UNITED STATES DISTRICT COURT
FOR THE
EASTERN DISTRICT OF NEW YORK

ALLEN and SHARON SCHNEIDER, on behalf of themselves and all others similarly situated	:	**CV 97-837 (NG)(CLP)**
PLAINTIFFS,	:	**MEMORANDUM OF FEDERAL TRADE COMMISSION AS AMICUS CURIAE REGARDING THE PROPOSED CLASS ACTION COUPON SETTLEMENT**
-against-	:	
CITICORP MORTGAGE, INC. and CITICORP,	:	
DEFENDANTS.	:	

Table of Contents

Table of Authorities

Cases

Statutes and Regulations

Miscellaneous

The Federal Trade Commission ("Commission") submits this memorandum as *amicus curiae* to assist the Court in evaluating the class action coupon settlement proposed by class representatives Allen and Sharon Schneider (collectively, "Plaintiffs") and Citicorp Mortgage, Inc. n/k/a. CitiMortgage, Inc. ("CMI") and Citicorp (collectively, "Defendants").

I. INTRODUCTION

In early 1997, Plaintiffs filed a class action suit alleging that yield spread premiums ("YSPs") the Defendants paid to mortgage brokers for originating class members' home mortgage loans were improper kickbacks that increased the interest rate of their loans in violation of Section 8 of the Real Estate Settlement Procedures Act, 12 U.S.C. § 2601 et seq. ("RESPA") and state consumer protection statutes. The legal landscape shifted fairly dramatically during the course of this litigation. Although the Court of Appeals for the Second Circuit has not yet addressed the issue, the likelihood that these claims could be litigated on a class-wide basis is now highly questionable. Nonetheless, the parties agreed to a proposed class settlement of this suit, consisting of coupons and other non-monetary relief. In determining whether this proposed settlement should be approved, this Court faces a number of difficult determinations.

First, this Court must determine whether use of the settlement class device to resolve the litigation is appropriate in this case. The Commission believes it is extremely doubtful that it is.. Second, if the Fed. R. Civ. P. 23 requirements have been met, the Court must then determine the value of the Plaintiffs' claims. Third, the Court must determine whether the settlement and Plaintiffs' counsel's anticipated request for attorneys' fees merit approval. Although courts typically consider a variety of factors, the key to whether a proposed class action settlement should be approved pursuant to Fed. R. Civ. P. 23 is whether the class recovery is a fair,

reasonable, and adequate reflection of the value of the case. The coupons made available to class members under this settlement are not likely to be of value to them and unlikely to be redeemed by more than a few class members. Nor does the other relief the settlement provides benefit class members.

In exercising its duty to estimate the litigation value of the claims of the class and determine whether the settlement is a reasonable approximation of that value, the Commission believes this Court is confronted with two possibilities. If the Court values the Plaintiffs' claims at greater than nuisance value, the proposed settlement is far from adequate. If, on the other hand, the Court finds that Plaintiffs' class claims are indeed valued at near zero, it must then determine whether Plaintiffs' counsel's request for $659,500 in fees and costs is reasonable in light of the recovery obtained on behalf of the class. Payment of attorneys' fees for having garnered a virtually worthless recovery on behalf of class members with virtually worthless claims is not in the public interest.

II. BACKGROUND

A. Statement of the Case

Congress enacted the Real Estate Settlement Procedures Act, 12 U.S.C. § 2601 et seq. ("RESPA") to protect home buyers from "unnecessarily high settlement charges caused by certain abusive practices." 12 U.S.C. § 2601(a). Congress intended, among other things, to eliminate "kickbacks or referral fees that tend to increase unnecessarily the costs of certain settlement services" in connection with "federally related" mortgage loans. 12 U.S.C. § 2601(b)(2) and 24 C.F.R. § 3500.5(a). RESPA Section 8(a) prohibits the payment of kickbacks and referral fees in connection with real estate settlements. 12 U.S.C. § 2607(a).

Section 8(b) prohibits fee splitting and charging of duplicative fees. 12 U.S.C. § 2607(b). RESPA Section 8(c) excepts from the prohibitions of Sections 8(a) and (b) legitimate payments for "bona fide salary or compensation or other payment for goods or facilities actually furnished or for services actually performed." 12 U.S.C. § 2607(c).

