blackout date: Consumers could only redeem coupons for products that would not be sold anyway, and thus the coupon served to induce purchases that otherwise would not occur.¹⁸⁰ The net effect of blackout dates and other product restrictions is to readjust the distribution of probable outcomes among the issued coupons, decreasing the likelihood of a Non-Induced Purchase and increasing the likelihood of either a Non-Use or an Induced-Purchase Outcome.

In contrast to limiting coupon use to inferior products, some defendants structure their settlement scrip so that it can only be used for expensive purchases, forcing consumers to expend a greater amount of their own money in order to partake in the settlement.¹⁸¹ For example, in settling anti-trust litigation involving bar review courses, the publisher-defendant issued coupons that were valid only on "certain publications from a specific list."¹⁸² In addition to limits on titles, class members could not redeem their coupons for paperback books, but only for hardcover books, which have the highest mark-up.¹⁸³ This resembles an Induced-Purchase Outcome in that

176. *See id.*

177. Furthermore, even if the coupons were interchangeable among various airlines, they still required that a class member fly (that is, use the defendant's product) in order to receive any compensation from the settlement. This meant that the class members could not receive the benefits of the settlement if they used another mode of transportation such as train, bus, or automobile.

178. *See, e.g., Hanrahan v. Britt*, 174 F.R.D. 356, 368 (E.D. Pa. 1997).

179. 407 F. Supp. 1285 (N.D. Ga. 1975).

180. *See Gramlich, supra* note 6, at 278.

181. *See, e.g., Tornabene v. Gen. Dev. Corp.*, 88 F.R.D. 53, 56 (E.D.N.Y. 1980) (describing a settlement in which some class members could only redeem their settlement credit for a house with a minimum purchase price of \$50,000).

182. *Phemister v. Harcourt Brace Jovanovich, Inc.*, 1984-2 Trade Cas. (CCH) ¶ 66,234, at 66,987 (N.D. Ill. Sept. 24, 1984). Although the court claimed that this list included bestsellers, the court did not explain why the class members should be constrained at all. In cash-based settlements, class members are not so limited in how they may spend their cash. The logical explanation is that the defendant was attempting to move inventory that would not otherwise be sold.

183. *See id.*

the class member must purchase a product that she would not purchase but for the settlement coupon.¹⁸⁴ To the extent that many class members may decide not to redeem their settlement coupons when they can already buy comparable products for less money, the defendant secures the Non-Use Outcome.

D. Other Problems with Coupon-Based Settlements

Many of the problems associated with coupon settlements flow from the defendants' ability to impose coupon restrictions in order to manipulate the probable distributions of various outcomes. In addition to these attempts to influence coupon usage and outcome probabilities, the use of settlement coupons raises other serious concerns from the class members' perspective. These include the requirement that class members purchase defendants' products or services, the risk that defendants can undermine the value of settlement coupons after the settlement is approved, and the price-discrimination effects of settlement coupons. This section discusses each of these problems in turn.

1. Coupon Settlements Force Class Members to Make Additional Purchases from Defendants

A class action settlement based on coupons often requires each class member to purchase the defendant's product or service.¹⁸⁵ Some proposed coupon settlements would require class members to make multiple purchases to redeem a settlement coupon.¹⁸⁶ For many class members, receiving coupons that require victims to spend more money is a hollow victory. It is the litigation equivalent of winning a pie-eating contest in which first prize is a pie that must be eaten immediately. Such requirements have been a rallying cry against coupon settlements for some critics.¹⁸⁷

This purchase requirement creates three related problems, all of which some courts have failed to appreciate. First, each class member must buy

184. To the extent that the postcoupon price of the hardcover exceeds the retail price of the paperback, this restriction could lead to the Non-Use Outcome.

185. This statement is subject to transferability options, *see supra* notes 115–133, and cash options.

186. *See State v. Dairylea Coop., Inc.*, 547 F. Supp. 306, 308 (S.D.N.Y. 1982) (“[C]oupons would be distributed by being printed on the packaging of Dairylea milk and would be redeemable for a discount on a subsequent purchase of Dairylea milk or milk-products.”). This “settlement coupon” is functionally indistinguishable from a promotional coupon.

187. *See HENSLER ET AL.*, *supra* note 15, at 83–84.

something from the defendant, who has allegedly wronged the class.¹⁸⁸ In some instances, coupon settlements limit the class member's ability to redeem the settlement coupon to the actual dealership where the initial product purchase was made.¹⁸⁹ Courts have rejected the complaint that a coupon settlement forces class members to purchase additional products or services from an allegedly wrongdoing defendant.¹⁹⁰ Second, in many cases, the item is a big-ticket purchase, such as a vehicle¹⁹¹ or even a house.¹⁹² This particularly disadvantages poorer members of the class, who may be unable to make another high-end purchase.¹⁹³ Many class members see the coupon as "a pittance compared to the price of a new car."¹⁹⁴ Nonetheless, some courts reject such arguments outright.¹⁹⁵ Third, class members should not have to pay cash to collect damages in class action litigation; yet many non-transferable coupons are worthless unless the class member expends money on an additional purchase.¹⁹⁶ Finally, because the class member is forced to make a purchase, the coupon settlement can be a net profit-maker for the defendant.¹⁹⁷ In rejecting proposed coupon settlements, some judges

188. In response to this complaint, at least some defendants have been forced to redeem coupons even if they are used for purchases of a competitor's goods or service. See, e.g., Nelson, *supra* note 2.

189. See, e.g., *In re Mid-Atl. Toyota Antitrust Litig.*, 564 F. Supp. 1379, 1556 (D. Md. 1983).

190. See *In re Cuisinart Food Processor Antitrust Litig.*, 1983-2 Trade Cas. (CCH) ¶ 65,680, at 69,473 (D. Conn. Oct. 24, 1983).

191. See, e.g., *In re Ford Motor Co. Bronco II Prod. Liab. Litig.*, 177 F.R.D. 360 (E.D. La. 1997); *Weiss v. Mercedes-Benz of N. Am., Inc.*, 899 F. Supp. 1297 (D.N.J. 1995) (discussing coupon settlement involving automobile manufacturers); Wolfman & Morrison, *supra* note 80, at 476 n.73, 502 (noting the parties' concession in a proposed GM settlement that the majority of class members would be unable or unwilling to redeem their settlement coupons during the prescribed redemption period); cf. *Clement v. Am. Honda Fin. Corp.*, 176 F.R.D. 15 (D. Conn. 1997) (rejecting a proposed coupon settlement involving the lease or purchase of an automobile).

192. See, e.g., *Tornabene v. Gen. Dev. Corp.*, 88 F.R.D. 53, 56 (E.D.N.Y. 1980); *In re Montgomery County Real Estate Antitrust Litig.*, 83 F.R.D. 305 (D. Md. 1979).

193. See, e.g., *In re Gen. Motors Corp. Pick-up Truck Fuel Tank Prods. Liab. Litig.*, 55 F.3d 768, 808 (3d Cir. 1995) ("Both the high cost of the trucks and the infrequency of a consumer's purchase of a new truck (relative to the fifteen month redemption period) make using these certificates significantly more difficult than those in the other coupon settlements, for all class members but particularly for the poorer ones.").

194. *Clement*, 176 F.R.D. at 26.

195. See *Dunk v. Ford Motor Co.*, 56 Cal. Rptr. 2d 483, 490 (Cal. Ct. App. 1996) (chastising an objector for failing to "present any authority for the proposition that all members of the class must be able to use the coupon before the settlement can be deemed fair").

196. A minority of coupon settlements do not require an additional purchase. For example, a settlement coupon may entitle the holder to a replacement package of the defendant's product. See *infra* note 454.

197. See *infra* notes 244-251 and accompanying text; see also *Clement*, 176 F.R.D. at 25 n.16. An objector to the proposed coupon settlement stated,

By [the proposed settlement's] terms, I get nothing unless I agree to enter into a new lease agreement with the defendants who already cheated me? . . . As far as I can tell,

recognize that coupon settlements can be just “a sophisticated [] marketing program” for the defendant.¹⁹⁸ Most courts, though, do not seem to recognize this fact.

2. Defendants Can Undermine Settlement Coupon Value

Another problem with coupon settlements, and another reason why defendants may prefer coupon settlements over cash-based settlements, is that even after distributing the coupons, defendants can still manipulate the value of the settlement coupons. Defendants can do so in two ways: by increasing price and by decreasing quality.

a. Negating Coupon Value by Increasing Price

Unlike a traditional cash-based settlement, defendants can render settlement coupons worthless by simply increasing the base price of their product by the face value of the coupon.¹⁹⁹ Furthermore, independent of the defendant-manufacturer, the retailer may increase the price of a given product following the implementation of a coupon-based settlement regime.²⁰⁰ Any price increase can eliminate the compensatory effect of coupons.²⁰¹ For

your deal is better for [the defendant] than no deal at all: In theory, they stand to sell/lease additional vehicles as a result of the incentive to sign a new lease.

Id. (ellipses in original); see *Tornabene* 88 F.R.D. at 59–60, 60 n.9.

198. *Gen. Motors*, 55 F.3d at 807; see also *Clement*, 176 F.R.D. at 28 (reaching the same conclusion).

199. See Gramlich, *supra* note 6, at 266; cf. *Petruzzi's, Inc. v. Darling-Del. Co.*, 880 F. Supp. 292, 298 (M.D. Penn. 1995) (discussing the risk that a defendant-buyer may reduce the price that it pays to certificate-holding plaintiff-sellers).

200. See Levedahl, *supra* note 35, at 68 (“[R]etailers have both the opportunity and the incentive to raise the full price in conjunction with a coupon offer.”).

201. See Gramlich, *supra* note 6, at 275. It may seem odd that a defendant could simply raise price after issuing the settlement coupons and not suffer meaningful losses. Yet she may do so for three related reasons. First, when the coupons are issued by multiple defendants in an industry, such as in *Domestic Air*, then all defendants may hike price in unison as each firm attempts to minimize the coupons' effect on marginal revenue. The result, even if arrived at by apparently independent decisions, resembles cartelization—prices rising in tandem. As long as most firms participate (at least enough so that nonparticipating firms cannot supply the excess demand), then most consumers will pay the higher price. Those consumers with sufficiently elastic demand or low reservation prices may opt out of purchasing the product, but cartel pricing assumes this effect. Second, the coupons can simply accompany the price hikes associated with coupon-based price discrimination. If defendants raise the price while issuing coupons, those consumers with a highly elastic demand (or low reservation price) can avoid the price hike by redeeming their coupons. In contrast, those consumers with higher reservation prices may simply pay the higher price, thereby generating greater profits for the seller on those sales. Third, the defendant could issue the settlement coupons in lieu of promotional coupons, or she could issue both while restricting aggregation. Either way, the defendant can raise the price for noncoupon users while minimizing the expected losses associated with coupon redemption. If this analysis is

example, after agreeing to settle class action litigation by giving each class member a coupon with a face value of \$50, the defendant can increase the price of her product by \$50.²⁰² In his study of antitrust class actions settled with coupons, Professor Severin Borenstein has demonstrated that class action defendants can increase the price of their product by the value of the settlement coupon “so that there is no economic effect on the seller or buyer.”²⁰³ For consumers as a whole, settlement coupons “have very small effects on the average price paid by all consumers; the harm to non-discount consumers is about equal to the benefit to discount consumers.”²⁰⁴ This means that the rational defendant will raise its retail price in such a way that the consumers not using settlement coupons will subsidize those consumers who do use the settlement coupons.²⁰⁵ Thus, the net effect on consumers as a group is nil. While some consumers are winners and some are losers, the defendant unambiguously wins.

The presence of alternative sources for the product does not alter the conclusion. Competition does not appear to prevent antitrust defendants from raising their retail price after disseminating the discount coupons.²⁰⁶ Yet, despite the settlement coupons’ susceptibility to manipulation, courts have rejected arguments that price increases could negate coupon utility.²⁰⁷

If the settlement were all cash, the defendant could still attempt to raise the price of its products in order to recoup the anticipated lost profits

correct, the greatest impact will be felt by non-class members who have a relatively low reservation price and have no redeemable coupon. Yet if the percentage of these consumers is relatively small, they will not constrain the defendant from raising price following distribution of the settlement coupons.

202. Logically, the defendant need not raise price by the full amount of the coupon face value for two reasons. First, an increase in price will diminish sales to non-coupon holders. Second, some sales at the higher price will be made without coupons, which will increase revenues such that the defendant can lose some net revenue by raising price less than the coupon’s face value.

203. Borenstein, *supra* note 5, at 382.

204. *Id.* at 379.

205. Professor Severin Borenstein shows that regardless of the actual percentage of the consumer population receiving the discount, “the total effect on all consumers will still be approximately zero and seems as likely to be negative as positive.” *Id.* at 382.

206. *See id.* at 386–88.

207. For example, in *Domestic Air*, the court rejected the argument, asserting that the defendant airlines would “not be able to negate the economic usefulness of the certificates by raising air fares.” *In re Domestic Air Transp. Antitrust Litig.*, 148 F.R.D. 297, 321 (N.D. Ga. 1993). The court did not meaningfully explain the reasoning behind this conclusion, but one suspects that the court was relying on the fact that the coupons could be combined such that the higher the airfare, the greater the number of coupons could be aggregated to go towards that purchase price. However, there was always a cap of 10 percent of the purchase price for any use of the coupons. *See id.* By raising airfares, defendant airlines could reasonably get a profit on 90 percent of the increase in price as well as effectively remove the coupons from circulation. In short, a price increase could diminish further the value of the coupons held by the class members.

caused by coupon redemption.²⁰⁸ However, the class members would not be required to spend their cash on the defendant's product. As a result, the consumer could purchase another product from another producer in response to any price increase by the defendant.

In sum, many rational class action defendants will raise their retail prices after disseminating settlement coupons.²⁰⁹ Class members who did not want to pay this higher price would not redeem their coupon and would consequently not receive any compensation from the settlement. For these members' coupons, the defendant achieves the Non-Use Outcome. Class members who did redeem their coupons would make purchases at the equivalent of the pre-settlement price and therefore would receive no net value under the settlement. For these members' coupons, the defendant makes sales at full profit.²¹⁰ In either case, the class member achieves the same utility as she would if there had been no litigation, or no settlement at all.

b. Negating Coupon Value by Reducing Quality

In addition to price increases, defendants can manipulate coupon value by selectively reducing quality or service. For some products, defendants can offset the value of settlement coupons by lowering the quality of goods for which the coupons are redeemable.²¹¹ It may seem counterintuitive that a defendant would decrease service or quality merely to negate the value of a settlement coupon. After all, one could lose customers. However, defendants can get around the risk of alienating non-class customers by restricting the coupons to specified products and then increasing price and/or reducing quality on this limited range of products. The case law is rife with examples of precisely this type of end-run.²¹² For example, in some cases, settlement coupons could only be used for a "weekly special." The defendant routinely produced a lower-quality product for the "special" that was targeted to coupon holders.²¹³

208. This assumes that the firm is not already charging its profit-maximizing price, which a rational firm would be doing according to economic theory.

209. See Borenstein, *supra* note 5, at 385–86. When the class is represented by state attorneys general in a *parens patriae* action, the settlement terms may prevent price hikes. See, e.g., *New York v. Nintendo of Am., Inc.*, 775 F. Supp. 676, 679 (S.D.N.Y. 1991) ("Nintendo will be enjoined from raising the wholesale price and the suggested retail price of the games during the redemption period."). However, such state-initiated actions represent a minority of coupon settlements.

210. If the sale is an Induced Purchase, the defendant is even better off.

211. See Gramlich, *supra* note 6, at 269.

212. See *id.* at 278. For a discussion on product restrictions in settlement coupons, see *supra* notes 166–184 and accompanying text.

213. Gramlich, *supra* note 6, at 275.

In some cases, decreased quality takes the form of decreased service. This is particularly evident in class actions against real estate brokers. In one case, the defendants settled the litigation by giving the class members scrip that reduced the amount of commission that they had to pay their realtors upon selling their property. Home sellers with scrip paid a 5 percent, instead of the standard 6 percent, commission to the realtors.²¹⁴ In addition to requiring the class members to sell their homes in order to partake in the class recovery, each class member had to deposit the scrip certificate with the listing broker at the time of listing. Such listings were denoted with asterisks in the multiple listing service; both home sellers and brokers recognized “that such 5% listings were not shown as readily to buyers.”²¹⁵ By notifying realtors which clients intended to pay with scrip, realtors provided inferior service to class members.²¹⁶

Like increases in price, decreases in quality can negate the utility of settlement coupons. Yet defendants achieve two strategic advantages by manipulating coupon value. First, both price increases and quality decreases increase the likelihood that class members will simply forego redeeming their coupons, thus allowing defendants to achieve their desired Non-Use Outcome for a greater proportion of the coupons issued.²¹⁷ Second, in the event that a class member chooses to use her settlement coupon to make a purchase, the defendant makes a greater profit on that sale than it would have if it had not manipulated price or quality.²¹⁸

3. Coupon Settlements as Price Discrimination

Promotional coupons are the classic vehicle for price discrimination whereby a producer can supply the same product to different consumers at different prices.²¹⁹ While some scholars argue that price discrimination is

214. See *id.*

215. *Id.* at 278.

216. See *id.* (discussing *Voith v. Allardt Gallery of Homes, Inc.*, No. IP 78-147-C (S.D. Ind. Mar. 6, 1981); *In re Montgomery County Real Estate Antitrust Litig.*, 83 F.R.D. 305 (D. Md. 1979); *McKerall v. Huntsville Real Estate Bd.*, No. 74-L-449, 1976 WL 1201 (N.D. Ala. Jan. 29, 1976); *Butowsky v. Prince George's County Bd. of Realtors, Inc.*, No. 71-1086K (D. Md. 1975)); *cf. Montgomery County*, 83 F.R.D. at 312 (requiring defendants to “apply equivalent effort” to the sale of houses covered by [settlement] certificates”).

217. See *supra* note 111.

218. For Non-Induced Purchases, the defendant reduces the coupons’ encroachment into the defendant’s profit margin. For Induced Purchases, the defendant still gets an additional sale, but now with an even greater profit.

219. See, e.g., Jamie Howell, *Potential Profitability and Decreased Consumer Welfare Through Manufacturers’ Cents-Off Coupons*, 25 J. CONSUMER AFF. 164 (1991); Chakravarthi Narasimhan, *A Price Discrimination Theory of Coupons*, 3 MARKETING SCI. 128 (1984).

efficient, consumers in the aggregate are made worse off. Price discrimination has two major, and related, effects: Seller profits increase and consumer welfare decreases.²²⁰ In general, as a result of varying tastes and levels of wealth, different consumers are often willing to pay a different price for the same good. If a supplier charges one low price for that good, the consumer who is willing to pay more experiences a consumer surplus. Coupons have the effect of allowing a supplier to charge a higher base price for the product whereby people willing to pay that price do so, but people who are not willing to pay that higher price can use a coupon that brings the price down. In general, when coupons are available, many consumers tend to pay the suggested retail price, whereas other consumers—who have more time to clip coupons (or a relatively low marginal value for their time)—redeem coupons, thus reducing the price they pay. The net result is that some consumers pay a higher price for the same good.

In many cases, settlement coupons may constitute court-sanctioned price discrimination. Settlement scrip is a form of coupon and all coupons create opportunities for price discrimination. Furthermore, some defendants structure settlement coupons to maximize the price discrimination effects.²²¹ Settlement coupons clearly facilitate price discrimination when the coupons have a low face value because “a significant proportion of possible beneficiaries would not find it worth the time or inconvenience to obtain and use the coupons even if they bought the product.”²²² As a result, while low-income class members may redeem the coupon because it reduces the purchase price, high-income class members may not bother to use their coupons. In both instances, the defendant wins by achieving its two preferred outcomes, Induced Purchase (for some class members who redeem) and Non-Use (for class members who do not bother to redeem).²²³

It is particularly ironic that courts approve coupon settlements when the underlying offense is price discrimination.²²⁴ Yet in a wide variety of

220. Because of this decrease in consumer welfare, antitrust law prohibits many forms of price discrimination.

221. For example, transfer restrictions facilitate price discrimination. The ability to price discriminate requires the power to stop arbitrage. By making settlement coupons nontransferable, the defendant has implemented an effective block against arbitrage. Class members cannot transfer the coupons to someone who would purchase the product at the higher price.

222. Borenstein, *supra* note 5, at 380 (citing the example of a soft drink settlement under which a bottler attached cents-off coupons to bottles).

223. See *supra* notes 110–111 and accompanying text.

224. See, e.g., Emily Nelson, *Corporate Focus: The Future May Not Be So Bright for Bausch & Lomb; Analysts Worry that Eyewear Maker Has Picked Out the Wrong Businesses*, WALL ST. J., Aug. 9, 1996, at B4 (noting that Bausch & Lomb “agreed to pay up to \$34 million in cash and \$34 million in coupons to settle a class-action lawsuit which charged it improperly sold identical lenses under different names for different prices”).

cases, courts often fail to comprehend the price discrimination effects of settlement coupons.²²⁵ When this occurs, judges may be unwitting participants in a marketing scheme in which firms sort their customers into categories and attempt to extract the maximum amount of money from each group.²²⁶

E. Net Effect of Restrictions on Settlement Coupons

Cataloging coupon restrictions and the potential problems of coupon settlements one at a time risks losing sight of the big picture. The cumulative effect of these restrictions is a low redemption rate. One study found that the final redemption rate was 26.3 percent for those cases in which the settlement was paid in coupons.²²⁷ The numbers vary wildly depending on whether or not the class members were individual consumers or businesses. For the ten cases that had consumers as plaintiffs, the redemption rate was 13.1 percent.²²⁸ In some cases, redemption rates have been as low as 3 percent.²²⁹ Low redemption rates prove that many defendants have been quite successful in achieving the Non-Use Outcome for the majority of coupons issued to consumers.

By imposing the restrictions discussed in this part, defendants structure settlement coupons like promotional coupons.²³⁰ Manufacturers structure all coupons to increase the probability that consumers will use coupons for purchases that would not otherwise occur and to decrease the probability that consumers will use the coupons for purchases that would take place without it. Thus, with both promotional and settlement coupons, issuers impose transferability, aggregation, product, and time restrictions on the

225. See Borenstein, *supra* note 5, at 381.

226. See *id.* (“Assisting the defendants in sorting consumers clearly is not the goal of the legal process in these cases.”).

227. See Gramlich, *supra* note 6, at 274.

228. See *id.* In contrast, in the two cases that had corporate plaintiffs, the redemption rate was 91.8 percent. See *id.*

229. See, e.g., *Buchet v. ITT Consumer Fin. Corp.*, 845 F. Supp. 684, 695 (D. Minn. 1994). In the *General Motors* case, “according to the marketing expert hired by *class counsel*, because of the high cost of purchasing a vehicle, the short redemption period, and the restrictions on transfer, *more than half of the class* would obtain no value at all from the settlement.” Wolfman & Morrison, *supra* note 80, at 474.

230. There are, of course, some differences. While many businesses may want high redemption rates for promotional coupons—because this indicates that new consumers have been induced to try the product—these same firms do not necessarily want high redemption rates for settlement coupons because class members are not new users who need to be induced to try the product. In theory, the class should be comprised of consumers who purchased the product at a fixed price. Thus, a settlement coupon does not induce new consumers to try a product. Similarly, consumers who would go to the effort to purchase a settlement coupon in a free market are probably not consumers being induced to make a purchase that they otherwise would not.

coupons. For defendants, settlement coupons have the same cost-benefit structure of traditional promotional coupons.²³¹ But settlement coupons have the additional advantage of wiping out millions of dollars of potential legal liability.

Courts and class counsel should not allow defendants to structure settlement coupons like promotional coupons. In a capitalist economy, businesses have great latitude to develop and structure their promotional schemes. Subject to consumer protection and antifraud laws, suppliers are generally free to impose restrictions on the redemption of coupons. Because most coupons are promotional tools that are gifts, not entitlements, the issuer can set any limitations it wants. No one would seriously argue that a supplier should not be free to impose restrictions, such as expiration dates, on voluntarily issued promotional coupons. In contrast, a class action defendant does not, and should not, have significant unilateral authority in structuring a proposed settlement, whether coupon-based or not. The two types of coupon schemes exist on different planes. The promotional coupon scheme is unilaterally designed and implemented; the settlement coupon scheme is negotiated and court-approved.

