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UNITED STATES DISTRICT COURT
CENTRAL DISTRICT OF CALIFORNIA

ANITA WHITE, et al., Plaintiffs, vs. EDEBITPAY, L.L.C., et al., Defendants.	Case No. : 2:11-cv-06738-CBM-FFM **FEDERAL TRADE COMMISSION'S MEMORANDUM OF LAW AS AMICUS CURIAE** Date: September 9, 2013 Time: 11:00 a.m. Judge: Hon. Consuelo B. Marshall

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The FTC opposes the pending class action settlement because it furthers the interests of plaintiffs' counsel, the defendants, and the defendants' insurance company at the expense of 1.2 million consumers. These consumers have tens of millions of dollars in claims against the defendants, which the settlement would extinguish with a $1 million payment – essentially none of which will go to the class. Plaintiffs' counsel would receive as much as $400,000 of these funds, while the claims administration process would likely consume the rest.

Meanwhile, the settlement would allow EDebitPay, LLC's ("EDP") owners to wash away EDP's liability and sell the sanitized company for a windfall. In short, the settlement does not protect consumers; instead, it is little more than a contract for cheap *res judicata* in exchange for attorneys' fees.

Moreover, the proposed notice process virtually ensures that most class members will never learn of the settlement's fundamental unfairness. The parties intend to provide notice largely through email, relying on addresses obtained as many as six years ago. Many of these addresses are likely no longer valid. For those that are, SPAM filters will block many emails. Moreover, even if they make it through the filters, consumers are apt to disregard emails concerning EDP, a company that billed them without authorization. Worse yet, the notice itself is so deeply flawed that even those few class members who receive and read the email will be unable to understand the settlement's terms. With or without adequate notice, there simply is no way to provide restitution to 1.2 million consumers with a mere $1 million recovery. Class counsel should explore whether additional pools of money are available (e.g., the remainder of the insurance coverage, the proceeds from the proposed sale of EDP, and the individual defendants' assets). It is worth noting that EDP's claims of insolvency are suspect given that the Agreement misrepresents that Defendants cannot pay the FTC's contempt judgment when, in fact, they already have done so.[1] Agreement at p. 3. However, even if raising sufficient funds for redress were impossible, the court should not countenance the misuse of the class action process to enrich plaintiffs' attorneys and the defendants while providing essentially nothing to injured consumers.

I. The FTC's Interest in This Matter

The FTC is an independent law enforcement agency whose mission is to protect consumers from unfair or deceptive acts or practices and to increase consumer choice by promoting vigorous competition. The FTC's primary legislative mandate is to enforce the FTC Act, 15 U.S.C. §§ 41-58, which prohibits unfair or deceptive acts or practices and unfair methods in or affecting competition.

As part of the FTC's consumer protection mission, the FTC seeks to halt deceptive marketing and unauthorized billing. A recent FTC study estimates that

[1] This payment may be subject to a claw back should EDP declare bankruptcy. The FTC retains a judgment lien against real property of Dale Paul Cleveland, a defendant in both this and the FTC action, to protect against that possibility. The same counsel represents all defendants in both matters.

in 2011, approximately 1.9 million adults in the United States were billed for internet services they had not agreed to purchase. Consumer Fraud in the United States, http://www.ftc.gov/os/2013/04/130419fraudsurvey.pdf. To address this problem, the FTC has brought numerous cases to stop businesses and individuals engaged in unauthorized billing.[2]

The FTC also seeks and administers restitution for victimized consumers. For example, in fiscal year 2011, the FTC obtained 90 permanent injunctions and orders requiring defendants to pay more than $218 million in consumer redress or disgorgement of ill-gotten gains. Federal Trade Commission, *Fiscal Year 2013 Congressional Budget Justification* (February 13, 2012), http://www.ftc.gov/ftc/oed/fmo/2013_CBJ.pdf.