On February 21, 1997, Plaintiffs filed suit on behalf of themselves and all similarly situated borrowers alleging that YSPs[1] the Defendants paid to mortgage brokers for originating their home mortgage loans were improper and increased the interest rate of class members' mortgage loans in violation of Section 8 of RESPA and state consumer protection statutes. Specifically, Plaintiffs alleged that CMI paid undisclosed YSPs to brokers in consideration for the brokers' roles in inducing the Plaintiffs to agree to above-market rate mortgage loans (also known as above par loans). Complaint ¶ ¶ 9-12, 15-16, 25-29, 32, and 47-49. Plaintiffs alleged that it was CMI's policy to pay YSPs regardless of and without any connection to any actual services performed by the mortgage broker. Complaint ¶¶ 27 and 48. The size of the YSP was determined solely by the interest rate paid by the borrower. The higher the rate, the higher the YSP. *See* Pls. Reply Supp. Mem. Mot. Class Cert. at 6.

YSPs have been the subject of class action lawsuits for over a decade.[2] Over the course

---

[1]HUD defines a YSP as a payment from a lender to a broker that is ordinarily based upon an above market interest rate on the loan. *See* RESPA; Simplifying and Improving the Process of Obtaining Mortgages to Reduce Settlement Costs to Consumers, 67 Fed. Reg. 49,134 at 49,141 (proposed July 29, 2002) (to be codified at 24 C.F.R. pt. 3500).

[2]In the past several years, more than 150 lawsuits have been brought seeking class action certification under RESPA to challenge the practices of lenders making indirect payments to mortgage brokers. *See* RESPA Statement of Policy 1999-1 Regarding Lender Payments to Mortgage Brokers, 64 Fed. Reg. 10,080 at 10,083 (March 1, 1999) ("1999 HUD Statement of Policy").

of this litigation, however, the legal landscape changed dramatically. In 2001, the Court of Appeals for the 11th Circuit in *Culpepper v. Irwin Mortgage Co.*, 253 F.3d 1324 (11th Cir. 2001) (*Culpepper III*), held that class certification in a case alleging virtually identical violations of RESPA was appropriate. Thereafter, in 2001 the Department of Housing and Urban Development ("HUD") issued a Statement of Policy clarifying that the Department did not consider YSPs *per se* illegal under Section 8 of RESPA. *See* Real Estate Settlement Procedures Act Statement of Policy 2001-1: Clarification of Statement of Policy 1999-1 Regarding Lender Payments to Mortgage Brokers, and Guidance Concerning Unearned Fees Under Section 8(b), 66 Fed. Reg. 53,052 at 53,055 (Oct. 18, 2001). ("2001 HUD Statement of Policy").[3] Based on the 2001 HUD Statement of Policy clarifying that the legality of such payments turned upon a highly individualized analysis consisting of a two-pronged test, the Eleventh Circuit effectively reversed *Culpepper III* one year later in *Heimmermann v. First Union Mortgage*, 305 F.3d 1257 (11th Cir. 2002), holding the claims were not susceptible to class-wide litigation.[4] Quite simply, since its announcement in 2001, courts have interpreted the 2001 HUD Statement of Policy as the death knell to class-wide litigation of YSP claims.

Defendants' motion to dismiss was denied on December 2, 1997, after which discovery proceeded apace and Plaintiffs filed their motion for class certification. On July 20, 2000, the Court ordered that Plaintiff's class certification motion be held in abeyance pending a Second Circuit decision in a virtually identical case, *Potchin v. Prudential Home Mortgage Co., Inc.*,

---

[3]The parties dispute whether it was always clear that RESPA precluded class-wide litigation of YSP claims, but the 2001 HUD Statement of Policy left no doubt about it.

[4]*See also Glover v. Standard Fed. Bank*, 283 F.3d 953 (8th Cir. 2002).

which ultimately settled before the court ruled. Suffice it to say, given the legal developments since the filing of the complaint in 1997, it is highly unlikely that any class would have been certified in this case had the parties not reached this settlement. Although Courts of Appeals addressing the issue since the 2001 HUD Statement of Policy have found YSP claims not susceptible to class litigation, the Second Circuit has yet to address the issue.

B. Terms of the Settlement

1. The Settlement Class

The class certified for purposes of settlement of this case consists of all persons for whom the computer system maintaining CMI's loan record indicates that (i) such person obtained a brokered mortgage loan from CMI during the period from February 20, 1996 through December 31, 2002 and (ii) CMI paid a fee to the mortgage broker who originated such loan.