Promotional and settlement coupons serve different purposes. The former exist solely to maximize the profits of their issuers; the latter are supposed to be compensatory to victims of the issuers' alleged wrongdoing. Settlement coupons should advance the purposes of settlement: compensation of class members and deterrence of wrongdoing. The vast majority of coupon-based settlements resolve class action litigation based on causes of action sounding in antitrust or tort, often products liability. The primary purposes behind federal antitrust and state tort laws are two-fold: to compensate the victims of the alleged violations and to deter the defendant (or others in a similar position) from committing future violations.²³² Class action litigation has the potential to achieve these goals.²³³ However, given the inherent

231. Settlement coupons have some characteristics that increase the likelihood of an Induced Purchase as compared to traditional promotional coupons. For example, when consumers believe that another coupon will be issued shortly, they are less likely to make an Induced Purchase. See Füsün Gönül & Kannan Srinivasan, *Estimating the Impact of Consumer Expectations of Coupons on Purchase Behavior: A Dynamic Structural Model*, 15 *MARKETING SCI.* 262 (1996). If consumers know that another coupon is about to be issued (or has, in fact, been issued), it functionally extends the expiration of the initial coupon, which can be discarded without perceived loss because it has been replaced. Thus, a stream of coupons will mitigate the increased coupon redemption associated with regret theory. However, the fact that another settlement coupon is not forthcoming should increase the Induced Purchases as the expiration date approaches.

232. See Geoffrey P. Miller, *Some Agency Problems in Settlement*, 16 *J. LEGAL STUD.* 189, 194 (1987).

233. See HENSLER ET AL., *supra* note 15, at 6.

problems with coupon-based settlements, neither of these goals is generally achieved when class members are paid in coupons.²³⁴

Settlement coupons rarely adequately compensate the class. Unused coupons constitute compensation denied.²³⁵ In those settlements characterized by low redemption rates, the class as a whole is denied adequate compensation. For those coupons that are redeemed, it is difficult to accurately determine what percentage were used for Non-Induced Purchases. For those transactions in which the coupons induced the sale, the compensation is less than a cash-based settlement.²³⁶ In short, as opposed to being a method of compensating class members, coupons appear to be used as an effective method for defendants to avoid paying damages.²³⁷

Secondly, payment based on settlement coupons does not adequately deter future violations. Both antitrust and tort law attempt to establish appropriate incentives for individuals and corporations to obey the law. Class actions sounded in antitrust and tort also seek to deter violations.²³⁸ Deterrence is often a function of two complementary sub-goals: punishment and disgorgement of ill-gotten gains. Punishment increases the costs of illegal conduct, such that the costs are greater than the perceived benefit. Conversely, disgorgement of ill-gotten gains should decrease the perceived benefits of violating the law by denying wrongdoers the fruits of their illegal conduct.²³⁹ Thus, punishment increases costs and disgorgement reduces benefits. Often working in tandem, the ultimate purpose of punishment

234. Some commentators argue that disgorgement of ill-gotten gains is a more important goal than delivering compensation to the victims of the underlying cause of action. See Richard L. Marcus, *They Can't Do That, Can They? Tort Reform Via Rule 23*, 80 CORNELL L. REV. 858, 889 (1995).

235. When a class member must send in for a claim form, the class member who does not redeem her coupon suffers a net loss under the coupon settlement. See Patrick Higginbotham, *Class Action Litigation*, 41 N.Y.L. SCH. L. REV. 343, 345 (1997).

236. When the stakes are higher, the specter of a potentially worthless settlement is even more offensive. See Marcus, *supra* note 234, at 889 ("Whether or not class members can make an accurate assessment of the coupons offered in settlement of price-fixing claims against airlines is less important than whether people who may be relinquishing the right to go to court to recover damages for life-threatening personal injuries understand what they are doing").

237. See Gramlich, *supra* note 6, at 279; Wolfman & Morrison, *supra* note 80, at 473 (noting that coupon settlements "rais[e] the question whether large segments of the class are releasing their claims without obtaining any value").

238. See NAT'L ASS'N OF CONSUMER ADVOCATES, STANDARDS AND GUIDELINES FOR LITIGATING AND SETTLING CONSUMER CLASS ACTIONS, 176 F.R.D. 375, 380 (1997) [hereinafter NACA].

239. The deterrent effect of settlements is primarily a function of disgorgement. Settlements are generally not punitive. Only a defendant who faced a very high probability of liability and imposition of punitive damages at trial would agree to pay the equivalent of punitive damages in a settlement. However, settlements should attempt to disgorge ill-gotten gains. If not, then the settlement serves little, if any, deterrent purpose.

and disgorgement is to make violating the law not cost-beneficial. Whether a payment is characterized as punishment or disgorgement, deterrence requires that the defendant pay a meaningful amount of money for its wrongdoing.²⁴⁰

Coupon settlements have minimal, if any, deterrent value. To serve as a deterrent, the settlement must force the defendant to pay out a sum of money sufficient to render the underlying alleged violation not net profitable.²⁴¹ Coupon settlements often fail to force disgorgement of illegal gains, let alone to punish.²⁴² First, defendants set coupon values and restrictions in order to insure that sales made with coupons still net a profit. For settlement coupons that entitle the purchaser to a percentage discount, that percentage is set below the defendant's profit margin for that item. For coupons with an absolute dollar discount, defendants restrict redemption to purchases greater than a certain price, thus insuring a profit on the overall sale.²⁴³ Most coupon settlements merely diminish the profit ratio on future sales while increasing the number of such sales. So long as the increase in sales compensates for the decrease in profits per sale, the coupon settlement can increase the defendant's net profits. This, in fact, occurs.²⁴⁴ Thus, many settlement coupons—far from making the defendant disgorge ill-gotten gains—may themselves be net beneficial to the defendant.²⁴⁵

240. See HENSLER ET AL., *supra* note 15, at 421. Payments to class counsel may serve a deterrent or disgorgement function. *Cf. id.* at 121 ("As long as defendants pay enough to deter bad behavior, economic theorists tell us, it does not matter how their payment is distributed."). The primary disgorgement is the payment to the class counsel, followed by administrative costs to implement the coupon plan. See, e.g., *New York v. Nintendo of Am., Inc.*, 775 F. Supp. 676, 679 (S.D.N.Y. 1991); *Ohio Pub. Interest Campaign v. Fisher Foods, Inc.*, 546 F. Supp. 1, 5 (N.D. Ohio 1982); *In re Montgomery County Real Estate Antitrust Litig.*, 83 F.R.D. 305, 312 (D. Md. 1979). Defendants also must pay their own attorneys' fees.

241. Even small monetary settlements that have been ridiculed in the press, see, e.g., Editorial, *Review and Outlook: Taken for a Ride*, WALL ST. J., Oct. 23, 1996, at A22, at least cost the defendant millions of dollars in the aggregate, which disgorges some ill-gotten gains and provides some level of deterrence.

242. See *Clement v. Am. Honda Fin. Corp.*, 176 F.R.D. 15, 27 (D. Conn. 1997) ("Even [the defendant's] corporate representative admitted at the final hearing that the coupon's value was negligible in determining the loss [that the defendant] would suffer from the settlement."); Bob Zarnetske, *Oregon Class Actions: The Continuing Need for Legislative Reform*, 72 OR. L. REV. 205, 222 (1993).

243. See, e.g., *Livingston v. Toyota Motor Sales USA, Inc.*, No. C-94-1377, No. C-94-1359, No. C-94-1960, 1995 U.S. Dist. LEXIS 21757, at *34 (N.D. Cal. May 30, 1995); *In re Domestic Air Transp. Antitrust Litig.*, 148 F.R.D. 297 (N.D. Ga. 1993).

244. See Zarnetske, *supra* note 242, at 224 (citing example).

245. The *Clement* court found that

For every coupon that [the defendant] receives, it is able to finance or lease another car. In other words, by merely offering to reduce the price of a car by less than 1% of its price, [the defendant] is able to increase business and profits by financing the sale and lease of more cars.

Clement, 176 F.R.D. at 28; see also *Boyed v. Gen. Motors Corp.*, 881 S.W.2d 422, 431 (Tex. Ct. App. 1994), *aff'd on other grounds*, 916 S.W. 2d 949 (Tex. 1996); HENSLER ET AL., *supra* note 15,

Second, unlike a cash-based settlement, the defendant need not disgorge any of the money made as a result of the alleged violation. For example, one study found that “coupons were never financed from a prefunded cash account dedicated solely to this purpose.”²⁴⁶

Finally, coupon settlements reward defendants because settlement coupons provide a competitive advantage to offerors. After all, coupons induce sales and encourage consumers to switch to the coupon issuers’ brands.²⁴⁷ For a product that consumers purchase every five years, a defendant who can induce class members to use a settlement coupon can lock its competitors out of the market for a considerable time.²⁴⁸ Courts often do not recognize the market-distorting properties of settlement coupons.²⁴⁹ At least one court has acknowledged the anti-competitive harm imposed on competitors who were not defendants that issued coupons.²⁵⁰ Thus, in extreme cases, after the parties announced the coupon settlements, nondefendants asked to be included in the litigation, lest the original defendants gain a competitive advantage through the settlement coupons.²⁵¹ Unfortunately, sometimes

at 33 (“The primary problem with coupon settlements is that [they fly] in the face of the sound precepts upon which our capitalist economy is based. Rather than punishing a wrongdoer for its wrongful actions, it instead rewards that wrongdoer with additional business from the very persons it caused harm.” (quoting attorney Stephen Gardner)); Nancy B. Rapoport, *Turning and Turning in the Widening Gyre: The Problem of Potential Conflicts of Interest in Bankruptcy*, 26 CONN. L. REV. 913, 966 n.197 (1994).

246. Gramlich, *supra* note 6, at 277.

247. See *supra* notes 28–32 and accompanying text.

248. Such an effect is particularly ironic when the underlying class action litigation seeks to remedy alleged antitrust violations. This suggests, at a minimum, a need for special consideration or rules when durable goods are involved because of the greater risk of settlement coupons distorting the market.

249. For example, the *Domestic Air* court tried to assert that promotional coupons were qualitatively different from traditional promotional coupons because the interchangeable settlement coupons were “not designed to induce a passenger to switch travel from one carrier to another.” *In re Domestic Air Transp. Antitrust Litig.*, 148 F.R.D. 297, 332 n.41 (N.D. Ga. 1993). But the coupons are designed to encourage people to fly who otherwise would not—an Induced-Purchase Outcome. (That is why the coupons are not usable during high traffic periods when consumers would fly anyway.)

250. See *New York v. Dairylea Coop., Inc.*, 547 F. Supp. 306, 308 (S.D.N.Y. 1982).

251. See Gramlich, *supra* note 6, at 262. Alaska Airlines asked to be added as a defendant in the airlines’ price-fixing case. Its spokesperson explained, “The airlines using these coupons are going to see substantial additional ticket sales because of them We asked to be named in the case because, once we saw the settlement, we realized it was to our competitive disadvantage not to do so.” Anthony Faiola, *In Settling with Airlines, There’s No Free Ride; Coupons for Travelers, \$16 Million for Lawyers*, WASH. POST, Mar. 20, 1995, at A1 (quoting Alaska Air spokesperson Louis Cancelmi); see also *Ohio Pub. Interest Campaign v. Fisher Foods, Inc.*, 546 F. Supp. 1, 5 (N.D. Ohio 1982) (“These Certificates may be used by the recipients to purchase food products from the settling defendants or from any other qualified grocery vendor that applies to the Court and agrees to redeem and honor the Certificates submitted by consumers in accordance with their terms.”).

courts fail to appreciate the anti-competitive effects of coupon settlements.²⁵² Both theory and empirical evidence show that coupon settlements do not deter future violations of the law.²⁵³

In theory, coupon values and redemption terms could be set to effect deterrence;²⁵⁴ however, defendants sufficiently control the settlement negotiation process to prevent this. A class action settlement limits the defendants' liability. Disgorgement is the price of extinguishing liability.²⁵⁵ But with many coupon settlements, the defendant eliminates future liability at minimal present cost.²⁵⁶

Despite these truths, courts have rejected such arguments when evaluating coupon settlements.²⁵⁷ Although some courts have recognized these problems,²⁵⁸ other courts impliedly distance themselves from disgorgement as a goal at all.²⁵⁹ In sum, coupon settlements neither punish the defendant nor adequately disgorge ill-gotten gains.²⁶⁰ This undermines the entire purpose of the class action mechanism.

252. See *In re Mid-Atl. Toyota Antitrust Litig.*, 564 F. Supp. 1379, 1386 (D. Md. 1983) ("[S]ome exploration of the competitive effect of the certificates might be merited later, but it should not derail the orderly workings of the settlement process at this point."); see also *In re Montgomery County Real Estate Antitrust Litig.*, 83 F.R.D. 305, 319-20 (D. Md. 1979) (discussing potential anti-competitive effects of coupon settlement).

253. See *Clement v. Am. Honda Fin. Corp.*, 176 F.R.D. 15, 30 n.24 (D. Conn. 1997); Stephen Calkins, *An Enforcement Official's Reflection on Antitrust Class Actions*, 39 ARIZ. L. REV. 413, 445 (1997) ("If the purpose [of the class action] is deterrence, it makes little sense to approve a coupon program so commercially attractive that non-defendant firms ask to participate.").

254. See HENSLER ET AL., *supra* note 15, at 85.

255. See *Amchem Prods., Inc. v. Windsor*, 521 U.S. 591, 626 (1997).

256. See Edwin Lamberth, Comment, *Injustice by Process: A Look at and Proposals for the Problems and Abuses of the Settlement Class Action*, 28 CUMB. L. REV. 149, 164 (1998).

257. See *In re Cuisinart Food Processor Antitrust Litig.*, 1983-2 Trade Cas. (CCH) ¶ 65,680, at 69,473 (D. Conn. Oct. 24, 1983).

258. See, e.g., *Bloyed v. Gen. Motors Corp.*, 881 S.W.2d 422, 431 (Tex. Ct. App. 1994), *aff'd on other grounds*, 916 S.W.2d 949 (Tex. 1996).

259. See, e.g., *Dunk v. Ford Motor Co.*, 56 Cal. Rptr. 2d 483, 490 n.14 (Cal. Ct. App. 1996) ("We do not imply, however, that settlements benefiting the defendant along with the class members should be automatically disapproved. 'Win-win' settlements are not per se unreasonable.").

260. Of course, private class actions are not the only litigation tool. State officials can bring *parens patriae* suits against businesses that violate consumer or antitrust laws. See, e.g., *Pennsylvania v. Budget Fuel Co.*, 122 F.R.D. 184, 186 (E.D. Pa. 1988). Nevertheless, private litigation can still provide supplemental deterrence. See Calkins, *supra* note 253, at 440. Stephen Calkins argues, "although inevitably there are some abusive cases, it is likely that many antitrust class actions still play a useful role, especially through deterring conduct that stops short of being criminal and through identification of antitrust violations that might otherwise go unchallenged." *Id.* at 451.

III. THE ACQUIESCENCE OF CLASS COUNSEL IN COUPON SETTLEMENTS

Given the litany of problems—potential and realized—presented by coupon settlements, the increasing popularity of coupon-based settlements may seem puzzling. After all, if coupon settlements are of so little value, why do class members agree to them? As a general matter, any defendant settles to avoid litigation costs and the risk of liability coupled with an excessive damages award. Applying the same principle from the opposite perspective, a plaintiff settles to avoid litigation costs and the risk of a finding of no liability (an all-out defeat) or of a low damage award (a marginal defeat). But these general propositions cannot be imported wholesale into discussions of class action litigation. In the class action context, the negotiating parties are not the defendant and the plaintiff, but the defendant and the plaintiffs' class counsel.²⁶¹ Attorneys, not class members, control the litigation. In any class action with a reasonable probability of success, a coupon-based settlement insures that the defendant will be able to settle the class claims for significantly less than the expected costs of going forward with the litigation. In short, the class context does not alter the defendant's incentive structure and coupon settlements present an excellent opportunity to settle on favorable terms. Coupon-based settlements can serve this goal by eliminating all potential liability in exchange for what is, in effect, a promotional scheme.²⁶² For plaintiffs, though, coupon settlements raise the specter of unfaithful fiduciaries and of unsatisfactory settlements.

261. Changing the identities of the decision-makers significantly changes the calculus. When settling a class action, the defendant's incentive in negotiations remains the same as it is in all litigation: settle the case for less than the expected value of the litigation if it were to proceed to trial.

Thus, if the defendant believes that there is a 25 percent chance of losing at trial and that the damages award would be \$10 million, then a rational defendant would settle for any amount less than \$2.5 million, which is the probability of losing multiplied by the cost of losing. Because this calculation is for illustrative purposes, it is overly simple. In reality, the defendant would also calculate all of the transactions costs associated with proceeding to trial and add these to the \$2.5 million figure in order to calculate the maximum acceptable settlement amount. Even this calculation can invite additional layers of complexity, such as decreasing the maximum permissible settlement figure by the monetary value of the risk that a settlement will encourage new plaintiffs to come forward and sue the defendant.

262. See *supra* notes 241–253 and accompanying text (explaining how coupon settlements can represent a net gain for class action defendants).

A. Agency Costs in Class Action Litigation and Risks of Collusion

Although the class counsel has a duty to represent the interests of the class,²⁶³ agency costs may encourage attorneys to pursue their own self-interest. Agency costs exist when a principal hires an agent to perform a task but the agent's remuneration is not directly tied to the principal's gain such that the agent may increase her payoff by being faithless. For example, an agent may fail to pursue the principal's agenda either by being lazy or by pursuing her own interests at the expense of her principal. When agency costs are sufficiently high, the principal may be unable to efficiently monitor the agent and must instead trust the agent to maximize the principal's payoff. This is when the faithless agent can have a field day.

Agency costs abound in attorney-client relationships. For example, the relative incentives of the client (the principal) and the attorney (the agent) to settle a given piece of litigation reflect agency costs. Attorneys in class action litigation have a high incentive to settle.²⁶⁴ The attorneys front litigation costs.²⁶⁵ Absent a settlement, the attorney has no guarantee that she will recover these costs.²⁶⁶ The self-interested attorney seeks to maximize the return on her involvement in the litigation while minimizing the resources expended. Such an attorney prefers an early settlement when it "bear[s] a higher ratio to the cost of the work than a much larger recovery obtained only after extensive discovery, a long trial and an appeal."²⁶⁷ As a result, even when a trial would increase the net recovery for class members, class counsel can maximize its rate of return by avoiding trial and settling early.

263. Indeed, a failure to adequately represent the interests of absent plaintiffs may make the action nonbinding on the absent plaintiff. See *Hansberry v. Lee*, 311 U.S. 32, 42–43 (1940) (discussing the Due Process Clause); see also Roger C. Cramton, *Individualized Justice, Mass Torts, and "Settlement Class Actions": An Introduction*, 80 CORNELL L. REV. 811, 827–28 (1995) ("It is a due process issue, not merely a fairness concern, whether class counsel adequately represented the class . . .").

264. See *Tornabene v. Gen. Dev. Corp.*, 88 F.R.D. 53, 56 (E.D.N.Y. 1980) ("An attorney may be willing to settle a class action, without due regard for the best interests of class members in order to avoid the risk of defeat at trial." (quoting *Developments in the Law—Class Actions*, 89 HARV. L. REV. 1318, 1605 (1976))).

265. See *Miller*, *supra* note 232, at 190 ("When the defendant has made a lump-sum offer of settlement, the attorney's interest may often call for accepting the offer, but the plaintiff might be better off going to trial.").

266. See Sylvia R. Lazos, Note, *Abuse in Plaintiff Class Action Settlements: The Need for a Guardian During Pretrial Settlement Negotiation*, 84 MICH. L. REV. 308, 314 (1985).

267. *Saylor v. Lindsley*, 456 F.2d 896, 900 (2d Cir. 1972) (Friendly, J.) (discussing shareholder derivative suits); see also *In re Superior Beverage/Glass Container Consol. Pretrial*, 133 F.R.D. 119, 124 (N.D. Ill. 1990) (citing *Chesny v. Marek*, 720 F.2d 474, 477 (7th Cir. 1983)).

While many attorney-client relationships are plagued by agency costs, agency costs are greater in the class action context.²⁶⁸ The agency costs are magnified in class action litigation in part because the vast majority of class members have absolutely no meaningful relationship with their counsel.²⁶⁹ As a result, some judges refer to class action litigation as “lawyer’s lawsuits.”²⁷⁰ In general, the problem of agency costs is magnified when the agent has more knowledge than the principal. Class counsel almost invariably have superior information compared to class members. Attorneys largely control the entire settlement process.²⁷¹ When the attorney has such a substantial financial stake in the outcome of the litigation, the class counsel arguably becomes the principal.²⁷² As a result, class actions are rife with actual and potential conflicts of interest.²⁷³

268. See Miller, *supra* note 232, at 195; Genine C. Swanzey, *Using Class Actions to Litigate Mass Torts: Is There Justice for the Individual?*, 11 GEO. J.L. ETHICS 421, 431 (1998).

269. See *In re Auction Houses Antitrust Litig.*, 197 F.R.D. 71, 78 (S.D.N.Y. 2000) (“However, they often can be far more severe in the class action context, primarily because classes tend to be large, dispersed and disorganized and therefore suffer from a collective action dilemma not faced by individual litigants.”).

270. *Van Gemert v. Boeing Co.*, 573 F.2d 733, 735 (2d Cir. 1978) (citing *Developments in the Law*, *supra* note 264).

271. See Deborah R. Hensler, *Resolving Mass Toxic Torts: Myths and Realities*, 1989 U. ILL. L. REV. 89, 92–97.

272. See Lester Brickman, *ABA Regulation of Contingency Fees: Money Talks, Ethics Walks*, 65 FORDHAM L. REV. 247, 285 (1996).

273. See Howard M. Downs, *Federal Class Actions: Diminished Protection for the Class and the Case for Reform*, 73 NEB. L. REV. 646, 651 (1994) (“In reality, every class action involves numerous conflicts of interest which must be identified, analyzed, and evaluated prior to class certification and during the course of litigation, as well as throughout any settlement proceedings.”); see also John C. Coffee, Jr., *Class Wars: The Dilemma of the Mass Tort Class Action*, 95 COLUM. L. REV. 1343, 1350 (1995) (discussing conflicts between present and future claimants in mass tort class actions); Rapoport, *supra* note 245, at 967 (discussing conflicts when class members seek different remedies); Swanzey, *supra* note 268, at 424.

Several factors may either increase or indicate the presence of agency costs. For example, cases in which the class is certified only for settlement purposes raise particular suspicion of collusion. See Mary J. Davis, *Toward the Proper Role for Mass Tort Class Actions*, 77 OR. L. REV. 157, 189 (1998); Susan P. Koniak, *Feasting While the Widow Weeps: Georgine v. Amchem Products, Inc.*, 80 CORNELL L. REV. 1045, 1153 (1995). The conflict between a class and its counsel increases when the counsel simultaneously negotiates its fees and the ultimate settlement. See *Prandini v. Nat’l Tea Co.*, 557 F.2d 1015, 1021 (3d Cir. 1977); HENSLER ET AL., *supra* note 15, at 78. *But see Evans v. Jeff D.*, 475 U.S. 717, 740–41 (1986).

The law of class actions recognizes the problem that the interests of class members not active in the litigation may not be adequately represented. For example, Federal Rule of Civil Procedure 23(e) requires the trial judge to approve any proposed settlement to class action litigation to insure that the class counsel has not succumbed to the temptation to maximize attorneys’ fees at the expense of the class members’ interests. See *infra* notes 313–321 and accompanying text.

Congress has expressed concern in many contexts about the disconnect between class members and class counsel. For example, in enacting the Private Securities Litigation Reform Act (PSLRA) of 1995, 15 U.S.C. § 77a–z (2001), Congress based its reform, in part, on “the manipulation by class action lawyers of the clients whom they purportedly represent.” H.R. CONF. REP.

Agency costs create a risk of collusion between the defendants and class counsel. Because the interests of class members and class counsel diverge, the class counsel may attempt to sell out the class.²⁷⁴ Some courts have recognized that class counsel “might urge a class settlement at a low figure or on a less-than-optimal basis in exchange for red-carpet treatment for fees.”²⁷⁵ Professor Charles Wolfram has argued that “most [class action] lawyers regard themselves as entrepreneurs and largely act accordingly.”²⁷⁶ Defendants are well-aware of these agency costs. Once in class action litigation, the defendant wants to maximize the number of claims extinguished at the minimum possible costs. Rational defendants are indifferent as to allocation of money between the class and its counsel. Defendants know that they can minimize their liability by effectively bribing the class counsel to reduce the class recovery in exchange for a greater payoff for the attorneys.²⁷⁷ In exchange

NO. 104-369 (1995), reprinted in 141 CONG. REC. H13,692, H13,699. Thus, to protect class members in securities class actions, Congress imposed specific settlement notice requirements in the PSLRA. See 15 U.S.C. § 77z-1(a)(7) (2001).

274. Professor John Coffee has explained:

The principal-agent problem that is endemic to class and derivative actions implies that there are three sets of interests involved in these actions: those of the defendants, the plaintiffs, and the plaintiff's attorneys. Often the plaintiff's attorneys and the defendants can settle on a basis that is adverse to the interests of the plaintiffs. At its worst, the settlement process may amount to a covert exchange of a cheap settlement for a high award of attorney's fees.