The FTC's interest in this case arises not only from its broader consumer protection mission, but also from its recent enforcement actions against EDP and its owners. On July 30, 2007, the FTC sued EDP, its owners, and three related entities for violating Section 5 of the FTC Act, 15 U.S.C. § 45, by deceptively marketing financial services products and making unauthorized debits from consumers' bank accounts. A Central District of California court entered a

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[2] *See e.g.*, *FTC v. Inc21.com Corp.*, 745 F. Supp. 2d 975 (N.D. Cal. 2010), *aff'd* 475 Fed. App'x 106 (9th Cir. Mar. 30, 2012); Stipulated Order, *FTC v. Nationwide Connections and BSG Clearing Solutions*, No. 06- 80180 (S.D. Fla. Sept. 18, 2008); Stipulated Order, *FTC v. Websource Media, LLC*, No. H-06-1980 (S.D. Tex. July 17, 2007).

stipulated order on January 22, 2008 that, among other things, permanently enjoined the defendants from misrepresenting, or not clearly disclosing, the nature of their products or services, and from debiting consumers' bank accounts without their express informed consent. *FTC v. EDebitPay, LLC*, No. CV 07-4880 ODW (AJWx), 2008 U.S. Dist. LEXIS 122126 (C.D. Cal. Jan. 17, 2008).

Defendants immediately began violating this order by, *inter alia*, deceptively advertising their Century Platinum shopping club as though it were a general line of credit. On May 27, 2010, the FTC moved for an order to show cause why the defendants should not be held in contempt. After an evidentiary hearing, the court found the defendants in contempt. Specifically, the court found by clear and convincing evidence that EDP had deceived consumers, wrongly billing them more than $3.7 million. It ordered the defendants to pay that amount to the FTC in compensatory sanctions. *FTC v. EDebitPay, LLC*, No. CV 07-4880 ODW (AJWx), 2011 U.S. Dist. LEXIS 15750, at *41 (C.D. Cal. Feb. 3, 2011), *aff'd* 695 F.3d 938 (9th Cir. 2012). The court's findings are entitled to collateral estoppel. *Parklane Hosiery Co., Inc. v. Shore*, 439 U.S. 322, 326-33 (1979).

II. The Allegations Against EDP and the Terms of the Settlement

Six months after the order holding EDP in contempt, plaintiffs' counsel filed this case. The plaintiffs allege that EDP misrepresented its shopping clubs and related products as a short-term loan, and then debited consumers for membership fees, including a $99 enrollment fee, without their informed consent. (Am. Compl.) Plaintiffs claim that approximately 1.2 million consumers thereby incurred more than $42 million in damages.[3]

The parties propose to settle plaintiffs' claims for $1 million. Settlement Agreement ("Agreement") at ¶ I.35. Plaintiffs' counsel would receive $250,000 in attorneys' fees, and as much as $150,000 in expenses from the settlement. *Id*. at ¶¶ VIII, I.2.

Tellingly, the Agreement does not guarantee that a single class member – other than the two named plaintiffs – will receive any money. Rather, after paying for attorneys' fees and expenses, the remaining monies fund a notice and claims process (collectively "claims administration"). *See id*. at ¶¶ I.4, V.1. The Agreement, however, fails to cap the amount of money the administrator may spend on this process, which will exceed the amount in the settlement pool even with an exceedingly low response rate. *Id*. at ¶¶ III, V.

Class members, in turn, will release all claims they now have or may in the future have arising out of the Defendants' collection or attempted collection of Membership Fees from Settlement Class Members' bank accounts. *Id*. at ¶ X.1.M.

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[3] Plaintiffs represent that the class consists of more than 1.2 million consumers, who each have claims of "approximately ninety-nine dollars ($99) for those individuals who had money withdrawn from their accounts, and Bank Account Fees of approximately thirty-five dollars ($35) per attempted withdrawal." Pl. Mot. at 12, 16.

Indeed, the settlement "[b]ars and permanently enjoins all Settlement Class Members who have not been properly excluded from the Settlement Class (i) from filing, commencing, prosecuting, intervening in or participating as plaintiff, claimant or class member in any other lawsuit or administrative, regulatory, arbitration or other proceeding against Defendants."[4] *Id*. at ¶ X.1.0. The release applies to *all* class members who do not opt out – even if they never receive compensation or notice of the case.

For those consumers who happen to receive notice, the settlement ensures that virtually no one will opt out for two reasons. First, while the settlement permits defendants the ease of email notice, to opt out consumers must use regular mail – thus imposing additional costs for removing themselves from the class, and thereby decreasing the chance consumers will opt out. More importantly, the opt-out must contain the name of the membership program in which EDP enrolled the consumer and his or her signed statement asking for exclusion. Consumers are

[4] The FTC is concerned that the defendants will make frivolous arguments, based on this broad language, that the settlement would preclude the 30,000 consumers eligible to receive distributions through the FTC's contempt action from doing so. Of course, as noted above, a court has ruled that those consumers are entitled to compensation, and EDP cannot use this settlement to collaterally attack them because those determinations are entitled to collateral estoppel. *See Parklane*, 439 U.S. at 326-33 (1979). Accordingly, the settlement should not be approved with this language. At a minimum, the Agreement should expressly exclude from the release consumer compensation under the contempt judgment.

highly unlikely to know the name of the membership program where, as here, the defendants allegedly billed consumers without their authorization.