2. The Settlement Benefits to Class Members

The settlement provides for the following:

1) Each class member is entitled to a coupon worth $100 (non transferrable either at public sale or auction) for each loan they obtained during the class period. The coupons may be applied against the cost of obtaining a new first mortgage directly from CMI through its telesales channel within two years from the date of final settlement approval. The coupon cannot be redeemed in conjunction with any other offer or promotion, class members may only redeem one coupon, and only one coupon can be redeemed in connection with any single mortgage real estate loan.

2) In the event the proposed HUD rule issued on July 29, 2002 at 67 Fed. Reg. 49,134 becomes final, CMI will implement new YSP disclosures for all of its brokered loans in

compliance therewith, within the time frame provided by the final rule.

3. Attorneys' Fees

The settlement agreement provides that CMI and Citicorp will pay Plaintiffs' counsel up to $659,500 in attorneys' fees and costs, as approved by the Court.

4. Releases and Conditions to Distribution and Payment

In exchange for the above described coupons and CMI's agreement to comply with HUD's proposed rule, class members must give CMI and Citicorp broad releases.

III. ARGUMENT

A. A Settlement Class Should Not Be Approved in this Case

As this Court noted in *In re Toys "R" Us Antitrust Litigation*, 191 F.R.D. 347, 351 (E.D.N.Y. 2000), "[u]nder *Amchem Products, Inc. Windsor*, 521 U.S. 591, 138 L. Ed. 2d 689, 117 S. Ct. 2231 (1997), a court determining whether to approve a class action settlement must first determine that a class is certifiable under Rule 23." The settlement class device allows the parties to concede, for purposes of settlement negotiations, the propriety of a class action and allows the court to postpone formal certification of the class until after settlement negotiations have ended. *Sheppard v. Consol. Edison Co. of N.Y., Inc.*, 2002 U.S. Dist. LEXIS 16314 at *6 (E. D. N. Y. 2002). A settlement class, however, can be certified only if all of the requirements for class certification under Rule 23 are met. *Id.*

Although on November 14, 2003, the Court granted preliminary certification to the Settlement Class (Notice Order dated November 14, 2003 and entered January 6, 2004 at 2-3), the 2001 HUD Statement of Policy, and the decision of the Court of Appeals for the 11th Circuit in *Heimmermann v. First Union Mortgage*, 305 F.3d 1257 (11th Cir. 2002) discussed above and

decisions by courts in this circuit suggest that this decision may have been in error. In 1999, Judge Amon in *Potchin v. The Prudential Home Mortgage Co., Inc.*, 1999 WL 1814612 (E.D.N.Y. 1999), held that in light of the 1999 HUD Policy Statement, the Fed. R. Civ. P. 23(b)(3) predominance requirement could not be met in a YSP case alleging violation of RESPA such as this:

> The predominance inquiry "begins with the elements of the alleged claim for relief, and requires an examination of the proof required to substantiate plaintiffs' allegations." (citations omitted) Pursuant to the recent HUD Policy Statement, to prove that a yield spread premium violated RESPA each plaintiff in the instant case will have to (1) document the nature and value of any goods, facilities or services that were actually furnished by the mortgage broker; and (2) show that the value of the total payments to the broker was not reasonably related to the value of the goods, facilities or services provided, (3) in part by comparison to "price structures and practices in similar transactions and in similar markets." Policy Statement, 64 Fed.Reg. at 10086. . . . Plaintiffs err by assuming that this inquiry can be performed in a way common to all class members. . . . Prudential's allegedly common policy and practice regarding yield spread premiums are not dispositive. A detailed examination of the facts of each transaction cannot be avoided. For this reason, plaintiffs have not met their burden of showing that common questions will predominate over individual ones.