John C. Coffee, Jr., *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, 714 (1986); see also *Plummer v. Chem. Bank*, 668 F.2d 654, 658 (2d Cir. 1982) (“Because of the limited control exercisable by class members, class settlements are susceptible to abuse. . . . The interest of lawyer and class may diverge . . . and certain interests may be wrongfully compromised, betrayed, or ‘sold out’ without drawing the attention of the court.” (quoting *In re Beef Indus. Antitrust Litig.*, 607 F.2d 167, 174 (5th Cir. 1979))).

275. *Weinberger v. Great N. Nekoosa Corp.*, 925 F.2d 518, 524 (1st Cir. 1991); cf. *In re Matzo Food Prods. Litig.*, 156 F.R.D. 600, 606 (D.N.J. 1994) (describing proposed settlement that distributed nothing to class members as “simply a thinly disguised ploy for the recovery of nearly \$500,000 in attorneys’ fees”).

276. Charles W. Wolfram, *The Second Set of Players: Lawyers, Fee Shifting and the Limits of Professional Discipline*, LAW & CONTEMP PROBS., Winter 1984, at 293, 295; see also *In re Auction Houses Antitrust Litig.*, 197 F.R.D. 71, 78 (S.D.N.Y. 2000) (“Under either of the most common fee structures, attorney/client agency costs are extraordinarily high. In some cases, they allow the class action device to serve the interests of the lawyers more than those of their clients.”); Janet Cooper Alexander, *Do the Merits Matter? A Study of Settlements in Securities Class Actions*, 43 STAN. L. REV. 497, 536 (1991) (“Although the lawsuit is supposed to be conducted for the benefit of the class, the class cannot look after its own interests. . . . [There is] a significant possibility that the litigation decisions will be made in accordance with the lawyer's economic interests rather than those of the class. . . .”); Miller, *supra* note 232, at 213 (noting that class actions and shareholder derivative suits are “almost always brought by entrepreneurial lawyers in hopes of obtaining an award of attorney's fees”).

277. See Charles Silver & Lynn Baker, *I Cut, You Choose: The Role of Plaintiffs' Counsel in Allocating Settlement Proceeds*, 84 VA. L. REV. 1465, 1527–28 (1998).

for class counsel's agreement to go along with a coupon settlement, defendants may agree to support that class counsel's request for attorneys' fees or at least not to take a position on the issue of attorneys' fees.²⁷⁸ Unfortunately, professional ethical canons are insufficient to constrain class counsel.²⁷⁹ In short, there is a risk—that often becomes a reality—of class counsel and defendants collaborating on settlements that do not serve the interests of class members.²⁸⁰

In theory, the market for class counsel should prevent plaintiffs' attorneys from proposing class action settlements based on worthless scrip. Attorneys often compete against each other to serve as class counsel. Both economic theory and common sense suggest that a plaintiffs' attorney in such a competition would point out to the presiding judge that another potential class counsel had previously negotiated settlements based on coupons that were either not redeemed or under-redeemed. Once a law firm or prominent attorney has a pattern of negotiating suspicious coupon-based settlements, the stigma of a weak track record would presumably preclude such an attorney from winning a class-counsel competition. But this has not happened, which is not surprising. Class counsel as a group are better off with coupon-based settlements. Attacking other attorneys for proposing coupon settlements may diminish the ability of any class counsel to negotiate such settlements. None has sufficient incentive to bite the hand that feeds. Perhaps more importantly, in those cases in which class actions are filed in multiple jurisdictions, the defendant itself essentially selects the class counsel.²⁸¹

Judges and scholars have proposed a wide range of possible remedies to solve the agency cost problems created by class action litigation.²⁸² A common

278. See *Polar Int'l Brokerage Corp. v. Reeve*, 187 F.R.D. 108, 112 n.3 (S.D.N.Y. 1999).

279. See Stephen J. Safranek, *Curbing the Fees of the Class Action Lawyers in Light of City of Burlington*, 41 WAYNE L. REV. 1301, 1333 n.190 (1995).

280. See *Reeve*, 187 F.R.D. at 119. The *Reeve* court stated that

Through the use of a non-pecuniary settlement coupled with an application for attorney's fees, defendants benefit by receiving release from suit, plaintiff's counsel benefits in the most tangible form—cash—and unless the non-monetary settlement offers something of real value to class members, they have relinquished their legal rights to maintain a suit in exchange for very little.

Id. (citing *In re Gen. Motors Corp. Pick-up Truck Fuel Tank Prods. Liab. Litig.*, 55 F.3d 768, 803 (1995)); HENSLER ET AL., *supra* note 15, at 94. Duplicative class actions escalate the risk that one set of class counsel will sell out the class. See *id.* at 74.

281. See HENSLER ET AL., *supra* note 15, at 415 (“[D]efendants then may also choose among competing lawyers—and among jurisdictions, venues, and judges—by deciding to negotiate with one set of class action attorneys rather than another.”).

282. See Janet Cooper Alexander, *The Agency Problem: Some Procedural Suggestions*, 41 N.Y.L. SCH. L. REV. 359, 360 (1997) (advocating opt-in requirement in securities class actions); Bruce L. Hay, *Asymmetric Rewards: Why Class Actions (May) Settle for Too Little*, 48 HASTINGS L.J. 479 (1997) (advocating that courts examine an attorney's “take” from a settlement compared to her “take” if the litigation had proceeded to trial); Mary Kaye Kane, *Of Carrots and Sticks: Evaluating the Role of the Class Action Lawyer*, 66 TEX. L. REV. 385, 397 (1987) (discussing possible

theme in many proposals is greater monitoring of class counsel. To control class counsel requires that someone, either the class or the court, be able to monitor the counsel's conduct to insure that attorneys are pursuing the class's interest, not the attorneys'.²⁸³

Unfortunately for the class, solving the agency cost problem through monitoring is an arduous task. Although, as the principal, the class would like to keep a close eye on its agent (the class counsel), several factors make monitoring difficult. First, accurate information is scarce. Class members are not kept abreast of the status of negotiations between class counsel and the defendant. The possibility for collusion between defendants and class counsel is even higher when class members are not informed of the attorneys' fees that the defendants have agreed to pay.²⁸⁴ In many cases, because of their attenuated relationship to the litigation, individual class members "may not know whether a compromise favors greater attorneys' fees and lesser benefits for them."²⁸⁵ If class members lack information, they can neither monitor the progress of negotiations nor advance meaningful objections to a proposed settlement.²⁸⁶ Neither does the named plaintiff serve as an adequate check against self-dealing by class counsel.²⁸⁷

Second, there is a public good problem. Under most circumstances, it is not cost-beneficial for any individual class member to invest the time and

procedural remedies); Jonathan R. Macey & Geoffrey P. Miller, *The Plaintiffs' Attorney's Role in Class Action and Derivative Litigation: Economic Analysis and Recommendations for Reform*, 58 U. CHI. L. REV. 1 (1991) (advocating that plaintiffs' lawyers bid against each other for the right to represent the class); Miller, *supra* note 232, at 196; George Rutherglen, *Better Late Than Never: Notice and Opt Out at the Settlement Stage of Class Actions*, 71 N.Y.U. L. REV. 258 (1996) (advocating greater opt-out opportunities for class members); see also Lazos, *supra* note 266, at 325–32 (advocating the appointment of a guardian to protect class interests during the settlement negotiations).

Procedural rules attempt to control conflicts of interest. See Lewis A. Kornhauser, *Fair Division of Settlements: A Comment on Silver and Baker*, 84 VA. L. REV. 1561, 1565 (1998) (noting intervention rules, opt-out rules, and voting rules). Concerns over unreasonable attorneys' fees in securities class action litigation moved Congress to explicitly limit fees to "a reasonable percentage of the amount of any damages and prejudgment interest actually paid to the class." 15 U.S.C. § 77z-1(a)(6) (2001).

283. See Kane, *supra* note 282, at 395 (arguing that attorneys' "self-interest can be restrained only by client control").

284. See Milo Geyelin, *Settlement Between Bronco II Owners, Ford Is Thrown Out by Federal Judge*, WALL ST. J., Mar. 24, 1995, at A3.

285. Kane, *supra* note 282, at 395.

286. See *infra* notes 379–382 and accompanying text (discussing judicial responses to objection by class members).

287. See Macey & Miller, *supra* note 282, at 5 ("The named plaintiff does little—indeed, usually does nothing—to monitor the attorney in order to ensure that representation is competent and zealous . . .").

resources necessary to effectively monitor the class counsel.²⁸⁸ Each class member generally receives a small fraction of the total settlement award. Each individual stake in the settlement is often quite small in absolute value.²⁸⁹ Any increase in the settlement pool brought about through monitoring efforts would generally be significantly less than an individual's costs of monitoring. Thus, it is perfectly rational for each individual class member to forego any monitoring.²⁹⁰ Empirically, monitoring does not occur.²⁹¹

Third, working in tandem with the public good problem is a free-rider problem: Individual class members may hope that another class member will do the monitoring for them. Public interest organizations, most notably Public Citizen, have willingly let the class free-ride on their efforts to educate judges about inadequate proposed settlements.²⁹² However, most class action litigation does not have a benevolent monitor.

Finally, individual class members may also be deterred from monitoring the class counsel and settlement proceedings because even when class members have employed independent counsel and have objected to a proposed class settlement, their monitoring efforts have rarely been rewarded.²⁹³ Without a diligent judge, the conscientious, objecting class member is powerless to

288. See *In re Auction Houses Antitrust Litig.*, 197 F.R.D. 71, 78 (S.D.N.Y. 2000) ("This collective action dilemma leads to significantly less monitoring of the attorney by the class and consequential higher agency costs.").

289. Indeed, class actions are generally lauded because they aggregate small claims that would not be worth litigating individually. See RICHARD A. POSNER, *ECONOMIC ANALYSIS OF LAW* 626 (5th ed. 1998).

290. See *Mars Steel Corp. v. Cont'l Ill. Nat'l Bank & Trust*, 834 F.2d 677, 681 (7th Cir. 1987) (stating that "ordinarily the unnamed class members have individually too little at stake to spend time monitoring the lawyer"); *Developments in the Law*, *supra* note 264, at 1605 ("[N]o class member may have a sufficient interest in the course of litigation to impose any check on the strongly interested attorney's dealing.").

291. See THOMAS E. WILLGING ET AL., *EMPIRICAL STUDY OF CLASS ACTIONS IN FOUR FEDERAL DISTRICT COURTS* 56-58 (1996).

292. See HENSLER ET AL., *supra* note 15, at 96.

293. One mechanism to monitor the class counsel is employment of an attorney to review the proposed settlement and object to it if it unfairly favors the class counsel's interests over the class members' interests. However, despite some successes, this is often not an effective check on class counsel. First, courts often ignore objectors. Second, employing yet another attorney creates another set of agency cost issues as the objecting attorneys are often paid out of the funds available to the class, thus further diminishing the pool of money for class members without necessarily providing any substantial benefit to the class. Indeed some observers have objected to lawyers who receive enormous attorneys' fees based off objecting to class action settlements. See Richard B. Schmitt, *Legal Beat: Objecting to Class Action Pacts Can Be Lucrative for Attorneys*, WALL ST. J., Jan. 10, 1997, at B1. As too many cooks spoil the broth, adding more attorneys depletes the settlement pool.

derail a proposed class settlement, whether or not it involves coupons as the method of compensation.²⁹⁴

As a result of their divergent interests and the existence of agency costs, a “plaintiff’s attorney trades a high fee award for a low recovery.”²⁹⁵

B. Coupon Settlements Increase Agency Costs and Further Inhibit Monitoring

The traditional check on agency costs has been tying the fate of the class to its counsel through a contingency fee arrangement. Under typical contingency agreements, the class counsel receives a percentage—often in the range of 20 to 30 percent or so—of the total recovery bestowed upon the class.²⁹⁶ In theory, this ties the interests of principal and agent together because the only way for the class attorneys to increase their own compensation is to increase the recovery for the class. This should make the interests of the class and its counsel congruent because both benefit when the total settlement amount increases.²⁹⁷

294. See *infra* notes 379–382 and accompanying text.

295. John C. Coffee, Jr., *The Regulation of Entrepreneurial Litigation: Balancing Fairness and Efficiency in the Large Class Action*, 54 U. CHI. L. REV. 877, 883 (1987). Capitalizing on these agency costs, defendants can sometimes influence which attorneys will serve as class counsel. Some commentators have observed that

major corporate defendants are often sued in multiple forums. Once rival and overlapping class actions are pending in different courts, defendants can play plaintiff’s attorneys off against each other, running what is in effect a reverse auction to gain the cheapest settlement. Paying the class’s lawyers to sell out their clients is invariably cheaper for defendants than paying the class.

John C. Coffee, Jr. & Susan P. Koniak, *Rule of Law: The Latest Class Action Scam*, WALL ST. J., Dec. 27, 1995, at 11. In essence, there is a “race to the bottom feeders” to see which attorneys will sell their clients out more quickly. *Id.* One response to this problem is for the trial judge to have prospective class counsel bid against each other for the opportunity to represent the class. See, e.g., *In re Oracle Sec. Litig.*, 131 F.R.D. 688 (N.D. Cal. 1990); *In re Oracle Sec. Litig.*, 132 F.R.D. 538 (N.D. Cal. 1990).

Some of the class action settlements “involve extraordinary fees, including arrangements that give individual clients of the attorneys better terms than class members.” Schmitt, *supra* note 71.

296. See HENSLER ET AL., *supra* note 15, at 78 (“The most widely cited standard is 25–30 percent.”); WILLGING ET AL., *supra* note 291, at 69 (median fee recovery rate in case studies between 27 and 30 percent; most “were between 20% and 40% of the gross monetary settlement”); Hay, *supra* note 282, at 490 n.28; see also *In re Superior Beverage/Glass Container Consol. Pretrial*, 133 F.R.D. 119, 127 (N.D. Ill. 1990) (noting a 40 percent contingency in asbestos class actions). However, a large settlement fund may correlate with a smaller contingency percentage. HENSLER ET AL., *supra* note 15, at 78.

297. Courts had traditionally used the percentage of common fund basis. In response to criticism against the percentage of fund (POF) method in the 1970s, some courts shifted from the POF method to lodestar. See REPORT OF THE THIRD CIRCUIT TASK FORCE, COURT AWARDED ATTORNEY FEES, 108 F.R.D. 237, 242–43 (1985); HENSLER ET AL., *supra* note 15, at 77. Under the lodestar method, “the fee award is calculated by multiplying the hours reasonably expended

However, coupons can decouple this linking of interests in a manner that essentially magnifies the agency costs. Paying the class members in coupons masks the relative payment of the class counsel as compared to the amount of money actually received by the class members. For example, if a settlement were based entirely on cash, a court would probably be reluctant to approve a settlement under which plaintiff's counsel received \$50 million in attorneys' fees and the class members received \$50 million in cash to be divided among them. Such a scheme would appear suspicious on its face. However, the same result can be achieved if attorneys for the class are paid \$50 million in cash and the class members receive \$200 million in coupons. On its face, such a settlement appears reasonable in that the class counsel is receiving 20 percent of the total payout by defendants of \$250 million. But if only one-fourth of the class members actually redeem their coupons (a reasonable estimate), then the net effect of the settlement is that class counsel received \$50 million in cash and the class members received \$50 million worth of coupons that were actually used. The actual contingency fee is around 50 percent.²⁹⁸ This shows how coupon settlements allow class counsel to increase the size of their contingency fee *sub rosa* by creating the illusion that the class is being paid more than it actually is. Class counsel wants to increase the perceived recovery of the class because this increases

times the reasonable hourly rates." WILLGING ET AL., *supra* note 291, at 69–70. However, the lodestar method creates problems as well. Most notably, lodestar breaks the direct link between the interests of the class and its counsel, which the contingency arrangement creates. Also, the lodestar method requires more judicial effort than the POF method. See HENSLER ET AL., *supra* note 15, at 77. As a result of these and other problems, many courts have abandoned the lodestar approach. See WILLGING ET AL., *supra* note 291, at 70; Samuel Issacharoff, *Class Action Conflicts*, 30 U.C. DAVIS L. REV. 805, 827 (1997) ("Basically, all courts except the Florida Supreme Court and, to some extent, the Fifth Circuit, have abandoned the failed lodestar experiment." (citations omitted)).

The two methods can be used as a hybrid under which each method serves as a check on the other. See, e.g., *Superior Beverage/Glass*, 133 F.R.D. at 124; HENSLER ET AL., *supra* note 15, at 78; WILLGING ET AL., *supra* note 291, at 73–74; Wolfman & Morrison, *supra* note 80, at 503. Arguably, this is what courts have been doing all along. Janet Cooper Alexander has observed,

[a]rguably, the lodestar "formula" is only a fiction. Courts claiming to follow the lodestar method use many different formulas and choose a wide range of multipliers under those formulas. Coincidentally, however, all of these arcane arithmetical calculations just happen to yield fee awards of about 25 to 30 percent of the recovery most of the time. Such consistency suggests that fee awards are really the product of a *sub rosa* percentage-of-the-recovery approach. In the words of plaintiffs' lawyers, the requested multiplier is simply a "plug figure" used to convert the lodestar into the desired percentage.

Alexander, *supra* note 276, at 541. Courts appear more likely to use the lodestar method when the class settlement relies upon nonquantifiable benefits. See WILLGING ET AL., *supra* note 291, at 11.

298. It is actually greater than 50 percent because class members who use coupons do not necessarily receive \$50 million in value since some redemptions will represent Induced Purchases. See *supra* notes 82–87 and accompanying text.

the base from which courts calculate the contingency fee.²⁹⁹ If the class counsel can convince the reviewing judge that the recovery is larger than it actually is, the attorneys may secure more money in attorneys' fees.³⁰⁰ Coupon settlements allow class counsel to decouple the attorneys' interests from the interests of the class, such that counsel can pursue its own interests at the expense of the class.

In the context of coupon settlements, the interests of the class counsel may converge more with the interests of the defendant than those of the class. Both the defendants and the class counsel may benefit from restricted settlement coupons. The defendant benefits because restricted coupons are more likely to achieve the Non-Use or Induced-Purchase Outcomes.³⁰¹ Class counsel benefits because a defendant who saves by settling the class action litigation with overly restricted coupons may be willing to support a higher payment of attorneys' fees as the price for the class counsel supporting a coupon settlement and allowing significant restrictions on those coupons. This is a classic agency cost problem. The restrictions hurt the principal but not the agent. A faithless, but rational, agent may attempt to maximize her own payoff at the expense of the principal's interests. In short, in some class action litigation, the agent's interests may be more aligned with the principal's adversary than with the principal.

Monitoring is supposed to prevent class counsel from pursuing its own interests at the expense of the class. As discussed above, monitoring is difficult even in class action litigation not involving coupons.³⁰² However, settlement coupons generate sufficient additional noise—the unknown variables that affect coupon value, including redemption rates and restrictions—to make effective monitoring nearly impossible. Traditionally, courts and observant class members monitor attorneys' fees by determining what percentage of the total recovery goes to class counsel. They compare the attorneys' fees to the class recovery to make sure that the fees are not an unreasonably high percentage of the total recovery. Coupon-based settlements obscure this mode of comparison because the two groups are paid in different currency. In all-cash settlements, courts and class members can calculate the contingency and see whether the attorneys' fees are so high, relative to the class recovery, as to indicate collusion. But in the apples and oranges world of coupon settlements,

299. See NACA, *supra* note 238, at 383.

300. See *In re Presidential Life Sec.*, 857 F. Supp. 331, 335 (S.D.N.Y. 1994) ("The key element in assessing the reasonableness of an attorney's fee and any adjustment made in the amount requested is 'the relationship between the amount of the fee awarded and the results obtained.'" (quoting *Hensley v. Eckerhart*, 461 U.S. 424, 437 (1983))).

301. See *supra* notes 110–111 and accompanying text.

302. See *supra* notes 284–294 and accompanying text.

no one can accurately predict the true value of the settlement package and, thus, no one can precisely calculate the actual contingency rate. Furthermore, appellate judges are unlikely to serve as effective monitors because appellate courts overwhelmingly defer to trial court determinations of attorneys' fees.³⁰³

In short, a coupon settlement allows class counsel to do indirectly what it cannot do directly: increase the net contingency fee after class litigation has begun. Class counsel attempt to make a proposed settlement look bigger than it is in order to justify a higher amount of attorneys' fees.³⁰⁴ Because class counsel are paid proportionally to the outcome,³⁰⁵ these attorneys have a strong incentive to make the settlement appear as large as possible. Scholars have observed that coupon settlements "are essentially a device to inflate the value of the settlement because the plaintiff's attorneys' fees typically are based on that inflated value (usually one-third)."³⁰⁶

C. The Net Effect of Agency Costs: Coupon Restrictions

Once the parties reach an agreement to compensate the class with settlement coupons, class counsel has little incentive to engage in hard bargaining over the coupon redemption terms. Normally, the plaintiff counsel's incentive is a function of the contingency fee: Counsel wants to increase the settlement amount in order to maximize the lump sum from which counsel extracts a set percentage. But this incentive to maximize the class gains does not translate to the coupon arena. While coupon restrictions diminish the value of settlement coupons for class members, these restrictions do not directly bear on counsel's compensation. If the class counsel seeks to maximize its own returns, then it cares primarily about the face value of the coupons—not actual value—because judges often use the coupons' face value as the starting point for calculation of attorneys' fees in these cases.³⁰⁷ Because any limitations on coupon redemption do not directly affect the attorneys' payoff, class counsel may give significant latitude to defendants in actually structuring the settlement coupons.

303. See WILLGING ET AL., *supra* note 291, at 11.

304. See HENSLER ET AL., *supra* note 15, at 81–82, 163.

305. See Samuel R. Gross, *We Could Pass a Law . . . What Might Happen If Contingent Legal Fees Were Banned*, 47 DEPAUL L. REV. 321 (1998).

306. Coffee & Koniak, *supra* note 295; see also HENSLER ET AL., *supra* note 15, at 462.

307. See *infra* notes 351–354 and accompanying text. While judges, in theory, should peg the attorneys' recovery to the actual aggregate value of the coupons, judges face tremendous obstacles in determining the actual value of coupon settlements. See *infra* notes 325–361 and accompanying text.

Indeed, class counsel have a marginal incentive to allow coupon restrictions. The lower the defendant's estimated value of the coupons (that is, the lower the expectation that settlement coupons will be used for Non-Induced Purchases), the more money that the defendant has available to compensate class counsel. In theory, each coupon restriction has an expected value for the defendant. If, for example, moving up the expiration date one year is estimated to save the defendant \$2 million in lost profits from coupons being used for Non-Induced Purchases, it is rational for the defendant to pay the class counsel any amount less than \$2 million in attorneys' fees in exchange for moving up the expiration date. Unfortunately, it is also rational for self-interested class counsel to agree to such an arrangement. After all, counsel suffers no loss from changing the expiration date and gets additional fees (up to \$2 million). Of course, the defendant cannot directly pay the class counsel; such collusion is clearly illegal.³⁰⁸ However, the defendant can increase the face value of the coupons. This would increase the base from which the attorneys' fees are usually calculated. Increasing the face value while imposing additional restrictions on the coupons could decrease the overall cost of the settlement to the defendant while simultaneously increasing the fee to the class counsel and decreasing the value of the settlement to the class.³⁰⁹ The net result of these dynamics is the issuance of settlement coupons laden with value-reducing restrictions.

IV. WHY COURTS APPROVE COUPON-BASED SETTLEMENTS

Recognizing the agency problems inherent in class action litigation, the Federal Rules of Civil Procedure and comparable state codes rely on trial courts to review and approve proposed settlements. Non-class civil settlements are simply private contracts; but class action settlements bind class members who do not negotiate—and may be unaware of—the settle-

308. The parties can, however, negotiate such a payment in the settlement. The parties can structure the settlement to include a cash payment to class counsel. As part of the proposed settlement, such payments are subject to court review and approval.