As set forth below, the Agreement should not be adopted because: (1) it is not fair, adequate, and reasonable; and (2) the settlement does not provide reasonable notice.

III. The Settlement Agreement Is Not Fair, Adequate, and Reasonable

This settlement does not meet the high standard for fairness mandated by Rule 23 when the settlement is proposed before the class has even been certified.[5] *Hanlon v. Chrysler Corp.*, 150 F.3d 1011, 1026 (9th Cir. 1998). When, as here, settlement takes place before class certification, review of the fairness and adequacy of the settlement is subject to a “higher standard of fairness.” *Shaffer v. Cont'l Cas. Co.*, 362 F. App’x 627, 629 (9th Cir. 2010). Specifically, the proposed Agreement guarantees that there is no possibility of real class recovery. Either all the money will be spent on attorneys’ fees and administrative costs, or, more likely, the response rate will be vanishingly small because of the deeply flawed notice. Of course, class counsel had no incentive to negotiate an effective notice or a fair and reasonable settlement – their fees are guaranteed even if no class members respond.

[5] Federal Rule of Civil Procedure 23(e) requires the district court to determine whether a proposed settlement is “fair, adequate, and reasonable.”

A. The Settlement Fund Cannot Cover the Costs of Claims Administration for More than a Tiny Fraction of the Class.

With even a *de minimis* response rate, the cost of claims administration will completely drain the settlement fund. Such costs frequently exceed $30 a claim. *See, e.g., Ko v. Natura Pet Prods.*, No. C-09-02619 SBA, 2012 U.S. Dist. LEXIS 128615, at *12 n.1-2 (N.D. Cal. Sept. 10, 2012) (per claim cost of more than $32.50); *Trombley v. Bank of Am. Corp.*, No. 08-cv-456-JD, 2012 U.S. Dist. LEXIS 63072, at *6 (D. Ri. May 3, 2012) (per claim cost of more than $60); *Genden v. Merrill Lynch*, 741 F. Supp. 84, 88 (S.D.N.Y. 1990) (per claim cost of more than $30).[6] At that rate, the cost of administration would empty the settlement fund (after deducting attorneys' fees and expenses) even if only 1.67% of class members submitted claims. Thus, 98.33% of the class can never receive compensation — a fact conspicuously absent from the notice.[7] This eventuality, however, is unlikely because the parties' notice proposal virtually guarantees the vast majority of class members will never learn about the settlement.

B. The Settlement Does Not Provide Reasonable Notice.

Before approval of a settlement, "[t]he court must direct notice in a reasonable manner to all class members who would be bound by the proposal."

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[6] Based on its experience administering redress, this is consistent with the FTC's estimate of claims administration costs in this situation.

[7] Obviously, this is a conservative figure. It neither accounts for the cost of newspaper advertising nor the fact that there have to be sufficient funds remaining after the notice and claims procedure to provide meaningful restitution.

FED. R. CIV. P. 23(e)(1). All class members bound by a proposed settlement are entitled to "the best notice that is practicable under the circumstances." FED. R. CIV. P. 23(c)(2)(B); *see Hanlon*, 150 F.3d at 1025 ("Adequate notice is critical to court approval of a class settlement."). Here, neither the method of providing notice, nor the content of the notice, is reasonable.

1. The Notice Would Not Reach Most Class Members.

Emailing notices to putative class members, as the parties propose, is flawed for at least three reasons. First, the administrator would send notices to email addresses that EDP obtained years ago. Many of the accounts associated with these addresses are likely closed or inactive. Second, spam filters will likely block emails sent to valid accounts. *Pokorny v. Quixtar Inc.*, 2011 WL 2912864, at *3 (N.D. Cal. July 20, 2011) ("In this era of spam-filters and mass email advertising . . . email notice alone may be insufficient to draw the attention of class members.").[8] Third, because the emails will reference EDP in the subject line, class members are