The court in *Potchin* acknowledged contrary authority finding class certification appropriate in RESPA cases, but noted that in light of the 1999 HUD Policy Statement those decisions that denied class certification were better reasoned.[5] The court further noted that the fact that RESPA provides for treble damages, as well as costs and attorneys' fees, *see* 12 U.S.C. § 2607(d), somewhat vitiates the argument that RESPA cases cannot be pursued for economic reasons if a

---

[5] *Id* at *10. In fact, courts in this circuit have refused to certify classes involving RESPA violations after the 2001 HUD Statement of Policy and before both the 2001 HUD Statement of Policy and the 1999 HUD Statement of Policy. *See Costa v. SIB Mortgage Corp*., 210 F. R. D. 84, 90 (S.D.N.Y. 2002); *Potchin*, 1999 WL 1814612 at *9-10; *Marinaccio v. Barnett Banks, Inc.* 176 F.R.D. 104, 107 (S.D.N.Y. 1997); *Konomos v. Chase Manhattan Corp*., 1998 U.S. Dist. LEXIS 3135 at 4 (S.D.N.Y. Mar. 17, 1998).

class is not certified.[6]

We recognize, of course, that while an appeal of Judge Amon's initial order in *Potchin* was pending before the Second Circuit, the parties in that case reached a settlement, and Judge Amon certified a settlement class in order to approve that settlement. Even assuming, however, that approval of such a settlement class was appropriate at that time, the subsequent issuance of the clarifying 2001 HUD Statement of Policy and the 11th Circuit's decision in *Heimmermann* have changed matters substantially, as explained above. It is now more firmly established that Judge Amon was correct in the first place, and that RESPA claims of the sort advanced here cannot meet the standards of Rule 23 for class certification. Accordingly, such a class should not be now certified, even for settlement purposes, and the settlement must be rejected. If the Court nonetheless finds that the proposed settlement class should be certified, it must determine that the proposed settlement is fair, reasonable, and adequate, and that it is the product of arms-length negotiations.

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

Both commentators and courts throughout the country have recognized that class actions are extraordinary proceedings with extraordinary potential for abuse. As Judge Posner from the United States Court of Appeals for the Seventh Circuit has noted:

> Because class actions are rife with potential conflicts of interest between class

---

[6]HUD clarified in its 2001 Statement of Policy that its position that YSPs were not *per se* illegal, did not imply that YSPs were legal in individual cases. To determine whether a YSP constituted an illegal kickback, a review of each transaction is required to determine whether the YSP paid to the broker reflected the goods or facilities provided or services performed. *See* 2001 HUD Statement of Policy at 53,052, 53,055.

> counsel and class members (citations omitted), district judges presiding over such actions are expected to give careful scrutiny to the terms of proposed settlements in order to make sure that class counsel are behaving as honest fiduciaries for the class as a whole. (citations omitted).

Mirfasihi v. Fleet Mortgage Corp., 365 F.3d 781, 785 (7th Cir. 2004). *See also* RICHARD A. POSNER, AN ECONOMIC ANALYSIS OF LAW 570 (4th ed. 1992).

As courts in this circuit have noted, the problem has become even more exacerbated by the use of nonpecuniary settlements:

> Through use of a nonpecuniary settlement coupled with an application for attorney's fees, defendants benefit by receiving release from suit, plaintiffs' 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.

Polar Int'l Brokerage Corp. v. Reeve, 187 F.R.D. 108, 119 (S.D.N.Y. 1999). Where, as here, a settlement class has been certified for purposes of settlement only, "courts must require a 'clearer showing of a settlement's fairness, reasonableness and adequacy and the propriety of the negotiations leading to it.'" *Id.* at 113 (citations omitted). In assuming its role as guardian of the class, *Grant v. Bethlehem Steel Corp*., 823 F.2d 20, 23 (2d Cir. 1987), this Court must hold an evidentiary hearing to examine both the substantive and procedural aspects of the settlement. *In re Lloyd's Am. Trust Fund Litig.*, 2002 U.S. Dist. LEXIS 22663, at *28 (S.D.N.Y. Nov. 26, 2002); *In re Blech Sec. Litig.*, 2000 U.S. Dist. LEXIS 6920, at *8-10 (S.D.N.Y. May 19, 2000).[7]

---

[7]As this Court noted in *In re Toys R Us Antitrust Litigation*, 191 F.R.D. at 351-352, the guidelines for evaluating the substantive fairness of a class action settlement are well established in the Second Circuit:

> They include the complexity, expense and likely duration of the underlying litigation, the risks of litigation for all parties; comparison of the proposed settlement with the likely result of litigation; the scope of discovery preceding settlement; the ability of the defendant to satisfy a greater judgment; and the