309. Similarly, self-interested class counsel may agree to limit the transferability of the coupons. Defendants want nontransferability and plaintiffs' attorneys are not directly affected because they are paid in cash. In exchange for class counsel's acquiescence, the rational defendant will increase the face value of the coupons. Transferability of coupons does not affect the cash payment to the attorneys, except to the extent that by agreeing to have coupons be nontransferable defendants may be more willing to increase the amount of the cash payment to the plaintiff's attorneys. Similarly, the transferability of the coupons does not affect the headlines that simply report the aggregate face value of the coupons, creating the illusion that the settlement is worth significantly more to the class members than it in fact is.

ment.³¹⁰ Judges serve as fiduciaries to absent class members³¹¹ and are to exercise their power to accept or reject a proposed settlement in order to protect the interests of the class members.³¹² Federal Rule of Civil Procedure 23(e) provides that “[a] class action shall not be dismissed or compromised without the approval of the court.”³¹³ The rule recognizes the agency costs inherent in class action litigation. Judges are to examine the merits of the settlement—especially as compared to the attorneys’ fees awarded to the class counsel—in order to insure that the defendant and the class counsel have not struck a bargain to sell out the class in exchange for higher attorneys’ fees.³¹⁴ State courts impose similar requirements on trial judges.³¹⁵ Under well-established common law, neither federal nor state judges should approve a proposed settlement unless convinced that it is “fair, adequate and reasonable and is not the product of collusion between the parties.”³¹⁶

Despite their authority to reject settlements and the inherent problems of coupon-based settlements in class action litigation, courts routinely approve such settlements. This is not surprising given that for many class action settlements, court approval is a mere formality.³¹⁷ For a variety of systemic and case-specific reasons, courts are loathe to reject proposed settlements in class action litigation. This magnifies the risk that class members will sacrifice their right to bring individual claims in exchange for worthless scrip.³¹⁸ This part

310. See HENSLER ET AL., *supra* note 15, at 76.

311. See *United States v. City of Miami*, 614 F.2d 1322, 1331 (5th Cir. 1980); *Int’l Union of Elec. Workers v. Unisys Corp.*, 858 F. Supp. 1243, 1264 (E.D.N.Y. 1994) (stating that the court “has the fiduciary responsibility of ensuring that the settlement is fair and not a product of collusion, and that the class members’ interests [are] represented adequately” (quoting *In re Warner Communications Secs. Litig.*, 798 F.2d 35, 37 (2d Cir. 1986))).

312. See *Officers for Justice v. Civil Serv. Comm’n*, 688 F.2d 615, 623 (9th Cir. 1982); *Silver & Baker*, *supra* note 277, at 1466 (noting that a “judge[] act[s] as a guardian and trustee”). Federal Rule of Civil Procedure 23(e) is supposed “to protect the nonparty members of the class from unjust or unfair settlements affecting their rights when the representatives become faint-hearted before the action is adjudicated or are able to secure satisfaction of their individual claims by a compromise.” 7B CHARLES ALAN WRIGHT ET AL., *FEDERAL PRACTICE AND PROCEDURE* § 1797, at 340 (2d ed. 1986).

313. FED. R. CIV. P. 23(e). Equivalent state rules are patterned after Rule 23.

314. See *Hay*, *supra* note 282, at 490.

315. See HENSLER ET AL., *supra* note 15, at 5 (“[M]ost states have modeled their class action rules on the federal rule.”); see also, e.g., *Dunk v. Ford Motor Co.*, 56 Cal. Rptr. 2d 483, 487 (Cal. Ct. App. 1996). Absent explicit state rules, some state “courts look to federal authority.” *Id.* at 487 n.7.

316. *Cotton v. Hinton*, 559 F.2d 1326, 1330 (5th Cir. 1977).

317. See *Downs*, *supra* note 273, at 682–83; *Silver & Baker*, *supra* note 277, at 1515 (noting that judges generally approve class action settlements “absent a clear showing of abuse”).

318. This is not to suggest that a court would approve a coupon-based settlement in which all of the coupons are worthless. Rather, for those class members who do not or cannot use the coupon before it expires, the scrip is worthless. As reflected in low redemption rates, the number

introduces the judicial test for reviewing proposed settlements, examines how courts apply that test to coupon settlements, and discusses the reasons why courts generally approve coupon settlements.

A. The Legal Standard for Reviewing Proposed Settlements

Rule 23(e) does not set forth any standards for determining the fairness of a proposed class-action settlement. In theory, a court scrutinizes both the substance of the proposed settlement and the procedure by which it was reached. With respect to substance, the reviewing court should determine what benefit, if any, the class members will receive from the settlement. Courts are supposed to engage in "a substantive inquiry into the terms of the settlement relative to the likely rewards of litigation."³¹⁹ Whether the likely benefits are sufficient to render the proposed settlement "fair" will depend on a number of factors, including:

- (1) the stage of the proceedings at which the settlement was achieved;
- (2) the likelihood of success at trial;
- (3) the range of possible recovery;
- (4) the point on or below the range of possible recovery at which a settlement is fair, adequate and reasonable;
- (5) the complexity, expense and duration of litigation; and
- (6) the substance and amount of opposition to the settlement.³²⁰

To determine the substantive fairness, courts are supposed to independently evaluate the proposed settlement's terms, short of performing a full trial on the merits of the case.³²¹

With respect to process, courts are supposed to determine "whether negotiations were conducted at arm's length by experienced counsel after

of class members, who receive completely worthless scrip, can be quite significant. See *supra* notes 227-229 and accompanying text.

319. *In re Gen. Motors Corp. Pick-up Truck Fuel Tank Prods. Liab. Litig.*, 55 F.3d 768, 796 (3d Cir. 1995).

320. *In re Domestic Air Transp. Antitrust Litig.*, 148 F.R.D. 297, 312 (N.D. Ga. 1993); see also *City of Detroit v. Grinnell Corp.*, 495 F.2d 448, 463 (2d Cir. 1974). The Third Circuit has articulated a nine-factor test in rejecting a coupon settlement:

- (1) the complexity and duration of the litigation;
- (2) the reaction of the class to the settlement;
- (3) the stage of the proceedings;
- (4) the risks of establishing liability;
- (5) the risks of establishing damages;
- (6) the risks of maintaining a class action;
- (7) the ability of the defendants to withstand a greater judgment;
- (8) the range of reasonableness of the settlement in light of the best recovery; and
- (9) the range of reasonableness of the settlement in light of all the attendant risks of litigation.

Gen. Motors, 55 F.3d at 785; see also *Girsh v. Jepson*, 521 F.2d 153, 157 (3d Cir. 1975).

321. See *In re Cuisinart Food Processor Antitrust Litig.*, 1983-2 Trade Cas. (CCH) ¶ 65,680, at 69,470 (D. Conn. Oct. 24, 1983) ("While settlement hearings need not be converted into mini-trials, the facts should be explored sufficiently to make intelligent determinations of adequacy and fairness." (citation omitted)).

adequate discovery.”³²² Judges should confirm an absence of fraud and collusion between the defendant and the class counsel. Yet it is particularly difficult to determine problems with the process by which the parties negotiated the proposed settlement. Judges, after all, do not observe the process first hand. With limited knowledge, some judges simply presume the settlement to be fair, adequate, and reasonable.³²³ In many cases, such a presumption is inappropriate.³²⁴

B. Coupon Noise and the Difficulty of Evaluating Coupon-Based Settlements

The most important factor in evaluating the proposed settlement is the amount of recovery obtained for the class.³²⁵ In determining whether to approve the ultimate settlement amount, courts examine whether the figure falls within a “range of reasonableness.”³²⁶ This, in turn, requires that judges understand the value of the settlement. Coupons make it more difficult for reviewing judges to evaluate the proposed settlement’s worth because the actual recovery to the class cannot be determined from the terms of the

322. *Gen. Motors*, 55 F.3d at 796. Courts have held that there is no collusion so long as the parties engaged in arm’s-length negotiations. See *Domestic Air*, 148 F.R.D. at 313. However, simply because the parties engaged in negotiations does not mean that there was not collusion between the class counsel and the defendants to strike a deal that satisfies their interests at the expense of the interests of the class members. For example, there can still be negotiations for how much the cash settlement portion of any coupon-based settlement would be because the attorneys know that they will get paid out of the cash element of the settlement, and the defendants want to make this aspect as low as possible. Furthermore, defendants will try to make as much of the settlement in coupons, which has the effect of driving up the apparent face value of the overall settlement, whereas plaintiffs’ attorneys will want to ensure that a sufficient sum of money is set aside for their attorneys’ fees. Simply looking for indicia of arm’s-length negotiation is not sufficient in and of itself to show that the counsel for the class and the defendants did not collude at some level to the detriment of the class members.

This is similar to the problem of illusory promises in contract law. Under basic contract law, a contract must be supported by consideration. Courts will not let a party create merely the form or illusion of a bargain; there must be actual consideration in which both sides are required to bring something of value to the table. Similarly, the fact that opposing counsel have agreed to a proposed settlement does not necessarily mean that the resulting document was a product of an arm’s-length (noncollusive) negotiation.

323. See *Hanrahan v. Britt*, 174 F.R.D. 356, 366 (E.D. Pa. 1997) (citing *MANUAL FOR COMPLEX LITIGATION* § 30.41 (2d ed. 1985)); *Heit v. Amrep Corp.*, 82 F.R.D. 130, 133 (S.D.N.Y. 1979).

324. See Brian W. Warwick, *Class Action Settlement Collusion: Let’s Not Sue Class Counsel Quite Yet . . .*, 22 AM. J. TRIAL ADV., 605, 622 (1999).

325. See *Tornabene v. Gen. Dev. Corp.*, 88 F.R.D. 53, 61 (E.D.N.Y. 1980).

326. *Domestic Air*, 148 F.R.D. at 319; *Fisher Bros. v. Cambridge-Lee Indus., Inc.*, 630 F. Supp. 482, 489 (E.D. Pa. 1985).

settlement.³²⁷ Estimates on the value of settlement coupons in a given class action can vary by as much as \$1.3 billion.³²⁸

Coupons create noise that makes it harder to evaluate the proposed settlement's benefit to the class. The face value of a coupon is often illusory.³²⁹ The value of a coupon-based settlement is a fraction of the coupons' face value for many reasons. First, many class members will never use their coupons for several reasons, including loss of coupons, failure to use them before the expiration date, no need for use in nonrestricted times, and so forth.³³⁰ The coupon has zero value if it is neither used nor sold.

Second, even for those people who use their coupons, the value of the coupon is not necessarily its face value. The coupon is worth its face value to a class member who uses it for a Non-Induced Purchase (when no other discounts are available). In many instances, because the settlement coupon cannot be used in conjunction with other coupons, the actual value to the consumer is not the value of the coupon but the difference between the settlement coupon and the promotional coupon that would have been used.³³¹ The coupon is also worth less than face value when used for an Induced Purchase or when the buyer had to forego an otherwise available discount in order to use the settlement coupon.³³²

Third, coupon-to-cash conversion rates prove that the actual value of a coupon settlement is typically significantly less than the aggregate face value of the coupons. In many coupon settlements the defendants offer a cash option that is but a fraction of the coupon's face value, usually at an average of one-third of the face value of the coupon.³³³ The fact that many class members choose the cash option demonstrates the coupon's actual value is significantly less than its face value. For example, in a case involving Toyota,³³⁴ 20,000 coupons were delivered as part of the settlement. Ninety-five percent of the coupon holders chose to receive \$135 in cash

327. See HENSLER ET AL., *supra* note 15, at 83.

328. See *Shaw v. Toshiba Am. Info. Sys., Inc.*, 91 F. Supp. 2d 942, 986 (E.D. Tex. 2000).

329. See *supra* note 92 and accompanying text (discussing how only the class member who achieves the Non-Induced-Purchase Outcome receives the equivalent of the coupon's face value).

330. See *supra* notes 75–81 and accompanying text.

331. For example, if a consumer already has a \$25 coupon for a product such as from a magazine or other promotion, and she has a \$25 settlement coupon, if she is only going to make one purchase then the fact that she uses the settlement coupon is of no consequence because even if she did not use the settlement coupon she could have used an alternative coupon which would have given her the same value.

332. See *supra* notes 83–87 and accompanying text.

333. See Gramlich, *supra* note 6, at 277; see, e.g., *Langford v. Bombay Palace Rests., Inc.*, No. 88 Civ. 5279 (CSH), 1991 U.S. Dist. LEXIS 4730, at *1 (S.D.N.Y. Apr. 8, 1991).

334. See *In re Mid-Atl. Toyota Antitrust Litig.*, 564 F. Supp. 1379 (D. Md. 1983).

instead of receiving \$250 in dealer services.³³⁵ This reveals that the vast majority of class members did not consider the \$250 voucher to be worth \$250.³³⁶ For all of these reasons, the face value of coupons is significantly less than their actual value, which creates the illusion that defendants are paying much more than they are in reality.³³⁷ That the coupons' face value is significantly less than the defendant's cost is illustrated by the refusals of defendants to pay cash.³³⁸ In short, coupons obscure the actual recovery to the class.³³⁹

Courts often make other mistakes in determining the value of coupon settlements. Some judges treat the aggregate value of the coupons as the total value of the proposed settlement.³⁴⁰ These judges ignore the fact that the estimated number of lost or unused coupons necessarily reduces the net present value of the coupon distribution.³⁴¹ Other courts treat "discount rights" as equivalent to cash when comparing the proposed coupon settlements to the likely outcome at trial.³⁴² Even courts that recognize that many class members will not redeem their settlement coupons make a more nuanced mistake by treating the dollar value of coupons that are used as equivalent to cash.³⁴³ But even if a coupon is used, a dollar of coupon is not equal to a

335. See Gramlich, *supra* note 6, at 274 n.31.

336. If a class member redeemed the coupon for a purchase of goods less than \$250, the balance would be refunded to the consumer "at a rate of \$.54 to \$1.00," thus further indicating that coupon dollars are worth significantly less than actual dollars. *Mid-Atl. Toyota*, 564 F. Supp. at 1556.

337. See Gramlich, *supra* note 6, at 265.

338. See, e.g., *Ohio Pub. Interest Campaign v. Fisher Foods, Inc.*, 546 F. Supp. 1, 11 (N.D. Ohio 1982) ("Although some class members might have preferred cash to Food Certificates, an equivalent cash settlement of these actions was not possible. As defendants' counsel repeatedly made clear during settlement negotiations, defendants simply could not and would not raise anything approaching \$20,000,000.00 in cash to settle these cases.").

339. See Gramlich, *supra* note 6, at 265-66; see also *Livingston v. Toyota Motor Sales USA, Inc.*, No. C-94-1377, No. C-94-1359, No. C-94-1960, 1995 U.S. Dist. LEXIS 21757, at *35 (N.D. Cal. May 30, 1995) (endorsing proposed settlement coupons while admitting that "actual value" of the vouchers "may be somewhat imprecise").

340. See, e.g., *Dunk v. Ford Motor Co.*, 56 Cal. Rptr. 2d 483, 490 (Ct. App. 1996) ("Dunk's settlement memorandum established coupons worth \$400 each would be made available to the class of over 65,000, for a total potential value of over \$26 million."). Ultimately, the court did not use this figure in calculating attorneys' fees. See *id.* at 493-94; see also *Mid-Atl. Toyota*, 564 F. Supp. at 1382; *Ohio Pub. Interest Campaign*, 546 F. Supp. at 11.

341. See, e.g., *Weiss v. Mercedes-Benz of N. Am., Inc.*, 899 F. Supp. 1297, 1304 n.5 (D.N.J. 1995).

342. See, e.g., *Phemister v. Harcourt Brace Jovanovich, Inc.*, 1984-2 Trade Cas. (CCH) ¶ 66,234 (N.D. Ill. Sept. 24, 1984).

343. See, e.g., *Livingston*, 1995 U.S. Dist. LEXIS 21757, at *34; *id.* at *90-*91 (involving an expert witness making the same mistake in evaluating proposed settlement coupons); *Phemister*, 1984-2 Trade Cas. (CCH) at *3, *10, *12. At least one court has claimed that the proposed settlement coupons "would be more valuable than cash" because the coupons were for a percentage

dollar in cash for many class members.³⁴⁴ For example, the availability of other discounts also renders coupon valuation difficult.³⁴⁵

Courts' mistakes in determining the actual value of a coupon settlement are understandable given the great difficulty of trying to estimate the actual value of the settlement coupons.³⁴⁶ True value is a function of several unknown variables. For example, an expert in the *Domestic Air* case concluded that the redemption rate of the coupons in that case would be a function of

the ease with which the discount certificates can be redeemed, the identity of the recipients of the certificates, whether they are business or leisure travelers, the total cost of the ticket and the percentage value of the certificates given escalating total fare prices, the number of certificates that will be lost or misplaced, and future fare increases.³⁴⁷

Judges cannot accurately predict such variables. Courts often fail to inquire about likely (let alone actual) redemption rates.³⁴⁸ This compels many judges to rely on representations by counsel, which is ironic given that counsel often create and profit from this confusion.

discount and therefore uneroded by inflation. *In re Montgomery County Real Estate Antitrust Litig.*, 83 F.R.D. 305, 318 (D. Md. 1979).

344. See *supra* notes 83–87 and accompanying text. The value of the settlement coupons to the class is not simply the number of coupons redeemed times their face value. To calculate true value requires an examination of reservation prices and subsequent price manipulation.

345. See *In re Gen. Motors Corp. Pick-up Truck Fuel Tank Prods. Liab. Litig.*, 55 F.3d 768, 807–08 (3d Cir. 1995); *supra* notes 143–156 and accompanying text.

346. See, e.g., *In re Superior Beverage/Glass Container Consol. Pretrial*, 133 F.R.D. 119, 132 (N.D. Ill. 1990); Swanzey, *supra* note 268, at 428 (“[V]aluation of in-kind settlements places a great burden on the court, requiring it to weigh evidence on the number of coupons that experts predict customers will redeem.”).

347. *In re Domestic Air Transp. Antitrust Litig.*, 148 F.R.D. 297, 322 (N.D. Ga. 1993). *Domestic Air* illustrates the difficulty of determining coupon value. One expert estimated that the actual value of the coupons, which had a face value of \$408 million, was \$379,394,345. See *id.* at 321. The court in *Domestic Air* ultimately concluded that “after adjusting for the likely redemption rates of 50–75 percent, the certificate program will have an economic value somewhere in the range of \$204 to \$306 million.” *Id.* at 323. Using this estimate of the economic value of the coupons, the court figured in the \$50 million in cash and determined the value of the total settlement ranged between \$254 to \$356 million. The court in *Domestic Air* believed that the certainty of coupons outweighed the uncertainty of litigation. See *id.* at 306. But this downplays the uncertainty of the coupons' value.

Furthermore, the court's reasoning assumes that the cash contribution to the coupon-based settlement is actually of benefit to the class. However, of the \$50 million cash portion of the settlement that the court touted as a benefit for the class members, much of that money appears to have gone directly to the attorneys. Attorneys received attorneys' fees approaching \$20 million. Furthermore, counsel could be reimbursed from that fund for the cost of administering the settlement and for providing notice to class members. See *id.* at 309.

348. See HENSLER ET AL., *supra* note 15, at 462.

The task of sorting through coupon noise is made more difficult because both defendants and class counsel benefit from the noise created by coupon settlements. Each restriction that the defendant inserts into settlement coupons ultimately undermines their value.³⁴⁹ Each restriction creates noise, making it more difficult to determine the true value of settlement coupons.³⁵⁰ Class counsel benefits from coupon noise because their attorneys' fees are often a function of the benefit that the settlement confers upon the class. Noise makes it hard to calculate attorneys' contingency fees.³⁵¹ "[C]oupon settlements' offer greater opportunity for plaintiff attorneys and defendants to collaborate in inflating the true value of the settlement when they present it to the judge for his approval."³⁵² The larger the monetary value of the settlement appears to be, the greater the attorneys' fees awarded to class counsel are likely to be. Courts use coupon face value in determining class counsel's attorney fees.³⁵³ They are falling for the illusion created by coupon settlements of a more lucrative settlement for the class when class counsel use the face value of the coupons as the starting point for calculating attorneys' fees. Furthermore, this "coupon noise" confuses the class members and may make some less likely to challenge the proposed settlement. A court's fiduciary responsibilities to absent class members include deciding attorneys' fees to class counsel,³⁵⁴ but coupon noise makes it very difficult for judges to perform their fiduciary duty.

Because they benefit from the noise, defendants and class counsel encourage judges to (incorrectly) believe that face value is equivalent to actual value. In many cases, the proponents of the coupon settlements assert to the court that the value of the settlement is in fact the face value of the coupons. For example, one economic expert in *Domestic Air* testified that the "value to the settlement class members of the certificates involved in this settlement is

349. See *Domestic Air*, 148 F.R.D. at 320 ("Common sense and expert testimony dictate that the limitations placed on the certificates by the settlement agreements and the rate at which the class members will redeem the certificates will affect the value of the certificates to the class.").

350. For example, some coupon settlements reduce the redemption value of the coupon if it is transferred, further obscuring the true value of the coupon from the court and the class.

351. See *Superior Beverage/Glass*, 133 F.R.D. at 124 ("What is 30% of up to \$70 million payable over a period of years? And how are fees, to be awarded in cash, to be compared to a recovery that consists of certificates, warrants or chits?").

352. HENSLER ET AL., *supra* note 15, at 83; cf. *Petruzzi's, Inc. v. Darling-Del. Co.*, 983 F. Supp. 595, 598-99 (M.D. Penn. 1996) (involving a noncoupon example of class counsel attempting to inflate apparent value of settlement).

353. See, e.g., *In re Montgomery County Real Estate Antitrust Litig.*, 83 F.R.D. 305, 323 (D. Md. 1979). Some courts appear convinced that the high face value of the coupons is strong evidence that the settlement could not be the product of collusion. See, e.g., *Shaw v. Toshiba Am. Info. Sys., Inc.*, 91 F. Supp. 2d 942, 959 (E.D. Tex. 2000).

354. See HENSLER ET AL., *supra* note 15, at 77.

almost as great as if the settlement were for cash."³⁵⁵ This position is simply implausible given that actual value was a function of several unknown variables.³⁵⁶ Indeed, expert valuations are often part of the noise, creating more confusion than clarity.³⁵⁷ Paid expert opinions on the value of coupon settlements appear suspect or grossly inflated in many cases.³⁵⁸

Even though it is possible for judges to sort through these variables and restrictions in an attempt to estimate the true value of the coupons, doing so would require using scarce judicial resources to debate the value of coupons. Attempting to cut through the noise created by coupon settlements costs money and resources that the settlement is supposed to save.³⁵⁹ Some courts have not been distracted by coupon noise and have realized that the face value of coupons does not constitute the economic value bestowed on the class.³⁶⁰ Yet even when judges recognize that the economic value of the coupons is less than their face value, they often nonetheless approve the settlement and high attorneys' fees.³⁶¹

C. Systemic Pressures for Courts to Approve Proposed Coupon-Based Settlements

In general, courts appear unwilling to reject settlement agreements that have been proposed by counsel for defendants and for the class. This is so for several reasons. First, there is a general policy to encourage settlement of class actions. Second, trial judges often defer to the parties submitting the proposed settlement. Third, judges point to approval of coupon settlements by

355. *In re Domestic Air Transp. Antitrust Litig.*, 148 F.R.D. 297, 321 (N.D. Ga. 1993) (quoting affidavit of Paul H. Rubin).

356. *See supra* note 347 and accompanying text.

357. *See In re Oracle Sec. Litig.*, 132 F.R.D. 538, 544 (N.D. Cal. 1990) ("The classic manifestation of the problem in a class action involves a non-pecuniary settlement (e.g., injunctive relief), 'expert valued' at some fictitious figure, together with arrangements to pay plaintiffs' lawyers their fees.").

358. *See In re Gen. Motors Corp. Pick-up Truck Fuel Tanks Prods. Liab. Litig.*, 55 F.3d 768, 807 (3d Cir. 1995) (involving expert estimate of coupon redemption rate between 34 percent and 38 percent even though "his own telephone survey revealed that only 14% of the class reported that they would 'definitely' or 'probably' buy a new truck").

359. *See HENSLER ET AL.*, *supra* note 15, at 89.

360. *See, e.g., In re Nat'l Media Corp. Sec. Litig.*, No. 90-7574 1992 U.S. Dist. LEXIS 16589, at *2 (E.D. Pa. Sept. 15, 1992) (recognizing "the speculative nature and actual benefit to the class members of these contingent 'special product discounts'" in "computing an award of attorneys' fees," the court refused "to place an award of cash discounts on equal footing with an award of cash").

361. *See, e.g., In re Domestic Air Transp. Antitrust Litig.*, 148 F.R.D. 297, 321 (N.D. Ga. 1993).

other courts. Even when conceding that “coupons . . . [are] not an ideal form of compensation,” courts approve proposed coupon settlements.³⁶²

1. Settlement Is the Be-All, End-All

In most litigation, judges desire settlement. Judicial pressure to settle is even greater in the class action context.³⁶³ Judges generally approve proposed settlements, whether based on currency, coupons, or conduct.³⁶⁴ Courts are “guided by ‘the strong judicial policy favoring settlement as well as the realization that compromise is the essence of settlement.’”³⁶⁵ Federal rules encourage settlement.³⁶⁶ Some courts suggest that overly scrutinizing and perhaps rejecting such settlements works against this public policy goal.³⁶⁷ Indeed, judges have gone so far as to opine that “a bad settlement is almost always better than a good trial.”³⁶⁸

Several factors encourage judges to promote settlements among the parties. First, court dockets are sufficiently full that judges have little incentive to coerce parties to litigate. The law favors settlement as a mechanism to promote judicial economy.³⁶⁹ Judges receive praise and prestige for having a “rocket docket,” whereby cases are concluded quickly, either through settlement or a trial on the merits. One criterion by which judges are evaluated, by their peers and the legal community as a whole, is the number of cases that they handle. In the justice factory, volume often equals respect. Class action litigation consumes significantly more judicial resources than non-class civil litigation.³⁷⁰ As a result, “[i]ndividual trial judges simply have

362. *New York v. Nintendo of Am., Inc.*, 775 F. Supp. 676, 681 (S.D.N.Y. 1991).