Despite the heavy burden they face in establishing this settlement's fairness, the settling parties filed only a *pro forma* submission in support of their motion for preliminary settlement approval.[8] It appears that the parties do not intend to file papers setting forth their arguments and evidence in support of the settlement until just before the fairness hearing, after the deadline for class members to file their objections. The Commission believes that class members typically need significant information about the status of the case and the state of the record in support of the class' claims to make an informed decision about whether to object to the settlement. It is difficult to imagine that most class members would have ready access to the court file or transcripts of various proceedings such as the preliminary approval hearing where the Court examined counsel about the proposal. The notice to class members here lacks information about the procedural posture of the case and legal developments that impact key allegations of the complaint that would allow them to assess the risks of not settling. Nor does the notice state the estimated total value for the benefits offered by CMI and Citicorp to the class or the amount of the undisclosed YSPs allegedly paid to brokers for facilitating the loans.

---

reaction of the class to the settlement.

[8]As this Court noted at the hearing on preliminary approval of the settlement:

> It's really a bare-bones submission that I have, in terms of supporting the settlement, so let me go over my questions with you.
>
> I don't believe there's anything in the papers that indicated what your evaluation of the strength of the plaintiffs' claim is, other than discussion of the likelihood or unlikelihood of getting class certification, and I don't have evidence of what the scope of discovery was that you took, what investigations were made, or any other bases for calculating the strength of your case.

Tr. of October 8, 2003 Hr'g at 2.

C. The Proposed Settlement Does Not Appear To Be Fair, Adequate, Or Reasonable

To evaluate the fairness of a proposed settlement or fee award, the court must first assess the actual value of the settlement to the class. Coupon settlements have generated enhanced scrutiny because, unlike money settlements, they are hard to value. *See Note: In-Kind Class Action Settlements*, 109 HARVARD L. REV. 810, 816-18 (1996).[9] Because the value of the coupon is debatable, the settlement valuation question is more susceptible to manipulation by the settling Defendants and Plaintiffs' counsel, each of whom typically has great incentive to see that the settlement is approved. In fact, only in extremely unusual circumstances would it be appropriate to value the settlement based on the total face value of all available coupons, as Plaintiffs' counsel seems to suggest here.[10] The face value may not represent real value to the class member when, as here, the coupon cannot be converted to cash, is time limited, and is connected to an expensive transaction most consumers are unlikely to engage in within the allotted time frame.

---

[9] For example, although a coupon or discount may have a face value of $100 and may be distributed to 77,000 class members, the settlement is worth nothing, not $7,700,000, if none of the coupons will ever be redeemed.

[10] *See* Tr. of October 8, 2003 Hr'g at 39 ("We've brought about $7 or $8 million worth of value through the class"). Counsel could not tell the Court when it inquired at the hearing on preliminary approval of the settlement how many class members they anticipated would seek to redeem the settlement coupons or how they arrived at the $100 face amount of the coupons, other than to assert that "the $100 comes out to be not that far off from what a quarter of the average yield spread premium would have been in these loans." *See* Tr. of October 8, 2003 Hr'g at 4-5, 29.

1. The coupon portion of the proposed settlement

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

Redemption rates as reported for consumer class actions are generally quite low.[11] A RAND study on class actions urges judges to (1) apply heightened scrutiny when coupons comprise a substantial portion of the settlement value and (2) require estimates of the rate of coupon redemption.[12] When the data exist, courts should insist on proof of the coupons' real value through redemption rates for coupons for the same or similar products or expert testimony regarding the real value of the coupons. In this case, there appears to be reasonably analogous redemption data from the virtually identical *Potchin* case that should give this Court great pause. As counsel for the Defendants conceded at the hearing on preliminary approval of this settlement, the *Potchin* settlement provided for a cash recovery to class members in the amount of approximately 25% of the yield spread premium, yet virtually none of the 1,000 class

---

[11] In a case involving defective heat coils in Renault, Encore and Alliance cars made in 1983-87, counsel for defendant Chrysler reported that only 1% of the 300,000 class members in that case ever used the $400 non-transferrable coupons good for the purchase of a Chrysler car. Barry Meier, *Fistfuls of Coupons: Millions for Class-Action Lawyers, Scrip for Plaintiffs*, N. Y. TIMES, May 26, 1995, available at LEXIS, News Library, New York Times File. In *Strong v. BellSouth Telecommunications, Inc.*, 173 F.R.D. 167, 172 (W.D. La. 1997), *aff'd* 137 F.3d 844 (5th Cir 1998), the district court, in a settlement that provided class members with the option of either continuing under a plan or canceling and obtaining a credit, declared the purported $64 million settlement a phantom when there was only a 4.3% response rate to the settlement and the credit requests actually submitted by class members only amounted to $1,718,594.40. In *Buchet v. ITT Consumer Fin. Corp.*, 845 F. Supp. 684, 694-95, *modified*, 858 F. Supp. 944 (D. Minn. 1994), the court rejected a settlement involving a discount coupon worth as much as $39 for the purchase of property insurance or related products, citing actual redemption rates ranging from 0.002% to 0.11% for similar coupons.

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

members filed a claim. As counsel for the Defendants, who was also counsel of record in that case, explained:

> Virtually nobody filed. As a matter of fact, the result was, Judge Amon said on the record that she was very perplexed, because the fees which we had agreed upon had exceeded the payout under the settlement. I said to her, But we didn't know that when we agreed. We assumed that virtually everyone would hit the bid.

Tr. of October 8, 2003 Hr'g at 18-19. There is very little likelihood that this considerably less desirable coupon settlement will garner the same, much less a greater response. In any event, this Court should not predicate its valuation of the likely benefits of this settlement to class members on the unsubstantiated suppositions and assumptions of counsel.

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

(1) Class members are not likely to want the coupons offered

To assess the value of the coupon in this case, the Court must determine the extent to which the good or service the coupon covers are likely to be ones that members of the class might want to use. Viewed from this perspective, most of the estimated 77,000 class members will not likely benefit from this proposed settlement. Here, the class consists of individuals who either bought real estate for the first time or refinanced their existing first mortgage within the past 1½ to 6 years. What is the realistic likelihood that any significant portion of the 77,000 class member will again be purchasing a house or refinancing their mortgage during the next two years? Available statistics suggest there is very little likelihood that they will do so. The years 2002 and 2003 saw record numbers of mortgage originations, and while no one can predict the future, projections show that these numbers will decline

significantly in 2004 through 2006. According to the Mortgage Bankers Association ("MBA"), in 2003 there were approximately $3.8 billion in mortgage originations, while 2004, 2005 and 2006 are projected at $2 billion; $1.7 billion and $1.8 billion, respectively. These projections dovetail with MBA's predictions on the 10-year Treasury yield, which shows the yield increasing from 4.0% in 2003 to 4.4% in 2004, 5.1% in 2005 and 5.4% in 2006.[13] Although no one has a crystal ball, given that the industry does not anticipate continued record levels of first mortgages and refinances, the value of the coupons cannot be determined by simply adding up the face value of each as the Plaintiffs' estimated value of the settlement suggests is appropriate.[14]

For those class members who do not object to doing business with CMI, they may well find better deals from the company on its internet site. CMI is currently offering an internet promotion of a $500 credit at closing when customers initiate their purchase or refinance through CMI's on-line Pre-mortgage Information Form.[15] This promotion benefits customers by $400 more than is being offered class members, further demonstrating the coupon's minimal value and the limited likelihood that it will ever be used by class members.

---

[13]*See* http://www.mortgagebankers.org/marketdata/forecasts/pdfltjan2004.pdf

[14] In addition, the face value of the coupons is misleading. The time value of money requires that the coupons be discounted to net present value.

[15]The settlement coupon cannot be used in conjunction with this or any other discount offer.

(2) The fact that the coupons are not freely transferable further lessens their value

Normally, transferability enhances the value of coupons.[16] Here, the settlement is clear on this point; the coupons are not transferrable at public sale or auction. Thus, no secondary market can be relied upon to create an albeit discounted value for the coupons so that class members who cannot use the coupons themselves may nonetheless benefit from the settlement. Whether the coupons may be privately transferred (e.g., may be given by a class member to her son or daughter or sold to a neighbor) is not clear. Even if this were the case, however, any value to class members would appear to be serendipitous. For every class member who seeks to benefit from the settlement by transferring his coupon, there must be a willing buyer who intends to redeem it. The availability of bulk or high volume purchasers will increase the number of coupons class members are able to sell and the price they will be able to obtain, but it is hard to imagine how that might be accomplished in the context of a private sale. Absent evidence that there will be a viable private, unadvertised market for these coupons and taking into consideration the internet promotions described *supra* in Section III.C.1.b(1), it is difficult to assess the value of the coupons' transferability, if they are indeed privately transferrable.