363. See Judith Resnik, *Litigating and Settling Class Actions: The Prerequisites of Entry and Exit*, 30 U.C. DAVIS L. REV. 835, 838 (1997).

364. See *Silver & Baker*, *supra* note 277, at 1511 (noting “weak judicial review for reasonableness”).

365. *Domestic Air*, 148 F.R.D. at 312 (quoting *Bennett v. Behring Corp.*, 737 F.2d 982, 986 (11th Cir. 1984)). Some commentators praise settlements as being based on mutual consent and eliminating the cost of lengthy trial. See Owen M. Fiss, *Against Settlement*, 93 YALE L.J. 1073, 1075 (1984).

366. See Resnik, *supra* note 363, at 837.

367. See *Bennett v. Behring Corp.*, 96 F.R.D. 343, 348 (S.D.Fla.1986) (“[S]ettlements of class actions are highly favored in the law and will be upheld whenever possible because they are means of amicably resolving doubts and preventing lawsuits.”), *aff d.*, 737 F.2d 982 (11th Cir. 1984).

368. *In re Warner Communications Sec. Litig.*, 618 F. Supp. 735, 740 (S.D.N.Y. 1985), *aff d.*, 798 F.2d 35 (2d Cir. 1986).

369. See *Weinberger v. Kendrick*, 698 F.2d 61, 73 (2d Cir. 1982).

370. See WILLGING ET AL., *supra* note 291, at 7, 11 (noting that another study found that class actions consume almost five times more judicial time than non-class civil cases); *id.* at 23 (“In the eleven certified class actions in the time study, judges spent, on the average eleven times more hours than they did in the average civil action.”); Roger Bernstein, *Judicial Economic and*

inadequate incentives to resist parties who want to settle" the class action litigation.³⁷¹ Hard-working, well-meaning judges may succumb to these pressures.³⁷² In short, judges want to clear their dockets, especially of complicated class action litigation, and settlement serves that goal efficiently.³⁷³ This suppresses judicial scrutiny of proposed settlements.³⁷⁴

Furthermore, some judges may feel pressured to approve class action settlements, including coupon settlements, because their decision is binary: The judge must either approve or reject the proposed settlement as written.³⁷⁵ The judge possesses no authority to modify the proposal or to strike a particularly onerous term from the settlement.³⁷⁶ In the context of coupon settlements, this means that the judge cannot unilaterally require that the coupons be transferable, have later (or no) expiration dates, or not be limited to particular products.³⁷⁷ Yet rejecting a proposed coupon settlement because of discomfort with the coupon terms could entail the consumption of significant judicial time and attention in the future.³⁷⁸ Judges may be

Class Actions, 7 J. LEGAL STUD. 349, 360–63 (1978); see also *Cotton v. Hinton*, 559 F.2d 1326, 1331 (5th Cir. 1977) ("Particularly in class action suits, there is an overriding public interest in favor of settlement. It is common knowledge that class action suits have a well deserved reputation as being most complex.").

371. *Coffee & Koniak*, *supra* note 295.

372. See *Issacharoff*, *supra* note 297, at 829 ("No matter how virtuous the judge, the fact remains that courts are overworked, they have limited access to quality information, and they have an overwhelming incentive to clear their docket.").

373. See *Miller*, *supra* note 232, at 214 n.73. Geoffrey Miller observes that the trial judge knows that if he or she approves the settlement there is little likelihood that the decision will be appealed, whereas if he or she rejects it there is certain to be an appeal. If the judge approves the settlement, the case will be removed from the docket, whereas if he or she rejects the settlement the case will continue to clog the docket and may even eventuate in a trial.

Id.

374. See *HENSLEY ET AL.*, *supra* note 15, at 120.

Judges who are constantly urged to clear their dockets and are schooled to believe that the justice system is better served by settlement than adjudication may find it difficult to switch gears and turn a cold eye toward deals that—from a public policy perspective—may be better left undone.

Id.; see also *Macey & Miller*, *supra* note 282, at 46 ("[T]rial judges are heavily conditioned by the ethos of their jobs to view settlements as desirable. . . . It would be unrealistic to expect trial judges to shift gears suddenly and view settlements with suspicion rather than approbation when they arise in the class action or derivative contexts.").

375. See *MANUAL FOR COMPLEX LITIGATION* § 30.42 (3d ed. 1995).

376. See *In re Domestic Air Transp. Antitrust Litig.*, 148 F.R.D. 297, 305 (N.D. Ga. 1993) ("[The] Court may not rewrite the settlement as requested by numerous objectors.").

377. However, while a court may not be able to strictly impose modifications on the parties, the court can still persuade and perhaps even control the parties to make a more equitable settlement. Or, alternatively, courts can take a harder line against certain coupon settlements so that counsel will know that if they impose particular restrictions, then judges will reject the proposed settlement. See Part V.B.2.

378. See *Lazos*, *supra* note 266, at 322.

rationally worried that rejecting a proposed settlement could doom any chance for settlement and lead to a trial, whose outcome for the class is uncertain and which will necessarily require significantly more judicial resources than merely approving the proposed settlement.

Given the pressures for settlement and inability to modify the proposed settlement, it comes as little surprise that objectors seldom succeed in derailing proposed class action settlements. Even when objectors invest the time and energy to oppose a proposed settlement as not fulfilling the interests of the class, objections rarely overcome the strong institutional presumption in favor of approving proposed settlements.³⁷⁹ A study by the Federal Judicial Center indicates that in those class action cases in which objections were filed, more than 90 percent of the settlements were still approved by the courts without change.³⁸⁰ Although it is tempting to characterize objectors as isolated obstructionists, the opposition to proposed settlements often exhibits considerable breadth.³⁸¹ Yet even when over 20 percent of the class members opposed a coupon-based settlement, trial courts have approved such settlements.³⁸²

2. Trial Court Deference to Class Counsel

Reviewing judges routinely defer to class counsel's representations that a proposed settlement is fair, adequate, and reasonable. This deference extends to coupon settlements.³⁸³ Deference to class counsel manifests itself on two levels in the context of coupon settlements. First, courts sign off on

379. In theory, the trial judge must create a record that sufficiently responds to objectors' arguments. See *Marshall v. Holiday Magic, Inc.*, 550 F.2d 1173, 1178-79 (9th Cir. 1977). However, these duties are often given short shrift.

380. See *WILLGING ET AL.*, *supra* note 291, at 58; Schmitt, *supra* note 293. Finally, in general, in that small minority of cases in which changes are made, they are often merely cosmetic. See *id.*

381. See *Suffolk v. Long Island Lighting Co.*, 907 F.2d 1295, 1325 (2d Cir. 1990); *Van Horn v. Trickey*, 840 F.2d 604, 606 (8th Cir. 1988); *Grant v. Bethlehem Steel Corp.*, 823 F.2d 20, 23 (2d Cir. 1987); *Holden v. Burlington N., Inc.*, 665 F. Supp. 1398, 1421 (D. Minn. 1987) (citing examples).

382. See, e.g., *In re Montgomery County Real Estate Antitrust Litig.*, 83 F.R.D. 305, 317-18 (D. Md. 1979) (citing *Bryan v. Pittsburgh Plate Glass Co.*, 494 F.2d 799, 803 (3d Cir. 1974)) (finding the district court did not abuse its discretion in approving a settlement despite the opposition of over 20 percent of class).

383. See, e.g., *Plemister v. Harcourt Brace Jovanovich, Inc.*, 1984-2 Trade Cas. (CCH) ¶ 66,234, at 66,993 (N.D. Ill. Sept. 24, 1984) ("It is appropriate for the Court to rely on the judgments of the experienced counsel who litigated this that this settlement is fair."); *In re Mid-Atl. Toyota Antitrust Litig.*, 564 F. Supp. 1379, 1385 (D. Md. 1983) ("While the Court might have insisted on certain different provisions [in the coupon settlement] had it been a participant in the negotiations, the Court should not substitute its business judgment for the business judgment of the parties whose 'business' is involved.").

the overall concept of payment in coupons, instead of cash.³⁸⁴ Some judges take comfort in the fact that “[c]ompensation in the form of coupons has been approved by other courts.”³⁸⁵ Nevertheless, approving a coupon settlement would appear to be at odds with the accepted factor that “the judge must consider the substantive terms of the settlement compared with the likely result of a trial.”³⁸⁶ The class members would never receive coupons if victorious at trial. Despite this, judges defer to counsel representations that coupons are as good as cash. Second, courts fail to critically examine the utility of the particular coupons proposed in the settlement. Reviewing judges grant proponents of coupon-based settlements significant latitude in imposing restrictions that, when aggregated, significantly diminish the value of the coupons. Despite the fact that the proponents of the settlement carry the burden of proof with respect to fairness,³⁸⁷ courts have held that these parties “do not have the burden of explaining their reasoning behind every condition and limitation to the settlement,” such as the restrictions on redemption in a coupon-based settlement.³⁸⁸ Ultimately, this institutional deference often means that judges fail to meaningfully scrutinize coupon terms.

Several factors explain this judicial deference. First, settlement review often occurs before comprehensive evidentiary hearings.³⁸⁹ The judge does not have the benefit of expert testimony or of documentary evidence with respect to the merits of the underlying claims.³⁹⁰ The court must rely on the attorneys for information.³⁹¹ Second, judges generally trust the class counsel because the court has presumably already certified the lawyers as adequate representatives under Rule 23(a).³⁹² Judges are strongly reluctant “to substitute [their] own judgment for that of experienced counsel representing the

384. Cf. *Livingston v. Toyota Motor Sales USA, Inc.*, No. C-94-1377, No. C-94-1359, No. C-94-1960, 1995 U.S. Dist. LEXIS 21757, at *32 (N.D. Cal. May 30, 1995).

385. *New York v. Nintendo of Am., Inc.*, 775 F. Supp. 676, 681 (S.D.N.Y. 1991); see also *In re Cuisinart Food Processor Antitrust Litig.*, 1983-2 Trade Cas. (CCH) ¶ 65,680 (D. Conn. Oct. 24, 1983); *Ohio Pub. Interest Campaign v. Fisher Foods, Inc.*, 546 F. Supp. 1 (N.D. Ohio 1982).

386. *In re Cuisinart*, 1983-2 Trade Cas. (CCH) at 69,471.

387. See *Holmes v. Continental Can Co.*, 706 F.2d 1144, 1147 (11th Cir. 1983).

388. *In re Domestic Air Transp. Antitrust Litig.*, 148 F.R.D. 297, 330 (N.D. Ga. 1993).

389. See HENSLER ET AL., *supra* note 15, at 88.

390. See *id.* Indeed, if there is limited discovery the counsel may have insufficient information to properly evaluate the settlement. If so, this counsels against approving a proposed settlement. See MANUAL FOR COMPLEX LITIGATION § 30.42 (3d ed. 1995).

391. See MANUAL FOR COMPLEX LITIGATION § 30.42 (3d ed. 1995). See generally POSNER, *supra* note 289, at 565-66 (noting that attorneys control the information available to a judge considering a proposed settlement).

392. FED. R. CIV. P. 23(a); see Resnik, *supra* note 363, at 855.

class.”³⁹³ Third, in most cases, no party before the court is highlighting potential problems with the proposed settlement,³⁹⁴ which is being advocated by both plaintiffs’ and defendants’ attorneys, who are no longer adversarial.³⁹⁵

Deference to class counsel is misguided. First, the reviewing judge “has an *independent* duty to ensure that the proponents of the settlement have met their burden of establishing that the settlement is fair, adequate, and reasonable.”³⁹⁶ Second, Congress required judicial approval of class action settlements precisely because the class counsel might make agreements that maximize their personal gain at the expense of absent class members.³⁹⁷ Class counsel have an interest in securing judicial approval of settlements that benefit the class counsel at the expense of class members’ welfare.³⁹⁸ As such, class attorneys sometimes fail to disclose bad facts³⁹⁹ or may represent their own case as weak in order to encourage the judge to approve a coupon settlement.⁴⁰⁰ For courts to defer to class counsel lets the fox guard the henhouse, the precise result that Rule 23(e) is supposed to prevent.⁴⁰¹

393. *Domestic Air*, 148 F.R.D. at 315; see also *In re Chicken Antitrust Litig.* Am. Poultry, 669 F.2d 228, 236 n.15 (5th Cir. 1982) (“Although there may be the potential for a conflict of interest to arise, it is best to avoid second guessing the judgment of counsel in settlement negotiations absent an actual conflict of interest which renders effective representation impossible.”); *Cotton v. Hinton*, 559 F.2d 1326, 1330 (5th Cir. 1977) (“[T]he trial judge, absent fraud, collusion, or the like, should be hesitant to substitute its own judgment for that of counsel.”); *In re Michael Milken & Assoc. Sec. Litig.*, 150 F.R.D. 57, 66 (S.D.N.Y. 1993) (“The court should not substitute its business judgment for that of the parties.”).

394. See *supra* notes 379–382 and accompanying text (discussing how courts often ignore objectors).

395. See Elliott J. Weiss & John S. Beckerman, *Let the Money Do the Monitoring: How Institutional Investors Can Reduce Agency Costs in Securities Class Actions*, 104 YALE L.J. 2053, 2066 (1995); see also Macey & Miller, *supra* note 282, at 46 (“[S]ettlement hearings are typically pep rallies jointly orchestrated by plaintiffs’ counsel and defense counsel.”). Courts particularly defer when the class is represented by state attorneys general. See, e.g., *New York v. Nintendo of Am., Inc.*, 775 F. Supp. 676, 680, 682 (S.D.N.Y. 1991).

396. *Petruzzi’s, Inc. v. Darling-Del. Co.*, 880 F. Supp. 292, 296 (M.D. Penn. 1995) (emphasis added) (citation omitted).

397. See HENSLER ET AL., *supra* note 15, at 15; *In re Montgomery County Real Estate Antitrust Litig.*, 83 F.R.D. 305, 315 (D. Md. 1979); see also MANUAL FOR COMPLEX LITIGATION § 1.46 (3d ed. 1995) (recommending that judges hold hearings to determine the value of proposed settlement “rather than automatically accepting the assurances of counsel that the proposed settlement is a good one and should be submitted to the class members”).

398. See *supra* notes 263–280 and accompanying text.

399. But see MANUAL FOR COMPLEX LITIGATION § 30.43 (3d ed. 1995) (admonishing class counsel to disclose all facts).

400. See, e.g., *Phemister v. Harcourt Brace Jovanovich, Inc.*, 1984-2 Trade Cas. (CCH) ¶ 66,234, at 66,988 (N.D. Ill. Sept. 24, 1984) (noting that class “counsel candidly concede that plaintiffs would have had a formidable burden to prove” their case).

401. See *Mars Steel Corp. v. Cont’l Ill. Nat’l Bank & Trust*, 834 F.2d 677, 681–82 (7th Cir. 1987); *In re Mid-Atl. Toyota Antitrust Litig.*, 564 F. Supp. 1379, 1387 (D. Md. 1983) (“[T]he primary purpose of Fed. R. Civ. P. 23(e) is to protect the absentee class member from the entry of a binding judgment when his interests have not been adequately represented.”).

Coupon settlements magnify these problems of judicial deference. Both parties represent to the court that the settlement is in the best interests of all litigants because the class members will receive “valuable coupons.” Because a coupon settlement may benefit the defendants and class counsel more than a traditional cash-based settlement, both sets of counsel have a significant incentive to represent the coupon settlement as highly beneficial to the class. Despite the inherent problems associated with coupon settlements, it should come as no surprise that in many cases every attorney in the courtroom sings the praises of the proposed coupon settlements, given that the only people hurt by the coupon settlements, the absent class members, are without an independent voice. The defendant corporation wins in a coupon settlement because it does not have to pay cash. Indeed, the defendant pays nothing to many, and sometimes most, class members. Defendants are unlikely to challenge the class counsel fee request; they have touted the value of the settlement in order to secure the judge’s approval.⁴⁰² The class counsel wins because they do get paid in cash. The amount of their attorneys’ fees looks reasonable compared to the face value of the coupons, even though that dollar figure does not represent the monetary benefit to the class of the settlement. While both the defense attorneys and the class counsel have an incentive to exaggerate the value of coupon settlements, some judges may feel more compelled to defer to counsel’s representations because coupons create noise.⁴⁰³ As noted above, it is significantly harder for judges to evaluate coupon settlements, as opposed to more traditional cash-based settlements.⁴⁰⁴ Although a reduction in restrictions—and thus in noise—would facilitate more meaningful judicial scrutiny of proposed settlements, attorneys on both sides of the class action have too many incentives to keep coupon settlements complicated and noisy. Noise increases judicial deference to counsel and, consequently, the likelihood of judicial approval of a coupon settlement. When faced with more complicated settlement proposals, some judges are left with “too little information to recognize when the settlement is collusive.”⁴⁰⁵

402. See HENSLER ET AL., *supra* note 15, at 90.

403. See *id.* at 83; see also, e.g., *Mid-Atl. Toyota*, 564 F. Supp. at 1385–86 (deferring to counsel while citing proposed coupon settlement’s “intricacy and comprehensiveness”).

404. Although judges may have to calculate the net present value of some structured settlements, many coupons are paid out—or redeemed—over time and are subject to numerous complicated restrictions foreign to cash settlements. See HENSLER ET AL., *supra* note 15, at 83.

405. *Coffee & Koniak*, *supra* note 295; *Kane*, *supra* note 282, at 403 (stating that judicial oversight of a proposed settlement is ineffective and “protects the parties only against the most egregious and blatant abuses”). One court noted,

Calculating the cash value of certificates is trickier than calculating the present cash value of an annuity but is still possible. Nonetheless, what is the present cash value of a

D. Case-Specific Incentives to Approve Proposed Coupon-Based Settlements

Applying the traditional factors used to evaluate the adequacy of proposed class action settlements, some courts have concluded a defendant's weak financial situation supports approving a coupon settlement.⁴⁰⁶ Judges have suggested that a victory at trial that bankrupts the defendant could leave the class without any recovery and result in a more anti-competitive marketplace as firms exit the market.⁴⁰⁷ Such justifications for coupon settlements raise several concerns. First, some companies may exaggerate their dire financial positions as a strategy for class action negotiations.⁴⁰⁸ Second, arguing that the tenuous financial condition of a defendant justifies a coupon-based settlement comes close to admitting that the coupons will be worthless to many class members and that payment with coupons does not disgorge

class recovery that provides for certificates, redeemable over time, in an undetermined amount to range from \$49 to \$70 million?

In re Superior Beverage/Glass Container Consol. Pretrial, 133 F.R.D. 119, 124 (N.D. Ill. 1990).

406. See, e.g., *In re Domestic Air Transp. Antitrust Litig.*, 148 F.R.D. 297, 323 (N.D. Ga. 1993) ("[T]he economic viability of the airline defendants is an important factor to be considered in analyzing the reasonableness of the proposed settlement as well."); *Langford v. Bombay Palace Rests., Inc.*, No. 88 Civ. 5279 (CSH), 1991 U.S. Dist. LEXIS 4730, at *1 (S.D.N.Y. Apr. 8, 1991) (approving proposed coupon settlement, while considering defendant's financial security); *Superior Beverage/Glass*, 133 F.R.D. at 129; cf. *Mid-Atl. Toyota*, 564 F. Supp. at 1386 ("As some doubt exists about the solvency of certain Dealer defendants, approval of a settlement in which all of them participate might be prudent, although the Court places little weight upon this factor.").

The court in *Domestic Air* reasoned that the potential recovery could bankrupt all of the defendants. See *Domestic Air*, 148 F.R.D. at 324. Both TWA and Continental were already in various stages of bankruptcy proceedings. See *id.* at 310. The court estimated that the possible recovery at trial for the class members could be in excess of \$2 billion before trebling, which is mandatory under the Sherman Act. See *id.* at 319. In essence, the court reasoned that coupons were better than nothing. See *id.* at 325. However, this ignores the fact that even if a monetary recovery could bankrupt the airlines, this is arguably a reasonable result for larger corporations that flagrantly violate the law. If you are a corporation that violates the antitrust laws to the tune of causing \$2 billion worth of damage to consumers, \$6 billion after trebling, then this would serve as an effective deterrent and send a message to corporations that if you violate the antitrust laws the cost may be an end to your business. Furthermore, even if the defendant airlines could not pay the full \$6 billion, and they did go into bankruptcy, this does not mean that avoiding bankruptcy under these circumstances is best for the class members. After all, such a recovery at trial would be in cash and while the consumers may not receive their entire recovery, even if the class members each received only ten cents on the dollar for their claims in bankruptcy, they would still be far ahead of the proposed settlement even if the coupon's face value was the equivalent of cash (10 percent of \$6 billion is \$600 million; in contrast, the face value of the coupons was only \$408 million, plus \$15 million in cash, which largely went to the attorneys).

407. See *In re Montgomery County Real Estate Antitrust Litig.*, 83 F.R.D. 305, 311 (D. Md. 1979).

408. See Schmitt, *supra* note 71. However, following the coupon settlement in *Domestic Airlines*, Pan Am and Midway Airlines did in fact go bankrupt. See Hunt, *supra* note 157, at 1008.

ill-gotten gains.⁴⁰⁹ After all, if a business could not afford to pay \$1 million in settlement, but can afford to pay \$1 million in coupons, then this tacitly demonstrates that the \$1 million in coupons is not the equivalent of \$1 million in cash.⁴¹⁰ In short, while the financial condition of the defendant may justify a reduced cash award, the risk of financial insolvency does not warrant payment in coupons rather than in cash.⁴¹¹ Finally, the threat of defendants' bankruptcy increases the risk that the class counsel will sell out the class.⁴¹²

E. Judicial Disapproval of Coupon-Based Settlements

Despite these systemic incentives encouraging judicial approval, courts nonetheless sometimes reject coupon-based settlements.⁴¹³ Courts that actually examine the nature of the proposed coupons have recognized the coupons may confer little, if any, value on the class members. The most likely indicator that the coupons may be functionally worthless to many class members is a projected low redemption rate. For example, in *Buchet v. ITT Consumer Financial Corp.*,⁴¹⁴ the defendant conceded that half of the class members would never be able to use their coupons because they could not qualify for new loans based on their poor credit record. Indeed, in a previous coupon settlement involving the same defendant, only 3 percent of the class members actually redeemed their coupons.⁴¹⁵ Ultimately, because of the difficulty of determining the redemption rate of the coupons and thus the

409. See *supra* notes 242–245 and accompanying text.

410. It may also demonstrate that settlement coupons have marketing value for the defendant.

411. See Gramlich, *supra* note 6, at 272. Gramlich argues:

Since there is no reason to believe that the value of a scaled-down money settlement falls more rapidly than that of a scaled-down scrip settlement, the presence of a bankruptcy problem should not affect the likelihood that a scrip settlement will prove useful. Bankruptcy is therefore also no argument for scrip.

Id.

412. If the defendant is about to declare bankruptcy, the class counsel have a greater incentive to make sure that they get *something* from the defendant. Similarly, the threat of impending bankruptcy should increase the willingness of the class to accept less in settlement. A victory at trial is difficult to collect from a bankrupt defendant.

413. See Editorial, *Review and Outlook: A Classy Ruling*, WALL ST. J., May 24, 1996, at A10; see also Geyelin, *supra* note 284 (“A federal judge in New Orleans threw out a class-action settlement between Bronco II owners and Ford Motor Co., citing the possibility of collusion between lawyers for the plaintiffs and the auto maker.”).

414. 845 F. Supp. 684 (D. Minn. 1994).