(3) Other terms of the settlement will likely result in many coupons not being redeemed

Other barriers to redemption set in place by the settlement may result in few class members taking advantage of whatever benefits the coupons may provide. For example,

[16]Only if a court can reasonably assess a transferrable coupon's future market price can it determine whether the amount of the coupon would satisfy class claims, but on balance in-kind settlements that provide for the transferability of coupons help to resolve the uncertainty whether a settlement's value is fair and reasonable under Rule 23.

although class members are entitled to receive one coupon for each loan they borrowed or mortgage they refinanced, class members are limited to redeeming only one coupon and only one coupon per transaction. Nor may the coupons be used in combination with any other promotion, thereby further undermining the value of the settlement. Finally, the coupons are only redeemable for two years after the date of final approval of the settlement, rendering it highly unlikely that many class members who only purchased or refinanced their homes 1½ to 6 years ago will actually use the coupon.[17]

All of these restrictions help to insure that it is unlikely that most coupons will in fact be redeemed. Accordingly, the real value of the coupons to class members is uncertain and it seems likely that the purported face value of the coupons ($7,700,000) wildly exaggerates the true value of the settlement to class members.

2. The proposed injunctive relief

Pursuant to the terms of the settlement, Defendants agree that in the event the proposed HUD rule issued on July 29, 2002 at 67 Fed. Reg. 49,134 becomes final, CMI will comply with the final HUD rule. This benefit is of little value. It merely provides some psychic reassurance that the defendants will do what the law requires should HUD's final rule be implemented. Counsel for the Defendants, again unabashedly, conceded as much at the hearing in support of preliminary approval of the settlement upon examination by the Court of the value of the proposed injunctive relief:

> THE COURT: What do you understand that provision of the settlement to require your client to do that it otherwise doesn't have to do?

---

[17]Obviously, with expensive items, like home mortgages, the longer the redemption period for the discount coupons, the more likely they might be used by class members.

MR. KAVALER: Nothing.
THE COURT: Well, that's an honest response.

Tr. of October 8, 2003 Hr'g at 11.

* * *

The Court must reject this settlement in the first instance because it does not meet the requirements for certification as a settlement class. In the event it certifies the class, however, it must reject the settlement nonetheless as inadequate or deny plaintiff's counsel their anticipated request of $659,500 in fees and costs as excessive. If Plaintiffs' chance of success on the merits is more than mere nuisance value, then the proposed relief to Plaintiffs is inadequate because class members would be releasing their claims in return for coupons of little or no value. If, on the other hand, this coupon settlement adequately compensates Plaintiffs for their claims, despite its likely low value, then the Court must take into consideration the provision for attorneys' fees, which cannot be justified in light of the poor result achieved.

D. Class Counsel's Fee Request May Be Excessive Given the Likely Low Value of the Settlement

The Second Circuit has held that both the "lodestar method" of computation (i.e., hours reasonably expended multiplied by a reasonable hourly rate, plus an enhancement, if appropriate) and the "percentage of the fund method" are available to district judges in determining appropriate attorneys' fees in common fund cases. *See Goldberger v. Integrated Res., Inc*., 209 F.3d 43, 50 (2d Cir. 2000). Although the trend in the Second Circuit is toward the percentage of recovery method, even when that method is used, the Second Circuit encourages looking to the lodestar as a cross check on the reasonableness of the percentage requested. *In re Visa Check/Mastermoney Antitrust Litigation,* 2003 U.S. Dist. LEXIS 22898 at *45 (E.D.N.Y. Dec. 19, 2003). Plaintiffs' counsel has not yet filed their fee petition, and thus the Commission

cannot comment on Plaintiffs' counsel's lodestar in the case.