415. See *id.* at 695. For one subclass, only 2 of the 96,754 settlement certificates issued were redeemed, for a redemption rate of 0.002 percent. See *id.*

overall value of the proposed coupons to the class, the court rejected a coupon-based settlement.⁴¹⁶

Probably the most noteworthy case in which a court has rejected a proposed coupon-based settlement is *General Motors*.⁴¹⁷ General Motors sought to settle class action litigation stemming from the allegedly faulty design of the gas tank placement on the company's trucks.⁴¹⁸ The district court accepted a proposed settlement that gave each class member a coupon towards the purchase of another GM vehicle.⁴¹⁹ However, on appeal, in a rare move, the Third Circuit reversed. The court decertified the class, but also launched an insightful attack on the proposed coupon settlement. The court noted several flaws in the settlement. For example, the settlement precluded the coupon from being transferred more than once.⁴²⁰ The Third Circuit recognized that such a "one-time transfer restriction . . . precludes the development of a market-making clearinghouse mechanism."⁴²¹

Although the Third Circuit's dicta in *General Motors* reflect sound criticism against proposed coupon-based settlements, the aftermath of the opinion illustrates the difficulty of reining in collusive, or at least low-value, settlements. First, it bears noting that for all the problems with this proposed settlement, the district court had approved it. Second, because proposed class action settlements are reviewed on a case-by-case basis, the *General Motors* opinion does not create a legal rule that coupons must be transferable in order for a coupon-based settlement to satisfy Rule 23(e).⁴²² This point is best illustrated by the aftermath of *General Motors* itself. Failing in the federal courts, the attorneys took the same class action to the state courts and achieved a coupon settlement.⁴²³ Finally, other courts approving proposed coupon settlements have explicitly rejected the Third Circuit's arguments,

416. See *id.* at 686–87. In addition to the uncertainty of the coupons' value, the court also noted the defendant's refusal to guarantee any cash value for the coupons and noted that many members of the class would receive nothing. See *id.* at 694–96.

417. See *In re Gen. Motors Corp. Pick-up Truck Fuel Tank Prods. Liab. Litig.*, 55 F.3d 768, 818 (3d Cir. 1995).

418. See NACA, *supra* note 238, at 382 (describing underlying claims).

419. See *In re Gen. Motors Corp. Pickup Truck Fuel Tank Prods. Liab. Litig.*, 846 F. Supp. 330, 332–33, 344 (D. Pa. 1993).

420. See *id.*

421. *Id.* Several other courts have noted the importance of transferability of settlement coupons and yet have nonetheless accepted coupon-based settlements with onerous value-reducing restrictions on transferability. See, e.g., *In re Domestic Air Transp. Antitrust Litig.*, 148 F.R.D. 297, 309, 321 (N.D. Ga. 1993); *In re Cuisinart Food Processor Antitrust Litig.*, 1983-2 Trade Cases (CCH) ¶ 65,473, at 69,471 (D. Conn. Oct. 24, 1983).

422. FED. R. CIV. P. 23(e).

423. See *Gen. Motors*, 134 F.3d at 137 (3d Cir. 1998).

and have actually chided that court for rejecting the expert testimony in the case.⁴²⁴

F. Summary

Ultimately, judicial review of a proposed coupon-based settlement provides insufficient protection to the class against collusion between the defendant and class counsel.⁴²⁵ Courts generally rubber-stamp proposed settlements,⁴²⁶ so bad settlements often survive judicial scrutiny.⁴²⁷ As a result, judges approve coupon settlements even while admitting that the settlement "coupons do not provide plaintiffs substantial monetary relief."⁴²⁸ Furthermore, appellate review is generally weak, as reversal requires "a clear showing of abuse of discretion" by the trial court.⁴²⁹ Even when an appellate court seems to understand the inherent deficiencies in a coupon settlement, deference to the trial judge usually prevails.⁴³⁰

V. ADDRESSING THE PROBLEMS OF COUPON SETTLEMENTS

The interests of three sets of participants converge to facilitate coupon settlements in class action litigation: Defendants pursue coupon settlements because the settlement eliminates liability in a relatively low-cost manner that could actually increase sales and profits, class counsel acquiesce

424. See, e.g., *Dunk v. Ford Motor Co.*, 56 Cal. Rptr. 2d 483, 489 (Ct. App. 1996).

425. See HENSLER ET AL., *supra* note 15, at 120 ("Procedural rules, such as the requirements for notice and judicial approval of settlements, provide only a weak bulwark against self-dealing and collusion."); John C. Coffee, Jr., *The Unfaithful Champion: The Plaintiff as Monitor in Shareholder Litigation*, 48 LAW & CONTEMP. PROBS. 5, 26–27 (1985) ("[T]he trial court's approval is a weak reed on which to rely once the adversaries have linked arms and approached the court in a solid phalanx seeking its approval.").

426. See Downs, *supra* note 273, at 682–83.

427. See, e.g., *Kamilewicz v. Bank of Boston Corp.*, 92 F.3d 506 (7th Cir.), *reh'g en banc denied*, 100 F.3d 1348 (7th Cir. 1996).

428. *Hanrahan v. Britt*, 174 F.R.D. 356, 368 (E.D. Pa. 1997).

429. 2 HERBERT B. NEWBERG & ALBA CONTE, *NEWBERG ON CLASS ACTIONS* § 11.60, at 11–158 (3d ed. 1992); see also, e.g., *Dunk*, 56 Cal. Rptr. 2d at 488. There are, of course, exceptions, the most important for our purposes being *In re General Motors Corp. Pick-up Truck Fuel Tank Products Liability Litigation*, 55 F.3d 768, 800–06 (3d Cir. 1995).

430. The *Dunk* Court stated:

Although we conclude the trial court did not abuse its discretion in approving this settlement, we stress we do not imply coupon settlements in class action cases are always ideal. Questions arise as to the value of a settlement where, as here, the coupon relates to a "big ticket item," is not transferable, represents only a tiny percentage of the purchase price, and is valuable to the defendant as an inducement to promptly purchase the defendant's product. We merely hold that the trial court's scrutiny here . . . was adequate to support its conclusion.

Dunk, 56 Cal. Rptr. 2d at 490.

because promoting a coupon settlement can increase their attorneys' fees, and judges often approve such settlements based on a mixture of deference to counsel, ignorance of coupon value, and, perhaps, a desire to clear their dockets of complicated matters. While it may be difficult to fault defendants' counsel for proposing and pursuing coupon settlements, the class counsel is sworn to protect the interests of the class, and reviewing judges are entrusted to insure that class counsel performs its responsibilities to the class. Unfortunately, agency costs divorce class counsel from class interests and the noise created by coupons makes it difficult for courts to evaluate the worth of coupon settlements. Judges must find a way to overcome this noise.

To evaluate possible solutions to the problems created by coupon settlements requires some standard by which to measure the proposals. The overriding goal should be to compensate the class. Of all of the litigation participants, class members are in the weakest position to protect their own interests.⁴³¹ Class counsel have the ability to protect the class but often fail in their duties. Thus, judges should not simply defer to class counsel; rather, courts should insure that the class counsel has not sold out the class.⁴³² Several tacks are possible.

A. Creating a Market for Settlement Coupons

To understand how to construct settlement coupons that confer actual value on the class requires an appreciation of the role that markets play in both determining the value of a commodity and providing an efficient means of selling that commodity at the market price. Creating a market for coupons is the only way to insure that settlement coupons confer value on all class members. Judges, counsel, and expert witnesses have invested significant time and energy into calculating the "true value" of settlement coupons. As stock issuers and Broadway producers know well, predicting how the buying public will value a commodity is fraught with peril. However, once a product is widely available for sale—whether the commodity is stock or Broadway tickets—the market price communicates the item's value. A commodity's value equals the amount that a willing and able buyer will pay for it. Absent onerous transfer restrictions, settlement coupons are a marketable commodity. Creating a market for settlement coupons insures that class members who do

431. As the negotiating parties, defendants (generally represented by in-house counsel or loyal outside counsel) and class counsel can protect their own interests directly. Reviewing judges can make their own independent decisions whether to approve or reject a proposed settlement. In contrast, class members are dependent on other actors (counsel and court) to protect the members' interests.

432. See *supra* Part III.A.

not choose to redeem their settlement coupons can sell the coupons and receive some compensation from the settlement.⁴³³

For a market to develop such that settlement coupons confer benefits on the class, the coupons must bear two characteristics: transferability and market value. First, the settlement coupons must be transferable.⁴³⁴ If an item cannot be bought and sold, then no market can evolve. In our case, nontransferable coupons have no market value because no rational person would pay any sum of money to buy a coupon that becomes void upon purchase. The more transferable coupons are, the closer their actual value approaches their face value.

Second, settlement coupons must have value. To have value in a secondary market, settlement coupons must be transferable; however, transferability alone is insufficient. Settlement coupons loaded with restrictions—like imminent expiration dates and use limited to inferior products—would have little market value even if they were fully transferable.⁴³⁵ Because coupon restrictions can render coupons worthless and unmarketable, effective monitoring of coupon terms goes hand in hand with creating a market for settlement coupons.

For any given set of settlement coupons, an efficient market could evolve along many lines. For example, coupon brokers could create markets by purchasing coupons from class members and reselling them at a mark-up to consumers wishing to buy the defendant's product. The market maker for settlement coupons would be similar to agencies that acquire large blocks of concert tickets and then sell them back to the public (often at exorbitant prices). The primary—and critical—difference is that the agency making a market for settlement coupons cannot charge exorbitant prices because no rational person would ever pay more than the face value of the coupon.⁴³⁶

Alternatively, businesses could facilitate transactions between coupon holders and potential buyers. For example, Internet auction sites facilitate trades for many diverse items. If unburdened by restrictions that needlessly diminish their value or prohibit transfers, settlement coupons could easily be bought and sold in cyberspace. Indeed, settlement coupons are better suited for Internet auctions than other commodities because coupons are

433. See NACA, *supra* note 238, at 383–84.

434. See *Weiss v. Mercedes-Benz of N. Am., Inc.*, 899 F. Supp. 1297, 1302 (D.N.J. 1995).

435. Furthermore, the total number of coupons should not exceed the expected demand for the product; otherwise some coupons would be worthless, redeemable for a product for which there is no demand.

436. Indeed, it seems unlikely that any rational person would pay the face value of the coupon given that monetarily they are no better off and they have to undergo the transaction costs of acquiring and using the coupon.

perfectly homogeneous. Unlike Beanie Babies and real babies,⁴³⁷ there are no issues of quality.⁴³⁸ The coupon terms can be posted on the Web so that potential buyers know exactly what they are buying, including all relevant coupon restrictions, such as the expiration date.

Empirically, it is possible to create a secondary market in settlement coupons.⁴³⁹ This is most likely to happen when judges recognize this as an explicit goal.⁴⁴⁰ It is possible to structure coupons so as to create a secondary market.⁴⁴¹ The Certificate Clearing Corp. (CCC) has already recognized the value of the Internet in creating markets for settlement coupons.⁴⁴² The CCC purchased from class members coupons used to settle class action litigation against Toyota. Its website has a facsimile of the \$150 coupon so that potential buyers can examine the coupon terms. The CCC sells the coupons for \$49.95.⁴⁴³ The market is robust and easy to use, but only because the settlement coupons were unburdened by common restrictions. The willingness of such third-party market makers to handle proposed settlement coupons provides independent evidence to a reviewing judge whether a coupon settlement confers value on the class. For example, the CCC refused to handle the proposed settlement coupons in *General Motors* because the numerous transfer restrictions prevented the development of a secondary market.⁴⁴⁴

If settlement coupons were fully marketable, class members who decide to sell their coupons would be guaranteed to receive some value under the settlement.⁴⁴⁵ Of course, coupons will trade at less than their face value.⁴⁴⁶ The face value of a coupon represents the ceiling for how much a class

437. See Elisabeth M. Landes & Richard A. Posner, *The Economics of the Baby Shortage*, 7 J. LEGAL STUD. 323 (1978); Richard A. Posner, *The Ethics and Economics of Enforcing Contracts of Surrogate Motherhood*, 5 J. CONTEMP. HEALTH L. & POL'Y 21 (1989).

438. Although there could be issues of fraudulent coupons, the question is binary (either the coupon is legitimate or not), not a question of judgment.

439. See, e.g., <http://www.certccc.com> (last visited Jan. 20, 2002).

440. See *Shaw v. Toshiba Am. Info. Sys., Inc.*, 91 F. Supp. 2d 942, 983 (E.D. Tex. 2000); *Livingston v. Toyota Motor Sales USA, Inc.*, No. C-94-1377, No. C-94-1359, No. C-94-1960, 1995 U.S. Dist. LEXIS 21757, at *32 (N.D. Cal. May 30, 1995). In some coupon settlements, defendants have actually "agreed to establish a clearinghouse for the purpose of helping those certificate holders desiring to sell their certificates to find buyers." *In re Montgomery County Real Estate Antitrust Litig.*, 83 F.R.D. 305, 312 (D. Md. 1979).

441. See *Shaw*, 91 F. Supp. 2d at 983.

442. See <http://www.certccc.com> (last visited Jan. 20, 2002).

443. See <http://www.certccc.com/toyota/> (last visited Jan. 20, 2002).

444. See *In re Gen. Motors Corp. Pick-up Truck Fuel Tank Prods. Liab. Litig.*, 55 F.3d 768, 809 (3d Cir. 1995) ("[T]he one-time transfer restriction also precludes the development of a market-making clearing house mechanism."); Wolfman & Morrison, *supra* note 80, at 473 n.64.

445. Of course, some class members will continue to neither redeem nor sell their settlement coupon.

446. See *supra* notes 329–344 and accompanying text.

member can receive for the sale of her coupon. After all, no rational consumer would pay \$600 to obtain a \$500 coupon toward the purchase of a new vehicle.

Several factors will decrease the market value of settlement coupons. First, redemption restrictions reduce market price. If a coupon has an unreasonable expiration date, then the trading price would be a significant discount off the face value as those people interested in purchasing a coupon know that their leverage is increasing significantly because the holder of the coupon must sell the settlement coupon at any price or risk expiration. Second, the actual value at which a coupon would trade would be a function of supply and demand, as with any other commodity. If there are a significant number of coupons on the market, and too few consumers chasing too many settlement coupons, then the coupons are unlikely to fetch close to their face value. Similarly, if there is not sufficient demand for the product toward which the coupon may be used, then consequently there is likely to be little demand for the coupons.

While the market price informs the judge as to what the settlement coupons are actually worth, this information arrives after the judge has approved the settlement. If the market price turns out to be negligible—or so low that no meaningful market develops—it is generally too late to find an alternative means of compensating the class.⁴⁴⁷ The defendant is off the hook. The problem for the judge reviewing a proposed coupon settlement is to insure in advance that the coupons *will be* marketable and confer real value on the class. Here, all of the noise created by coupon restrictions again prevents judges from accurately predicting redemption rates and coupon value. The solution then lies in creating the proper incentive for class counsel to insure that settlement coupons will have real value on an open market.

B. Proposals to Reform Coupon Settlements

This part will discuss four possible solutions to the problems created by coupon settlements. First, courts could reject all coupon settlements out of hand. Second, courts could review the terms of the actual coupons involved in a coupon settlement—in order to determine whether the class members are getting value in exchange for their sacrifice of any future legal remedies for the underlying claims—and approve only those settlements in which the coupons confer benefits on the class. Third, courts could attempt to increase the redemption rates for settlement coupons. For example,

447. Some settlements have addressed this contingency by requiring a minimum redemption rate.

judges could retain jurisdiction and, by agreement, require the defendant to issue settlement coupons until a certain minimum number had been redeemed. Or, judges could delay payment of attorneys' fees to the class counsel until after all settlement coupons have been redeemed and/or expired, at which point the actual benefit conferred upon the class can be estimated and an appropriate contingency fee can be calculated. Fourth, and finally, courts could approve only coupon settlements when the class counsel is paid in the same currency that the class members receive. This represents a process-based solution to eliminate the agency problems inherent in class actions and magnified by coupon settlements. The proposals are not all mutually exclusive; some may be employed in conjunction with others.⁴⁴⁸

1. Banning Coupon Settlements

Given the inherent problems associated with coupon settlements, the simplest response would be to avoid the issue of making settlement coupons marketable by rejecting all coupon-based settlements as a matter of course. A complete ban on coupon settlements would solve most problems laid out in Parts II through IV. Defendants could not structure the class action settlement to increase their own sales while simultaneously denying any benefit to many class members. Class counsel could not use the noise created by a coupon settlement to pursue their own interests. Judges would not allow the complexity of the coupon settlements to override their duty to ensure that the settlement does, in fact, provide fair and adequate compensation to the class.

Efficiency counsels in favor of banning coupon settlements.⁴⁴⁹ Judges generally find it more convenient to apply bright-line rules,⁴⁵⁰ and an outright ban represents such a bright-line rule. As such, judges need not invest significant time or resources in evaluating the merits of every proposed coupon settlement. The court would not have to consider the likely redemption rates, transferability, or the reasonableness of expiration dates, product limitations, or any other restrictions that may diminish the value of the coupons to the class. The parties would not invest their resources into

448. Courts could also change nothing at all. Parts II through IV counsel against preserving the status quo because coupon settlements are currently too susceptible to manipulation by defendants without adequate oversight by the class counsel or the reviewing court.

449. Judges often consider administrative burdens when determining the form of settlement. See *Silver & Baker*, *supra* note 277, at 1481 (discussing *In re Corrugated Container Antitrust Litig.*, 659 F.2d 1322 (5th Cir. 1981)).

450. See Christopher R. Leslie, *Achieving Efficiency Through Collusion: A Market Failure Defense to Horizontal Price-Fixing*, 81 CAL. L. REV. 243, 285-86 (1993).

negotiating a complicated coupon settlement because the court would reject it out of hand.

Courts could justify an outright ban on coupon settlements and their refusal to investigate the intricacies of any given coupon settlements. First, judges can point to the agency cost problems and the fact that those class members who do not use their coupons before expiration receive absolutely nothing from the settlement. Second, judges can cite their reasonable reluctance to parse every single restriction and attempt to predict what the ultimate value of the coupons will be for the average class member.

Despite the apparent advantages of a bright-line rule against coupon settlements, the proposal suffers from two major flaws. First, the proposal's simplicity is illusory in that it may be difficult to determine what constitutes a coupon settlement. Some proposed settlements include a coupon component in a much larger settlement structure.⁴⁵¹ For example, to settle class action litigation alleging deceptive pricing practices by Bausch & Lomb, the defendant agreed to pay class members cash to compensate for the actual damages suffered, as well as to provide coupons for future purchases.⁴⁵² In cases such as this, the coupons are "gravy."⁴⁵³ To reject all settlements with coupon provisions outright may deny concrete benefits to the class and force litigation in which every member of the class could wind up with nothing. If judges attempt to build flexibility into the rule by analyzing whether a proposed settlement is "really" a coupon settlement, then the advantages of the bright-line rule are diminished because judges must determine the value of the coupons in the context of the overall settlement scheme.

Second, perfunctory rejection of coupon settlements may be too sweeping and inflexible. Some coupon settlements may be appropriate.⁴⁵⁴ Even critics of coupon settlements recognize the legitimacy of coupon settlements under certain conditions.⁴⁵⁵ In theory, coupons could be structured to

451. See, e.g., *New York v. Nintendo of Am., Inc.*, 775 F. Supp. 676, 681 (S.D.N.Y. 1991).

452. See HENSLER ET AL., *supra* note 15, at 158. However, these cases still raise issues with respect to inflated attorneys' fees when trial judges include the coupons' face value when calculating the counsels' fees. See, e.g., *id.* at 163.

453. Similarly, the main advantage of a settlement may be to create and maintain formal antitrust compliance programs. See, e.g., *In re Domestic Air Transp. Antitrust Litig.*, 148 F.R.D. 297, 310 (N.D. Ga. 1993) (discussing how Northwest Airlines established an antitrust program as part of a coupon-based settlement).

454. See, e.g., *Sampson v. Eastman Kodak Co.*, 552 N.E.2d 1194, 1195 (Ill. App. Ct. 1990) (discussing a settlement to a consumer action related to a patent infringement suit in which Kodak permitted camera owners to exchange their (infringing) cameras for either a replacement Kodak "camera and film, a \$50 rebate coupon, or one share of Kodak stock").

Another coupon-for-product settlement involved cereal. See HENSLER ET AL., *supra* note 15, at 97; *General Mills Inc.: Judge Approves \$10 Million Accord in Suit Over Cereals*, WALL ST. J., May 24, 1995, at C21.

455. See NACA, *supra* note 238, at 383-84.

effectively compensate the class and even to deter future transgressions.⁴⁵⁶ A handful of conscientious judges have insured that settlement coupons are freely transferable with minimal restrictions in order to facilitate the creation of a secondary market in settlement coupons.⁴⁵⁷ Although these cases are the exceptions, they show the possibility of properly structured coupon settlements. Thus, the real problem is how to distinguish a proper coupon settlement from a collusive coupon settlement.⁴⁵⁸

Furthermore, coupons may represent the only way to settle litigation in some instances. For example, when there is a genuine threat that the defendant may be insolvent, a cash-based settlement could force bankruptcy, in which case the class members may receive little, if anything. A coupon settlement is unlikely to bankrupt a defendant because every "payment" to a class member is tethered to a cash inflow to the defendant. Thus, a coupon settlement can provide some small measure of relief to the class without forcing the defendant to declare bankruptcy.⁴⁵⁹

2. Enhancing Judicial Scrutiny of Coupon Terms

Instead of rejecting all coupon settlements outright, trial judges could be more proactive in scrutinizing all of the terms of proposed settlement coupons. When a proposed settlement relies on payment in coupons, a red flag should be raised, signaling courts to scrutinize the proposed settlement with particular care.⁴⁶⁰ The presence of coupons raises issues about the fairness and adequacy of the settlement. The *Manual for Complex Litigation* notes: "The need for close review of provisions for attorneys' fees is particularly acute where the settlement provides for distribution in kind to the plaintiff class in lieu of money."⁴⁶¹

456. See HENSLER ET AL., *supra* note 15, at 85.

457. See, e. g., *In re Gen. Motors Corp. Pickup Truck Fuel Tank Prods. Liab. Litig.*, 134 F.3d 133 (3d Cir. 1998); *In re Auction Houses Antitrust Litig.*, 197 F.R.D. 71 (S.D.N.Y. 2000); *Shaw v. Toshiba Am. Info. Sys., Inc.*, 91 F. Supp. 2d 942 (E.D. Tex. 2000) (involving a judge who employed five law professors, all recognized experts in class action settlements, to evaluate the proposed coupons); *Livingston v. Toyota Motor Sales USA, Inc.*, No. C-94-1377, No. C-94-1359, No. C-94-1960, 1995 U.S. Dist. LEXIS 21757, at *32 (N.D. Cal. May 30, 1995).

458. One indication might be the presence of a cash option. See *infra* notes 512–518 and accompanying text.

459. Also, coupons can generate a certain level of sales that will keep the defendant afloat long enough to provide some level of compensation to those class members who use their coupons.

460. See Wolfman & Morrison, *supra* note 80, at 501 ("[S]ettlements that propose to provide nonmonetary relief should be a warning signal to the court that certain segments of the class may be left out in the cold."). Brian Wolfman and Alan Morrison then propose a test for evaluating nonmonetary settlements. See *id.* at 501–02.

461. MANUAL FOR COMPLEX LITIGATION § 30.42 (3d ed. 1995).

Courts could reject those coupon settlements in which the coupons have so many restrictions that they confer little value to the class.⁴⁶² Part II laid out several typical restrictions that diminish coupon value. Courts could look for these restrictions and consider them either as indicia of collusion or as evidence that substantively the settlement is not fair and adequate for the class. Taking either path, a judge could conclude that a coupon settlement in which the coupons are laden with restrictions is not fair, adequate, and reasonable.

Judges can examine coupon restrictions for either substantive fairness or for indications of collusive conduct in the negotiation process, which judges cannot directly observe. If the coupons have overly restrictive transferability, expire in a short period of time, cannot be aggregated with publicly available discounts, or can only be redeemed for inferior products, then judges should reject the proposed settlement as inadequate. Courts can also develop common law presumptions to handle coupon settlements. For example, a settlement based on nontransferable coupons could create a presumption of inadequacy. Nontransferable coupons are inherently suspicious. Class members are always better off with transferable coupons, if for no other reason than the common sense notion that people benefit from having more options. Those class members who want to make another purchase can use the coupon towards their next purchase. Those class members who do not desire to make another purchase can sell their coupon to another person at the market price for such coupons.

While examining each of the individual terms governing the proposed coupons, judges should keep sight of the big picture by considering the cumulative effect of these restrictions on the likely redemption rates and the expected value of the coupons to the actual members of the class. As part of this inquiry, courts should compare the number of settlement coupons issued to the projected number of sales over the redemption period. If the latter is smaller, either all of the coupons cannot be used or the defendant is benefiting from increased sales induced by the settlement coupons. In either case, such a finding may undermine faith in the proposed settlement's fairness.

Enhanced judicial scrutiny of coupon terms has several potential advantages. First, strict scrutiny of coupon terms is a more precise tool than a uniform rejection of coupon settlements. Instead of banning all coupon settlements, regardless of their likely benefits to the class, by exercising

462. Some courts appear to be headed in this direction. See Geyelin, *supra* note 284 ("The courts are going to scrutinize very hard these settlements that give nonmonetary relief, whether it's coupons or so-called safety information," said Brian Wolfman, a lawyer with Public Citizen, a consumer-advocacy group.).

greater scrutiny judges can target those specific aspects of a proposed coupon settlement that cause concern.

Second, greater scrutiny does not represent a dramatically new policy. Judges are already obligated to examine terms of proposed settlements. The judge's fiduciary duty to the class should include a duty to examine and independently evaluate the restrictions in settlement coupons. The court's burden to scrutinize coupon terms should be particularly high when parties use coupon settlements to settle antitrust class action litigation. The Tunney Act⁴⁶³ requires that a judge reviewing a consent decree that settles a government-initiated civil antitrust suit to confirm that the settlement is "in the public interest."⁴⁶⁴ At a minimum, this should entail strict scrutiny of coupon terms. Furthermore, under-utilized resources are available for judges to receive unbiased analysis of proposed coupon settlements. For example, courts can use special masters to evaluate proposed settlements.⁴⁶⁵

Finally, and most importantly, a more activist position by reviewing judges could result in fairer coupon settlements—settlements that confer more benefits on the class. While a reviewing judge cannot unilaterally change the coupon terms in a proposed settlement, judges often frame the settlement.⁴⁶⁶ In some cases, courts have approved proposed settlements on the condition that the parties make specific changes.⁴⁶⁷ In the context of proposed coupon settlements, a judge could announce that she will reject a coupon settlement so long as the coupons have certain restrictions. For example, a judge can announce that she will not approve a coupon settlement unless the coupons are fully transferable. Similarly, the judge can reject a proposed coupon settlement and inform counsel that she will approve the settlement if the coupons have a later expiration date or can be redeemed for a wider range of the defendant's products.⁴⁶⁸ A judge can reject a proposed settlement while instructing the parties to come back with another proposal that

463. 15 U.S.C. §§ 5c–f (2000).

464. 15 U.S.C. § 16(e) (2000).

465. See FED. R. CIV. P. 53; *Livingston v. Toyota Motor Sales USA, Inc.*, No. C-94-1377, No. C-94-1359, No. C-94-1960, 1995 U.S. Dist. LEXIS 21757, at *26–*27 (N.D. Cal. May 30, 1995) (using a special master to evaluate a proposed coupon settlement); *WILLGING ET AL.*, *supra* note 291, at 64 (stating that magistrate judges were sometimes used to evaluate proposed settlements); see also *Ohio Pub. Interest Campaign v. Fisher Foods, Inc.*, 546 F. Supp. 1 (N.D. Ohio 1982) (requiring a judge-appointed accountant/attorney to serve as an economic advisor to evaluate a coupon settlement).

466. See Resnik, *supra* note 363, at 855.

467. *WILLGING ET AL.*, *supra* note 291, at 58.

468. See Wolfman & Morrison, *supra* note 80, at 490 & n.110; see also *Adams v. Robertson*, 676 So. 2d 1265, 1268 (Ala. 1995) (approving proposed settlement conditionally "so long as the parties agreed to certain court-imposed modifications").

addresses a range of concerns.⁴⁶⁹ Parties in antitrust class actions often agree to include terms suggested by a judge after that judge has rejected the settlement originally proposed by the parties.⁴⁷⁰ A judge's threat of rejection is all the more serious because the rejection of a proposed settlement is not appealable.⁴⁷¹ Over time, if courts reject coupon settlements, then future coupon settlements will be structured properly or class counsel will negotiate cash-based settlements.⁴⁷²

Despite the potential for enhanced scrutiny to reduce some of the problems associated with coupon settlements, this proposed solution has several drawbacks as well. First, although this solution boasts greater precision than a uniform rule, flexible rules come at the expense of ease of application. A solution that asks judges to review coupon terms in greater detail is harder to apply than a bright-line rule. Even after carefully reviewing and considering a proposed coupon settlement, it is exceedingly difficult for courts to determine whether or not any given coupon-based settlement is in fact fair, reasonable, and adequate.⁴⁷³ Fairness criteria applicable across settlements are generally difficult to establish.⁴⁷⁴ Coupon settlements exacerbate this difficulty. For example, a "fair" expiration date depends on the nature of the product or service, its durability, purchase patterns, the number of settlement coupons compared to the annual sales figures, and so on.

Second, if judges eventually become adept at correctly analyzing current restrictions and predicting redemption rates, proponents of inadequate

469. See, e.g., *New York v. Dairyalea Coop., Inc.*, 547 F. Supp. 306, 308 (S.D.N.Y. 1982), appeal dismissed, 698 F.2d 567 (2d Cir. 1983); see also *Dairyalea*, 698 F.2d at 570 ("The parties remain free to return to the bargaining table to devise a settlement which would respond to [the trial judge's] objections."); *Petruzzi's, Inc. v. Darling-Del. Co.*, 880 F. Supp. 292, 303 (M.D. Penn. 1995).

470. See, e.g., *Calkins*, *supra* note 253, at 421 (discussing *In re Brand Name Prescription Drugs Antitrust Litig.*, 7 Trade Reg. Rep. (CCH) ¶ 71,449 (N.D. Ill. June 21, 1996)). Even when the proponents of a rejected coupon settlement move the litigation to another jurisdiction, the initial rejection can affect the ultimate settlement. After the parties in the *General Motors* litigation failed in the Third Circuit, they attempted a coupon settlement in Louisiana state court. However, the parties modified the proposed coupons by extending the expiration date and increasing transferability. See *HENSLER ET AL.*, *supra* note 15, at 91.

471. See, e.g., *Dairyalea*, 698 F.2d at 568.

472. See *Petruzzi's, Inc. v. Darling-Delaware Co.*, 983 F. Supp. 595, 601 (M.D. Penn. 1996). After the judge rejected proposed coupon settlement, the parties negotiated a significantly better cash-based settlement. This is particularly ironic given that, when advocating the coupon settlement, the class counsel had represented to the court that the coupon settlement was the "absolute maximum that [the defendant] would pay to settle this case." *Petruzzi's*, 880 F. Supp. at 298-99; see also *Livingston v. Toyota Motor Sales USA, Inc.*, No. C-94-1377, No. C-94-1359, No. C-94-1960, 1995 U.S. Dist. LEXIS 21757, at *26-*27 (N.D. Cal. May 30, 1995) (noting improvements over time in proposed coupon-based settlements).

473. *In-Kind Class Action Settlements*, *supra* note 15, at 810-11.

474. See *Kornhauser*, *supra* note 282, at 1565.

coupon settlements could create harder-to-decipher restrictions that reduce the value of the settlement coupons. It will always be easier for judges to determine the benefit to the class of a cash-based settlement and to compare that benefit to the requested attorneys' fees. Furthermore, no matter what amount of data, projections, and expert reports are provided, judges may never have enough information. Judges can always demand more information from the parties.⁴⁷⁵ However, this is unlikely to be sufficient to make a fully informed opinion that accurately predicts the true value of the settlement to the class members.

Finally, courts currently do an inadequate job of monitoring class action settlements.⁴⁷⁶ When judges evaluate class action settlements, "fine-tuning is not the norm."⁴⁷⁷ Judges are notoriously bad at evaluating the terms of proposed settlements.⁴⁷⁸ If judges already did an adequate job of evaluating coupon settlements with the tools currently available to them, we would not be experiencing the problems outlined in Part II.

3. Require Minimum Redemption Rates

If settlement coupons were truly marketable, redemption rates would be significantly higher than those witnessed with many current coupon-based settlements. In addition to any class members who redeem their settlement coupons, many non-class members who intended to purchase the defendant's product would purchase settlement coupons from class members and redeem the settlement coupons in order to lower the overall purchase price.⁴⁷⁹ In theory, a high redemption rate may indicate that the settlement coupons were both reasonably transferable and sufficiently valuable such that non-class members would purchase them in voluntary transactions in which both buyer and seller received value. The seller (the class member) receives value by receiving cash for her settlement coupon. The buyer (the non-class member) receives value by paying less for the settlement coupon than he gains by redeeming it. This part discusses how courts could attempt to require minimum redemption rates and the problems associated with this form of solution.

475. See Resnik, *supra* note 363, at 858.

476. See HENSLER ET AL., *supra* note 15, at 98 (quoting a plaintiffs' attorney as saying, "[i]f judges would do their job, we could solve the problems that exist with class action practices, we do not need rule changes to do this"); Downs, *supra* note 273, at 650; Susan P. Koniak & George M. Cohen, *Under Cloak of Settlement*, 82 VA. L. REV. 1051, 1122-30 (1996).

477. Silver & Baker, *supra* note 277, at 1482 (discussing damage averaging).

478. See Resnik, *supra* note 363, at 856.

479. See *supra* notes 98-101.

Judges cannot unilaterally require minimum redemption rates. A judge reviewing a proposed settlement to class action litigation can only accept or reject the proposal.⁴⁸⁰ However, judges can try to influence redemption rates for settlement coupons in a number of ways. For example, redemption rates would undoubtedly increase if judges closely scrutinized coupon terms to insure transferability and value and rejected proposals with suspicious coupon terms, but we have already dismissed such an approach as inadequate and infeasible.⁴⁸¹ Alternatively, courts can refuse to approve coupon-based settlements that fail to include an adequate incentive for defendants or for the class counsel to insure that a minimum number or percentage of settlement coupons are in fact redeemed.

Judges can try to create "redemption incentives" for either defendants or class counsel. First, courts could try to incentivize defendants to increase redemption rates. Defendants currently have no incentive to insure that settlement coupons are actually redeemed. In fact, defendants have a strong self-interest in seeing coupons expire, lest the coupons be used in a Non-Induced Purchase. However, judges may be able to incentivize class-action defendants to make settlement coupons more valuable. Courts can refuse to approve a coupon-based settlement unless the defendant agrees to continue to issue settlement coupons until a specific number of coupons have been redeemed. In at least one case, state attorneys general dealt with the problem of low redemption rates for coupons by including a clause providing that unless a set number of purchasers (in this case \$1 million) redeemed their coupons, the defendant would pay a guaranteed minimum of up to \$5 million to state attorneys general.⁴⁸²

Alternatively, courts can try to create a proper incentive for defendants to make sure that coupons are redeemed by employing a modified *cy pres* approach, in which defendants must pay money (or give coupons) to charity unless a specific number or percentage of settlement coupons are redeemed.⁴⁸³ However, in addition to the several problems associated with redemption rate-based solutions in general,⁴⁸⁴ this proposal suffers from two unique defects.

480. In one coupon settlement involving a state attorney general, the official negotiated a provision of the coupon settlement that allowed the court to revisit the case in the event of low redemption. See *In re Montgomery County Real Estate Antitrust Litig.*, 83 F.R.D. 305 (D. Md. 1979) (stating "if fewer than 30% are redeemed, he may bring this fact to the attention of the court, with the alternative of seeking a modification").

481. See *supra* notes 473-478 and accompanying text.

482. See *New York v. Nintendo of America, Inc.*, 775 F. Supp. 676, 679-82 (S.D.N.Y. 1991).

483. See, e.g., *Ohio Pub. Interest Campaign v. Fisher Foods, Inc.*, 546 F. Supp. 1, 5 (N.D. Ohio 1982).

484. See *infra* note 494 and accompanying text.

First, the *cy pres* approach fails to compensate the class because class members receive no pecuniary benefit if the defendant gives something to charity. Courts should not use settlement funds for charitable purposes when that money can, somehow, be distributed to class members.⁴⁸⁵ Second, a *cy pres* type of solution does not necessarily disgorge the defendant's ill-gotten gains. This is especially true for those instances in which the *cy pres* package is a bundle of coupons.⁴⁸⁶

Any solution that relies on manipulating the defendants' incentive to increase redemption rates will run into the problem of countervailing incentive. Defendants still have a baseline incentive to insure that settlement coupons do not confer value to the class at the defendants' expense. High redemption rates are not necessarily synonymous with valuable coupons.⁴⁸⁷

Whereas defendants have an inherent interest in making settlement coupons worthless, the class counsel does not directly lose when a coupon is used to make a Non-Induced Purchase. After attorneys' fees are calculated and awarded, the class counsel is indifferent as to the distribution of the four possible outcomes. This means that class counsel do not currently have sufficient incentives to insure that coupons are in fact valuable. The negligible value of many settlement coupons is reflected in low redemption rates. However, when redemption rates are particularly low for a given set of settlement coupons, the class counsel suffers no economic detriment.

Second, judges could try to create an incentive for class counsel to structure coupon-based settlements that have higher redemption rates. For example, a reviewing judge could refuse to approve a coupon-based settlement that did not directly tie the counsel's attorneys' fees to the actual redemption rate for the settlement coupons. Logistically, the judge can retain jurisdiction over the case after the settlement is approved and implemented.⁴⁸⁸ Judges could announce that class counsel will not be paid until the court can calculate the benefit *actually* conferred on the class.⁴⁸⁹

485. See NACA, *supra* note 230.

486. Cf. Brian Wolfman, *Forward to THE NAT'L ASS'N OF CONSUMER ADVOCATES' STANDARDS AND GUIDELINES FOR LITIGATING AND SETTLING CLASS ACTIONS*, 176 F.R.D. 370, 373 (1998) (suggesting that courts should not support "cy pres distributions that have had little, if any, relationship to the subject matter of the class action").

487. See *infra* note 494 and accompanying text.

488. See, e.g., *Livingston v. Toyota Motor Sales USA, Inc.*, No. C-94-1377, No. C-94-1359, No. C-94-1960, 1995 U.S. Dist. LEXIS 21757, at *78 (N.D. Cal. May 30, 1995); *Connecticut ex rel. Lieberman v. Stop & Shop Cos.*, 1989-2 Trade Cas. (CCH) ¶ 68,796 (D. Conn. July 19, 1988) (retaining jurisdiction for five years after approval of a coupon-based settlement).

489. Janet Cooper Alexander argues for tying

the amount of the fee more directly to the benefit conferred on the class by holding the hearing on the fee award only after the close of the period for filing claims. If the recovery is stated on a per-share basis, then once all the claims are filed you know exactly

Because the true value of a coupon-based settlement cannot be determined until after the coupon redemption period expires,⁴⁹⁰ the class counsel would not be paid until all the coupons have expired and the redemption rate calculated.⁴⁹¹ The attorneys would then receive a percentage fee award based on the number of settlement coupons actually redeemed.⁴⁹² This would give class counsel a powerful incentive to insure that settlement coupons are structured so as to increase the likelihood of redemptions. For example, class counsel may negotiate longer expiration periods because this should increase overall redemption rates.⁴⁹³

Whether a reviewing judge uses her power to reject a proposed settlement in order to create an incentive for the defendant or for the class counsel to insure minimum redemption rates, such redemption rate-based solutions will

what the benefit is that has been conferred on the class, and the fee can be determined in that light.

Alexander, *supra* note 282, at 361–62. However, in the case of coupon settlements, the class member must do more than merely file a claim in order to receive compensation; she must also redeem the coupon. To the extent that Professor Alexander means delaying the fee hearing until all coupons have been used or expired, her claim is stronger that postponement “would take much of the uncertainty out of” tying attorneys’ fees to class benefits. *Id.* at 363. But even after final redemption rates are calculated, it is difficult to determine the actual value conferred on the class.

490. See *Dunk v. Ford Motor Co.*, 56 Cal. Rptr. 2d 483, 493 (Ct. App. 1996).

491. Alternately, courts can use a pay-as-you-go system in which counsel are paid in installments based on actual coupon redemption every, say, six months. In *Duhaime v. John Hancock Mutual Life Insurance Co.*, 989 F. Supp. 375 (D. Mass. 1997), *aff’d*, 183 F.3d 1 (1st Cir. 1999), the court staged the attorneys’ fees. The court reasoned that:

[s]taging the fee award . . . will serve a number of purposes. First, it will help ensure that the fee award is proportionate to the actual value created for the class. Second, it will reinforce class counsel’s continuing incentive to monitor the ADR process vigorously, an obligation counsel have assumed under the agreement. Finally, staging the fee award to permit a second look will emphasize the principle that in class actions the interests of counsel who negotiate settlements should align with the interests of the class.

Id. at 380; see also HENSLER ET AL., *supra* note 15, at 462.

While such a proposal is more precise, it increases the complexity and the judge’s obligation to manage the case.

492. See HENSLER ET AL., *supra* note 15, at 489, 491. Courts should not increase attorneys’ fees to compensate for the delay in payment; the attorneys negotiate the delay. If they want to be paid in a more timely manner, class attorneys should negotiate immediate payment for the class. Delaying payments means that the class counsel is no better off than the last class member to redeem a settlement coupon; such is how it should be.

493. However, there could be countervailing pressures regarding the expiration date. If the expiration date is short, then fewer class members will have redeemed their coupons and the counsel will receive less money. In contrast, if the expiration date is long, then the counsel will have to wait to receive its money. Ultimately, class counsel may determine that less money in three years is better than more money in ten years, especially given the time value of money. This would be to the detriment of the class because a long expiration date is an unmitigated good thing for class members. The same-currency solution, proposed *infra* Part V.B.4, creates a clear incentive for value-increasing long expiration dates, which the class members prefer (as would the class counsel if it were paid in settlement coupons).

run into the same problem: Redemption rates can be manipulated. Such solutions are premised on the logical fallacy that if low redemption rates signal a worthless settlement, then high redemption rates are proof that the settlement coupons conferred value. However, while low redemption rates reflect worthless coupons, the reverse is not necessarily true.

A solution measured solely in redemption rates is subject to manipulation. Even if all class members actually redeem their coupons, they may not receive actual value from the settlement. Defendants who issue coupons to settle class action litigation can simultaneously increase the price of their products. In response to the price increase, many people would redeem settlement coupons. The redemption rate would be high. However, consumers would not be receiving any true value. For example, if a business went to issue coupons with the face value of \$20 and simultaneously increase the price of the product by \$20, most class members would be no better off and those consumers who did not have coupons would be worse off. Furthermore, independent of any price manipulations by the defendants, not all redemptions indicate that value has been conferred. Some class members may redeem their settlement coupons out of spite or to avoid regret.⁴⁹⁴

Even if the class members sell their coupons to non-class members who ultimately use the coupons—thereby creating high redemption rates—the settlement could still be of marginal value to the class as a whole. If the coupons have a low face value, then redemption rates could be high but little value would be conferred on the class. Alternatively, if coupons have a high face value but are burdened by onerous restrictions, then class members may be forced to sell their coupons at drastic discounts off of face value. If class members sell their coupons at bargain-basement prices, then even if the coupons are ultimately redeemed in significant quantities the class will have gained little of substance.

In short, redemption rates are not the best proxy for class compensation. Judges must insure that settlement coupons confer actual value and do not merely satisfy a false indicia of value. Because of price manipulation or coupon restrictions, redemption rates alone may be deceptive. Any solution to the problems created by coupon-based settlements cannot rely solely on redemption rates.

494. See *supra* notes 84–87 and accompanying text.

4. Requiring that Class Counsel Be Paid in the Same Currency as the Class

The flaws in the first three options reveal several important insights. First, settlement coupons will continue to exist in some form. Second, trial judges alone cannot insure that settlement coupons confer value on the class. Thus, given the empirical problems with many coupon settlements, courts must find an effective mechanism to monitor coupon terms.

To cure the inherent problems with coupon settlements requires an actor with better information—and with actual power in the settlement proposal and approval process⁴⁹⁵—who can monitor coupon terms to insure that settlement coupons confer actual monetary value on class members. One candidate stands out: class counsel. The current system, while envisioning such a solution, falls short of the mark due to agency costs. The class counsel often has leverage but fails to use it appropriately. However, if the interests of the class and its counsel were more aligned, then rational self-interest would compel class attorneys to protect the class's interests. While coupon settlements decouple the interests of the class and its counsel, judges can realign these interests and minimize agency costs by refusing to approve any proposed settlement under which class counsel is compensated in a different currency than the class.⁴⁹⁶ Thus, if the class is compensated with coupons, attorneys' fees should be paid in coupons as well. When class counsel settle a class action that results in a lump-sum cash payment to the class, the counsel generally receives a set percentage—often approximately 25 percent—of the cash. Similarly, when the class attorneys negotiate a coupon settlement, the attorneys should be compensated by receiving a set percentage of those settlement coupons. Finally, when a settlement is composed of a mixture of cash and coupons, class counsel should receive the same percentage of each component (for example, 25 percent of the cash and 25 percent of the coupons). Thus, the only way for the class attorneys to receive cash is to insure that the class receives cash as well. No cash for the class means no cash for the counsel. If the class counsel wants to increase its attorneys' fees, it must increase the overall settlement, most of which will go to the class members. This is precisely what contingency fees are supposed to accomplish

495. This formulation excludes public interest organizations like Public Citizen, which perform a valuable service but possess no authority and generally depend on convincing the judge of their position in order to effect the settlement outcome.

496. Professor Alexander argues that there are two approaches to agency costs: have clients monitor attorney performance, or "take steps to align the lawyers' interests more perfectly with the class's interest." Alexander, *supra* note 282, at 359. Requiring common currency is an example of this realignment solution, which is more effective than monitoring. See *supra* notes 284–294 and accompanying text (discussing inherent and empirical problems of class monitoring).

but fail to when the class receives coupons while the counsel receives cash. If the class counsel receives its set percentage in the precise form of the lump-sum payment to the class, the attorneys now have a powerful incentive to make sure that the payment to the class is, in fact, valuable, whether the settlement is based on cash, coupons, or a mixture of both. Requiring that counsel be paid in the same currency as the class does not spell the demise of coupon settlements but should be the death knell for worthless coupons.

The core problem with coupon settlements is that none of the three power centers in the negotiation and approval process—the defendant, the class counsel, and the reviewing judge—has a vested interest in insuring that settlement coupons are marketable. Ideally, judges would closely examine the coupons' terms, but judges cannot do that efficiently.⁴⁹⁷ Due to agency costs, the class counsel's payoff is generally unaffected by whether the settlement coupons are marketable.⁴⁹⁸ Defendants do not want settlement coupons to be marketable, as freely transferable coupons are more likely to be used for Non-Induced Purchases, defendants' least favored outcome.⁴⁹⁹ The result is often unmarketable coupons that confer little benefit on the class as a whole.

Because it is too difficult for judges to accurately predict coupon value and defendants have an inherent incentive to make coupons less marketable, judges should create an incentive for class counsel to make settlement coupons marketable. Courts should "manipulate the incentives that the law holds out so as to motivate attorneys to perform as we believe informed clients would want them."⁵⁰⁰ The most powerful lever that the judge has to prevent class counsel from negotiating an inadequate coupon settlement is her control over attorneys' fees.⁵⁰¹ Judges should use their ability to set attorneys' fees in order to solve the agency cost problem. To eliminate the agency cost problem, the class counsel's compensation must be meaningfully tied to the class's recovery. When the agent and principal are receiving remuneration in different currencies, the link between agent and principal is severed. Judges should re-establish the bond between class and counsel by requiring that class counsel be paid in the same currency as the class members. If both the class members and class counsel are paid in a common currency, then the class counsel has a powerful incentive to make sure that

497. See *supra* Part IV.B.

498. See *supra* Part III.A.

499. See *supra* notes 98–101 and accompanying text.

500. John C. Coffee, Jr., *The Regulation of Entrepreneurial Litigation: Balancing Fairness and Efficiency in the Large Class Action*, 54 U. CHI. L. REV. 877, 878 (1987).

501. See HENSLER ET AL., *supra* note 15, at 445; Kane, *supra* note 282, at 391.

the currency has value. Thus, when the class is paid in the currency of coupons, class counsel should be paid in coupons. To date, this option has been suggested in jest⁵⁰² or in a pique of facetious rage.⁵⁰³ But when class counsel represent to a reviewing judge that settlement coupons are as good as cash, why not pay the class counsel with these same coupons?

A requirement that class counsel receive a percentage of the final settlement in the same form as the class members—whether that settlement is in cash or coupons—carries many advantages. First, requiring a common currency diminishes agency costs by re-aligning the interests of the class and its counsel. While seemingly dramatic on its face, requiring that class counsel be paid in coupons in the event of a coupon settlement makes a coupon settlement more like a traditional common fund case. While the proposal may seem controversial, paying class counsel a set percentage of the negotiated settlement package restores the traditional approach to attorneys' fees awards in class action litigation. The whole theory of attorneys' fees in such cases is built on the premise that the class attorney "who recovers a common fund . . . is entitled to reasonable attorney's fee *from the fund as a whole.*"⁵⁰⁴ A coupon-based recovery is essentially a "constructive common fund."⁵⁰⁵ Scholars have long recognized that courts force class counsel to be efficient managers and loyal advocates for the class by awarding attorneys' fees from the precise fund that the attorneys negotiated for the class.⁵⁰⁶ Relying on this same principle, courts can ensure that attorneys negotiate reasonable settlements by requiring that attorneys get paid in the same currency as the class members. To make it similar to those class actions in which attorneys' fees are extracted from any fund that is

502. See Robert R. Merhige, Jr., *The Federal Courts: Observations from Thirty Years on the Bench*, 32 U. RICH. L. REV. 867, 882 (1998):

I said [to class counsel], "I want you to know before you get too involved in this, that this is the type of case that's going to end up with coupons for successful plaintiffs, and if [you] are successful, you better prepare to accept coupons for your fee." Okay, I laughed too.