The Court should be particularly wary of fee requests justified upon a percentage of recovery calculation based on the face value of the coupons, most of which will not likely be redeemed. In the event the Court decides to use the percentage of recovery method of fee calculation, the analysis must be premised on the real value of the settlement and not the face value of the coupons. A low value case with a concomitant low recovery would not justify $659,500 in fees and costs. Although the uncertainties of litigation may make such a settlement a plausible business decision for the Defendants, an excessive fee is inimical to the public interest. Whether the burden of such an unwarranted fee award is borne by Defendants' shareholders or its future customers, it constitutes an economic loss that the results achieved in this litigation cannot justify.[18]

[18] A number of courts have held back large portions of fee requests or denied them altogether when the fee request was based on a percentage of recovery and the actual value of the settlement was uncertain. *See, e.g.*, *Bussie v. Allmerica Fin. Corp.* 1999 U.S. Dist. LEXIS 7793 *9-10 (D. Mass. May 19, 1999)(staging fee award, preserving the right to adjust the award in light of actual experience under the settlement); *Duhaime v. John Hancock Mut. Life. Ins. Co.*, 989 F. Supp. 375, 379-80 (D. Mass. 1997)(staging fee award); *Strong v. BellSouth Telecommunications, Inc*., 173 F.R.D. at 172 (denying fee petition because actual value of settlement fund based on credits claimed by class members was approximately $2 million, as opposed to class counsel's prior estimate of $64.5 million); *Bowling v. Pfizer, Inc.*, 922 F. Supp. 1261, 1283-84 (S.D. Ohio), *aff'd*, 102 F.3d 777 (6th Cir. 1996) (holding back large portion of fee award until additional "future" benefits to class were actually paid into class fund); *Voege v. Ackerman*, 67 F.R.D. 432, 436-37 (S.D.N.Y. 1975)(reserving fee determination until all claims of shareholders entitled to participate had been filed and determined since settlement's benefits to class could not be determined with any certainty beforehand); *NACA Standards and Guidelines for Litigating and Settling Consumer Class Actions*, 176 F.R.D. 375, 399 (1997)(in cases involving certificates and no minimum settlement level, class counsel should not request a percentage fee "until such time as the court can accurately assess the actual value of the settlement (i.e., after the deadline for class member claims [or] after the certificates expire).").

E. Suggestions for Reformation of the Settlement

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

If the Court finds that Plaintiffs have claims large enough to justify a distribution to them, to the extent possible, settlement of these consumers' claims should include a cash payment. Those factors that might suggest the appropriateness of coupons are simply not present here. The defendants are not impecunious or on the verge of bankruptcy and the class members are identified. An all cash settlement, or a coupon settlement that has a cash component, would eliminate or reduce the uncertainty as to the value of the recovery to the class, the cost to the defendants, and the value of the work performed by class counsel.

Urging the parties to commit to a fixed payment amount would also bring certitude to the value of the settlement to the class. Payment of attorneys' fees out of the common fund obtained on behalf of class members would insure that the amount of attorneys' fees paid as a percentage of the recovery is discernible, and hopefully reasonable.

Finally, in the event the Court approves this coupon settlement or any settlement with a coupon component, we urge the Court to require that counsel for the parties submit detailed information about the number and percentage of coupons redeemed, the rate of redemption, and the number of coupons transferred during the life of the coupons. This data, which is of great interest to courts, legislators, various government enforcement agencies, legal scholars and the community at large, will assist all in assessing the efficacy of nonpecuniary coupon settlements.

The Commission recognizes that Plaintiffs' counsel have devoted years to litigating this case. Nevertheless, in light of the uncertainty of the true value of this proposed coupon settlement, if approved, we further urge the Court to adopt the approach taken by others and stage Plaintiffs' attorneys' fees so that their ultimate compensation is tied to and reflective of the actual benefit received by the class members under the settlement. Tracking actual redemption experience, of course, would be critical to implementing this approach to fee approval.

IV. CONCLUSION

This settlement should be rejected because the proposed settlement class cannot meet the requirements of Fed. R. Civ. P. 23. If the Court nonetheless finds that settlement class certification is appropriate then, the present settlement should not be approved as fair, reasonable, or adequate. The value of this settlement to class members is likely to be significantly lower than the face value of the coupons. The coupons are likely of little interest to class members, and most class members are not likely to redeem them. Plaintiffs' counsel's anticipated request of $659,500 in fees and costs appears excessive in light of the benefits to the class.

Dated:_____

Respectfully submitted,

William E. Kovacic
General Counsel

_____
Patricia F. Bak PFB7051
Adam B. Fine
Robert M. Frisby
Bureau of Consumer Protection/Div. Enf.
Federal Trade Commission
600 Pennsylvania Avenue, N.W.
Mail Drop NJ 2122
Washington, D.C. 20580
(202) 326-2842