Id.

503. See *Clement v. Am. Honda Fin. Corp.*, 176 F.R.D. 15, 25 n.16 (D. Conn. 1997). The *Clement* court quotes an objector to a proposed coupon settlement as stating, "I am flabbergasted at the proposed settlement. Coupons which require buying or leasing another car from [the defendant] at a future date . . . are practically worthless. Maybe the attorneys involved should be paid in 'coupons' then there would probably be a more reasonable settlement." *Id.*

504. *Boeing Co. v. Van Gemert*, 444 U.S. 472, 478 (1980) (emphasis added).

505. *In re Gen. Motors Corp. Pick-Up Truck Fuel Tank Prods. Liab. Litig.*, 55 F.3d 768, 821 (3d Cir. 1995).

506. See Kane, *supra* note 282, at 391 ("One of the most effective means courts have to force lawyers to become better managers is their control over fees. In successful class actions, courts typically award attorneys' fees from any fund that is obtained, unlike most other forms of litigation in which each side bears its own expenses." (citations omitted)).

obtained, a coupon-based settlement can be negotiated from which the attorneys' percentage of the coupons is determined after agreement on the amount and face value of the coupons. This will insure that the class counsel negotiate the largest amount of useable coupons possible. In short, if class counsel are paid in a common currency, then the class counsel's interests are more in line with those of the class and less aligned with the defendant's interests.

Second, if class counsel receive a certain percentage of the precise bundle that the class members receive, then the attorneys representing the class would have to make sure that the class members actually benefit from the settlement. This could lead to fewer coupon settlements and more cash-based settlements.⁵⁰⁷ However, if such a class counsel negotiates a coupon settlement, the coupons would undoubtedly have greater utility from the class members' perspective. Class counsel would be compelled to negotiate settlement coupons that can be sold in a robust secondary market. At a minimum, class counsel would negotiate away the value-limiting redemption restrictions commonly found in settlement coupons.⁵⁰⁸ For example, class counsel would make sure that the coupons are transferable because otherwise the class counsel may receive worthless scrip.⁵⁰⁹ Class counsel will want to make sure that the coupons are not rendered worthless by product restrictions, expiration dates, and other limitations. Because such restrictions will decrease the value of coupons, they would also decrease the ability of counsel to sell coupons for a meaningful amount in a free market. No matter how long class counsel intend to hold their coupons, restrictions diminish resale value.⁵¹⁰ In short, as the largest single holder of the settlement coupons, the class counsel will have the greatest

507. See *infra* note 534 and accompanying text. If plaintiffs' attorneys put up resistance, they can achieve a cash-based settlement. See, e.g., *In re Mid-Atl. Toyota Antitrust Litig.*, 585 F. Supp. 1553, 1557 (D. Md. 1984) (discussing the example of counsel in Pennsylvania negotiating a cash-based settlement even while counsel in other states were settling for coupons (with lower cash-out options) in the same underlying cause of action).

508. See *supra* Part II.B.

509. Of course, the scrip would only be worthless to the extent that it was not used, but to the extent that class counsel could not possibly purchase enough products to use all the scrip, they would be saddled with worthless paper.

510. For example, a longer expiration period has value for the class. See *Shaw v. Toshiba Am. Info. Sys., Inc.*, 91 F. Supp. 2d 942, 974 (E.D. Tex. 2000) (awarding \$6 million to counsel for objectors as the fee for efforts at extending coupon redemption period from 180 days to one year). Even if the class counsel intends to sell its settlement coupons immediately, the attorneys would still care about the expiration date because this affects the long-term value of the coupons and, thus, the short-term market price. Thus, the attorneys would have to make sure that the coupons do not expire before a market could be created for the coupons and that the expiration date was far enough into the future that coupons would not have to be sold under time pressure. In sum, forcing payment of counsel in a unified form of currency will ensure that class counsel will negotiate coupons of maximum value.

incentive to insure that the coupons have meaningful resale value in a robust and dynamic secondary market.⁵¹¹

Similarly, if class counsel is paid in a common currency, the attorneys are more likely to negotiate a meaningful cash-out option. A cash-out option allows the class member to redeem her settlement coupon for its full value on a purchase of the defendant's product or to redeem the coupon for a stated cash value. The cash value is generally less than the coupon face value, but allows the class member to receive cash without having to purchase the defendant's product (or sell her settlement coupon for money). This achieves the primary advantage of marketable coupons by insuring that the settlement coupons have a cash equivalent for class members, whether that sum is paid by the defendants or through private purchases in a market for settlement coupons. Indeed, some courts have found the cash option to be critical in approving a coupon-based settlement.⁵¹² Unfortunately, corporate defendants have structured cash-out options with two limitations to reduce the value of the option to class members. First, the cash-out figure is a fraction of a coupon's face value, generally less than half.⁵¹³ Second, in many cases, class members cannot redeem their coupons for cash until a significant amount of time has passed. In a settlement involving Mercedes-Benz, the certificates could not be redeemed for cash until the class member had held the certificate for three years.⁵¹⁴ Only then could a class member redeem her coupon for half of its face value.⁵¹⁵ Many settlements impose both low cash options and long waiting times.⁵¹⁶ Other class action defendants have created sliding scale

511. Some may fear that the class counsel could flood the market with its coupons. If class counsel did decide to sell its coupons, it would drive the price down in the market for such coupons. But, as the largest holder of settlement coupons, class counsel would also insure that not too many coupons were issued, as a glut of coupons would depress the value of the attorneys' coupons.

512. See *Langford v. Bombay Palace Rests., Inc.*, No. 88 Civ. 5279 (CSH), 1991 U.S. Dist. LEXIS 4730, at *3 (S.D.N.Y. Apr. 8, 1991). In *Buchet v. ITT Consumer Financial Corp.*, 845 F. Supp. 684 (D. Minn. 1994), the court reasoned that the proposed coupon-based settlement's failure to guarantee a minimum cash payment was fatal to the proposed settlement. Without a guaranteed minimum cash payment, the court has no "benchmark for evaluating the proposed settlement." *Id.* at 696. An unwillingness to create a minimum guaranteed cash payment reflects the defendant's belief that the redemption rate for the coupons will be low.

513. This should definitively indicate that the face value of the coupon is not the actual worth of the coupon.

514. See *Weiss v. Mercedes-Benz of N. Am., Inc.*, 899 F. Supp. 1297, 1300 (D.N.J. 1995).

515. See *id.* When offering a cash-out option, some settlements provide a narrow window that minimizes the likelihood that class members can exercise the option. For example, one coupon settlement allowed each class member to exchange his coupon for cash at 30 percent of the coupon's face value so long as the class member held the coupon for at least six months, but no longer than twelve months. See *Langford*, 1991 U.S. Dist. LEXIS 4730, at *1.

516. For example, to settle a class action arising from computer companies misrepresenting the viewable size of their monitors, the defendants paid in rebate coupons worth \$13 off of the class members' next purchase, with an option to receive \$6 in cash instead if the class member

payments that reward class members for not exercising the cash-out option. For example, in one case the defendant structured the settlement coupons so that the coupon holders could receive a gradually increasing amount of cash (up to 25 percent of the face value of the coupon) if they waited five and one-half years from the date of settlement to redeem their coupon for cash.⁵¹⁷ Given the time value of money, this means that coupon holders received significantly less than 20 percent of their coupons' face value. If the class counsel is paid in the same coupons as the class, then the class counsel has a strong incentive to negotiate a meaningful cash-out option in settlement coupons. This, in turn, significantly increases the probability of entrepreneurs creating a viable secondary market in coupons.⁵¹⁸

Third, requiring that class counsel and class members be paid in the same currency makes it easier for judges to see how much the attorneys are being paid relative to the class members and to calculate appropriate attorneys' fees. Currently, headlines and court documents give aggregate face value of the coupons and use that as a starting point for calculating attorneys' fees, but in the end most of the coupons are not actually used. So while it may appear that the class counsel is being paid, say, one-fourth of what the class members are receiving, they may actually be receiving more than the class members, taking coupon redemption rates into account. Requiring that counsel and class members be paid in the same currency eliminates the problem of comparing apples and oranges.

Fourth, requiring a common currency not only creates parity in the method of payment, but equalizes the timing of the payment. Timing of payment is a critical, yet often overlooked, issue in coupon settlements. Coupons make a consumer wait to receive compensation until the class member redeems (or sells) her settlement coupon.⁵¹⁹ Even when settlements provide a cash-out option for settlement coupons, the cash-out provisions generally make class members wait up to five years to receive cash compensation. In contrast, the class counsel typically receives its payment soon after the settlement is approved. Allowing the class and its counsel to be paid at different times—given the time value of money—again decouples the interests of the attorney and client. The class counsel has no

waited until five years after the proposed coupon-based settlement had been negotiated. HENSLER ET AL., *supra* note 15, at 97. By making class members wait to redeem their coupons for cash, such coupon terms convert the class member into the defendant's creditor. Each class member is essentially making an interest-free loan to the defendant.

517. See Gramlich, *supra* note 6, at 274 n.31.

518. See *In re Auction Houses Antitrust Litig.*, 197 F.R.D. 71 (S.D.N.Y. 2000).

519. Some courts have argued that coupon settlements speed up recovery to the class by alleviating the need for a long trial. See *Ohio Pub. Interest Campaign v. Fisher Foods, Inc.*, 546 F. Supp. 1, 12 (N.D. Ohio 1982).

self-interest in negotiating a timely cash-out option because the attorneys will receive their money soon regardless. Requiring payment with the same settlement scrip provides an incentive for attorneys to negotiate a cash-out option for the settlement coupons and to insure that the option can be exercised in a more timely manner. In sum, a common-currency requirement increases the likelihood that class members will receive their monetary compensation in a timely manner.

Furthermore, when class counsel have an incentive to insure that the settlement coupons will be marketable, this provides a better indication for the reviewing judge of the settlement's probable effect on the defendant's bottom line. If the settlement coupons were marketable, all coupons would be used because even a class member or attorney who did not want to use the coupon could sell the coupon to someone who was going to make a purchase anyway. Knowing that all of the coupons would be used would provide a better indicator of the defendant's likely revenue reduction as a result of the settlement.

Finally, a common currency requirement represents a straightforward, efficient rule for judges to apply.⁵²⁰ Judges can trust class counsel to negotiate valuable coupons if the class counsel receive payment in kind. Some judges may feel compelled to approve proposed coupon settlements because of limited judicial resources, the difficulty of predicting actual coupon value, and the scarcity of objective data given that both parties are advocating the settlement coupons. While judges may be rationally reticent to delve into each and every coupon restriction, they need some way to determine whether any given proposed coupon settlement will in fact confer real benefits on the class. Judges already defer to the representations of class counsel during the fairness hearings for proposed settlements. If class counsel are paid in the same settlement coupons as the class, then a reviewing judge has a more sound basis for believing attorney representations about the value of the coupons. The common-currency requirement approach has the advantages of a bright-line rule without the inflexibility of a total ban.

Judges could implement such a proposal in different ways. For example, a judge could simply call the bluff of class counsel who represent at the fairness hearing for the proposed settlement that the coupons confer significant value. A reviewing judge can simply ask, "If these coupons are as valuable as you say they are, would you accept one-quarter of the coupons as payment for your services?" The hearts of many class counsel would

520. The solution is even easier to implement if the class counsel's percentage of recovery is set at the beginning of the litigation. See generally REPORT OF THE THIRD CIRCUIT JUDICIAL TASK FORCE, *supra* note 297.

miss a beat, not because settlement coupons are inherently worthless but because many plaintiffs' attorneys in class action litigation do not currently negotiate worthwhile coupons. But a judge need not grandstand (or even secure the parties' agreement) to require that counsel be paid in the same currency as the class. While judges cannot impose a term into a settlement agreement, they can calculate attorneys' fees on their own. After a proposed coupon settlement is approved, a judge could announce that given her reliance on counsel's representations about the coupons' value, she has decided to award attorneys' fees in these same coupons. Alternatively, a judge could state at the onset of negotiations that counsel will receive a set percentage of the precise lump-sum package negotiated for the class.

In either case, the overriding objection to requiring common currency is that attorneys will refuse to serve as class counsel.⁵²¹ Class counsel must receive compensation to initiate class action litigation, so the argument goes.⁵²² If attorneys' fees are paid in coupons, many attorneys may be unwilling to be serve as class counsel. But this argument proves too much. If the settlement coupons aren't good enough for the class counsel (who negotiated the coupons' terms), why are coupons sufficient payment for the class members to drop their legal claims against the defendant?

Plaintiffs' attorneys will no doubt resist being paid in settlement coupons. Under the current system they get paid in cash and do not have the complications of creating a secondary market for coupons. Counsel will no doubt argue that they are in business and need to be paid in money to keep operating; that they do not barter and trade goods and services in order to be paid for their legal assistance. Class counsel, the argument goes, should not have to create a market for coupons in order to receive compensation for their legal services. But class members can make similar arguments. They paid cash (or incurred debt with a credit card) and would prefer to be reimbursed in cash rather than have to go through the effort of receiving a coupon, filling out the necessary paperwork, keeping track of the expiration date, finding a willing buyer for the coupon, and negotiating a price for the sale of the coupon. Requiring that attorneys be paid in coupons—if they negotiate a coupon settlement for their clients—is only unfair if the coupons are not valuable. If such is the case, then the class counsel deserves no attorneys' fees.⁵²³ But the best way to insure that the coupons do, in fact, confer value is to require that the attorneys be paid with them.

521. Cf. Miller, *supra* note 232, at 212.

522. Beyond their time, the plaintiff law firms front the costs of litigation and run the risk of no recovery. See HENSLER ET AL., *supra* note 15, at 74.

523. See *id.* at 490.

Some attorneys may resist accepting coupons for payment in lieu of cash because the attorneys know that coupons are not worth their face value. Coupons would necessarily trade at a discount from their face value. Nobody purchasing the coupon in a competitive market would pay the coupon's face value because they would receive no gain from the transaction. No rational consumer in an arm's-length transaction would spend \$50 for a \$50 coupon. Furthermore, the consumer purchasing the settlement coupon would incur transactions costs in finding, acquiring, and redeeming the coupon. Any transactions costs should necessarily decrease the settlement coupon's market price. However, if the class counsel were paid in settlement coupons, then they must take into account this projected discount rate when structuring the coupons, including the coupons' face value and the number of coupons compared to the number of projected sales of the product.

Judicial rejection of proposals to pay counsel with coupons illustrates the underlying paradox: If settlement coupons are so worthless that attorneys will not bring litigation if paid in coupons, then why pay attorneys millions of dollars in cash to negotiate settlements in which their clients receive these same coupons? For example, objectors to the class settlement in *Domestic Air* urged the court to pay class counsel in discount certificates instead of cash.⁵²⁴ The court rejected requests that class counsel be paid in coupons by arguing that the position "totally ignores the value of the settlement and the financial incentive necessary to induce experienced and well qualified counsel to take on complex and time-consuming cases for the benefit of the public and for which they may never be paid or even reimbursed for considerable out-of-pocket expenses."⁵²⁵ However, this argument implicitly acknowledges that the coupons are worthless or, alternatively, that this objection to paying counsel in coupons is only true if the coupons are worthless. If the coupons have value, then they should entice attorneys to take the case. If the coupons do not have sufficient value to entice an attorney to litigate the case, then they raise a significant question as to whether or not they have sufficient value to compensate class members.

If settlement coupons are, in fact, not valuable enough to induce any qualified attorney to take on a particular class action, then this may suggest one of two conclusions: Either the coupons are not worth what the attorneys claim, or the litigation should not have been brought in the first place. Far from being a disadvantage, reducing class actions by requiring that attorneys who negotiate and propose coupon settlements be paid in coupons could achieve the additional advantage of deterring frivolous class

524. See *In re Domestic Air Transp. Antitrust Litig.*, 148 F.R.D. 297, 306 (N.D. Ga. 1993).

525. *Id.*

action litigation.⁵²⁶ Some amount of class action litigation is no doubt frivolous.⁵²⁷ Courts have long observed the potential and actuality of attorneys using the class action vehicle to file frivolous suits in search of settlement and attorneys' fees.⁵²⁸ Many critics argue that class counsel seek out class action suits for their settlement value, regardless of whether the underlying suit has any merit.⁵²⁹ The same incentives that the class action vehicle creates for lawyers to identify and pursue legitimate causes of action also "produce significant opportunities for lawyers to make mischief, to misuse public and private resources for litigation that does not serve a useful social purpose."⁵³⁰ Reducing the possibility of attorneys receiving a cash payout while the class receives scrip would decrease the amount of frivolous class action litigation.⁵³¹ This restores the proper balance to the class action equation. Class counsel are rewarded with attorneys' fees because the attorneys have benefited the public at large. However, as Professor Deborah Hensler and her team have noted, "[i]f coupon settlements simply provide an easy means of settling damage class actions without regard to underlying merit and with few—if any—gains to class members or consumers generally, then such settlement tilts the scales on the side of private gain, rather than public good."⁵³² If a class action suit is so weak that it can only be settled with coupons of dubious value to the class, then attorneys should not be encouraged to bring that litigation.⁵³³ Less class action litigation is not necessarily a bad thing. Fewer suits may reflect a more efficient level of

526. See Koniak, *supra* note 273, at 1153; Merhige, *supra* note 502, at 881–82.

527. See Robert G. Bone, *Modeling Frivolous Suits*, 145 U. PA. L. REV. 519 (1997); Avery Katz, *The Effect of Frivolous Lawsuits on the Settlement of Litigation*, 10 INT'L REV. L. & ECON. 3, 3 (1990). In theory, plaintiffs' attorneys screen for frivolous suits because under a contingency arrangement, attorneys will be left holding the bag, receiving no fees if a case loses at trial. See Thomas J. Miceli, *Do Contingent Fees Promote Excessive Litigation?*, 23 J. LEGAL STUD. 211, 212 (1994). However, the class action context fundamentally changes the calculus. Because the potential stakes are so high, many defendants are willing to pay to settle even a frivolous suit. This decreases the plaintiffs' attorneys' incentive to screen out frivolous suits because they can secure a settlement even if the case is weak.

528. See *Piambino v. Bailey*, 757 F.2d 1112, 1143–46 (11th Cir. 1985).

529. See HENSLER ET AL., *supra* note 15, at 4.

530. *Id.* at 7.

531. See *Polar Int'l Brokerage Corp. v. Reeve*, 187 F.R.D. 108, 120 (S.D.N.Y. 1999) ("A practice of rubber stamping settlements of dubious merit that give attorneys significant fee awards but do not require defendants to contribute anything will, in the long run, encourage the filing of more frivolous suits."); HENSLER ET AL., *supra* note 15, at 485–86. Preventing collusive settlements may also restore deterrence against the underlying misdeeds. See *Coffee*, *supra* note 14, at 246 ("[T]he ultimate danger is that the corporate law-breaker will know that, even if detected, it can bribe the plaintiff's attorney—who represents the real threat of financial sanction—through the medium of the nonpecuniary settlement coupled with a high fee award.")

532. HENSLER ET AL., *supra* note 15, at 85.

533. See *Clement v. Am. Honda Fin. Corp.*, 176 F.R.D. 15, 25 (D. Conn. 1997).

litigation. By directly tying class and counsel payoffs together, the litigation that does get filed is more likely to be meritorious. In short, requiring parity in settlement currency may increase the efficiency of the class action litigation regime.

Another effect of requiring payment in common currency may be a drastic reduction in coupon settlements. If class action cases that would have been settled with coupons are not settled with cash, most class members would be better off,⁵³⁴ and deterrence is enhanced. To the extent class action litigation that would have been settled with coupons no longer settles, the net effect is not clearly negative. If class counsel refuse to negotiate coupon settlements under a common-currency regime, some actions may not be brought (thus reducing the number of settlements by reducing the number of cases). For those class actions that are filed, most class members would prefer trial (and the possibility of cash payment) over a guaranteed payment in coupons (at least as settlement coupons are currently structured). Coupon settlements do not deter future violations and do not adequately compensate the class. The primary beneficiary of current coupon settlements is the class counsel, followed by the defendant who eliminates liability at a minimal cost and potential profit. Would class members and the commonweal really be worse off in a world with fewer coupon settlements?

Another downside of the common-currency requirement is its inapplicability to class actions for injunctive relief. The common-currency solution appears equipped to align class and counsel interests in actions for damages because courts can observe the damages award and give the class counsel a set percentage of that bundle. In contrast, courts cannot award class counsel a percentage of injunctive relief. Of course, if no coupons are awarded to the class, then the proposed settlement would not raise any of the problems discussed in Part II. But to the extent that the common-currency requirement represents a general solution to the agency cost problem in class action litigation, settlements resulting in injunctive relief cannot be easily brought within a common-currency framework. Perhaps more relevant for our purposes are those settlements that include both a measure of injunctive relief and a payment to the class in settlement coupons. The calculation of attorneys' fees under a common-currency approach becomes more difficult. A few approaches come to mind. For example, courts could attempt to calculate attorneys' fees for each component of the settlement. The judge could award class counsel a percentage of what the class actually

534. However, an exception exists for class members who would have made a Non-Induced Purchase. Such a consumer would prefer a coupon with a high face value over a lesser cash payment. See Mark C. Weber, *A Consent-Based Approach to Class Action Settlement: Improving Amchem Products, Inc. v. Windsor*, 59 OH. ST. L.J. 1155, 1192-93 (1998).

receives (for example, 25 percent of the coupons) and calculate separate attorneys' fees for the injunctive relief. In such an approach, the judge must value the injunctive relief independently of, and without reference to, the settlement coupons (for which the attorneys have already received their compensation).

Alternatively, the court could attempt to employ a modified lodestar in which the class counsel is paid for the hours worked on the injunctive relief aspects of the case. Unfortunately, it would be prohibitively difficult to determine which hours are attributable to the injunctive relief versus the coupon relief given that most of class counsel's time is not relief-specific but rather goes to investigating the underlying legal claims. To the extent that courts cannot calculate a separate lodestar amount for the injunctive relief part of the settlement, a judge may feel compelled to use a lodestar for the entire settlement. This raises the risk that class attorneys may negotiate illusory injunctive relief to accompany a coupon settlement in order to escape the common-currency requirement. This risk is diminished by the fact that judges routinely evaluate proposed injunctive settlements under Rule 23(e). Judges should conclude that any injunctive relief is real and meaningful before awarding any attorneys' fees based on such relief. If the injunctive relief is merely a subterfuge to circumvent a common-currency requirement, then the reviewing judge should reject the proposed settlement as inadequate. In short, while this limitation means that a common-currency requirement cannot easily resolve all agency cost problems, it can diminish agency costs in the context of most coupon-based settlements.

Finally, some may argue that it is "unfair" to pay attorneys in coupons. Yet it is difficult to feel sorry for the class counsel given that the attorneys negotiate the proposed settlement. If the class counsel is worried that settlement coupons will be worthless, then the class counsel should insure that the coupons have value, that they are transferable and unburdened by unfair restrictions. If the class counsel does not want to be paid in coupons under any circumstances, the class counsel should negotiate a cash-based settlement (or litigate the case). The class counsel ultimately calls the shots; if counsel desires a certain level or type of compensation, it knows that it must negotiate a corresponding settlement package for the class.

In sum, given the problems inherent in coupon settlements, courts need an efficient rule or touchstone to determine whether such settlements adequately compensate the class. One rule of thumb should be that class and class counsel be paid in the same currency. The attorneys receive cash only when the class receives cash; when class members are paid in coupons, the class counsel should expect payment in kind. While such a proposal may seem

dramatic, it is less drastic than other possible solutions.⁵³⁵ Ultimately, requiring a common currency restores the purpose of the contingency fee: to tie the reward of the counsel to the compensation of the class.

CONCLUSION

The ubiquity of promotional coupons should not render us complacent about the growing popularity of settlement coupons. The use of coupons in class action settlements has, in effect, converted a legal device created to serve the public good into a mechanism that advances private interests at the expense of class members. Due to agency costs and institutional limitations, neither class counsel nor reviewing judges, respectively, provide an efficient check against improper coupon settlements. However, trial court judges could solve the agency costs problem by requiring that class counsel be compensated in the same currency as the class. This could lead to an appropriate decrease in coupon settlements. Alternatively, it would insure that when the class does receive settlement coupons, the class counsel has carefully negotiated any restrictions on coupon transfer and redemption. Once class counsel have a rational self-interest in making settlement coupons marketable, judges can again rely on attorneys to scrutinize coupon terms and to propose only those settlements that confer tangible benefits on the class.

535. See Resnik, *supra* note 363, at 857 (noting that "courts might decline to permit settlements in collective actions on the grounds that non-participants (absentees) can never be bound without their individual consent").