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[8] Even if consumers were to receive the message and read it, they may doubt the reliability of its contents. "[E]lectronic communication inherently has the potential to be copied and forwarded to other people via the internet with commentary that could distort the notice approved by the Court. Electronic mail heightens the risk that the communication will be reproduced to large numbers of people who could compromise the integrity of the notice process." *Reab v. Electronic Arts, Inc.*, 214 F.R.D. 623, 631 (D. Colo. 2002); *see also Espenscheid v. DirecStat USA, LLC*, No. 09–cv–625–bbc, 2010 WL 2330309, at *14 (W.D. Wis. June 7, 2010) ("I agree with the reasoning of the courts suggesting caution be used in allowing email notification because of the potential for recipients to modify and re-distribute email messages.")

apt to think the emails are another scam, and delete or ignore them. *Cf. Karvaly v. eBay, Inc.*, 245 F.R.D. 71, 91-92 (E.D.N.Y. 2007) ("eBay and PayPal are popular targets of unscrupulous email spoofing schemes; as such, it is likely that many prospective Eligible Class Members would delete or ignore an electronic communication from PayPal that purports to address a class action settlement in which the recipient may be entitled to a monetary award.").

The *Cohorst* case, favorably cited by plaintiffs' attorneys, underscores the futility of email notice. In *Cohorst*, much like the proposal here, the administrator sent email notice to 1.1 million class members, placed advertisements in *USA Today*, and operated a settlement website. With that notice, 99.83% of the consumers failed to submit claims.[9] There is no reason to believe that the response rate would be any better here, leaving essentially the entire class uncompensated.

2. The Notice Does Not Adequately Inform Class Members of the Settlement Terms.

Even if consumers receive them, the proposed settlement notices do not provide class members with "the best notice that is practicable under the circumstances." FED. R. CIV. P. 23(c)(2)(B). To do so, the notices must "clearly

[9] Administration costs in that case were more than $190 dollars per claim received. *See Cohorst v. BRE Properties, Inc.*, Case No. 3:10-cv-02666-JM-BGS, Supplemental Declaration of Lisa Mullins in Further Support of the Motion for Final Approval (April 2, 2012), ECF #101, ¶¶ 7-8, 31.

and concisely state in plain, easily understood language . . . the binding effect of a class judgment on members." *Id.*

The proposed notice does not inform consumers of the effect of the class judgment. In particular, the "Short Form Notice"—the notice sent to class members by email—fails to inform class members which claims they will release under the settlement. On the second page, the notice merely informs class members that they "will be bound by the settlement terms and give up [their] right to sue regarding the Released Claims." The email notice does not define the term "Released Claims." Instead, a footnote to text located elsewhere says "Capitalized terms not otherwise defined herein have the same definitions as set forth in the Class Action Settlement Agreement and Release (the "Settlement Agreement"), a copy of which can be found online at www.edebitpaysettlement.com." It is highly unlikely consumers will undertake this cumbersome process.

Indeed, the email notice is so fundamentally flawed that if it were a commercial mailing, it would likely violate the FTC Act. The FTC's "Dot.com Disclosures" publication advises "[f]or disclosures to be effective, consumers must be able to understand them. Advertisers should use clear language and syntax and avoid legalese or technical jargon. Disclosures should be as simple and straightforward as possible." FTC, DOT.COM DISCLOSURES, 1 (March 2013), *available at* http://www.ftc.gov/os/2013/03/130312dotcomdisclosures.pdf. The email notice here does not identify the claims that class members will release if they are included in the settlement, contains pages of legalese, and buries much of the important information deep in the document or in footnotes that refer to other documents.

C. The Settlement Is Subject to a Heightened Standard of Review it Cannot Survive.

This flawed settlement may derive from the lack of incentives class counsel had to negotiate a good deal for the class members. Indeed, courts have expressed concern that "[i]ncentives inhere in class-action settlement negotiations that can, unless checked through careful district court review of the resulting settlement, result in a decree in which 'the rights of [class members, including the named plaintiffs] may not [be] given due regard by the negotiating parties.'" *Staton v. Boeing Co.*, 327 F.3d 938, 959 (9th Cir. 2003) (quoting *Officers for Justice v. Civil Serv. Comm'n of San Francisco*, 688 F.2d 615, 625 (9th Cir. 1982)).

Clear sailing arrangements – in which defendants agree not to object to the fees of plaintiffs' counsel like the one in this case – heighten this concern. Agreement at ¶ VIII.1. *Lane v. Facebook, Inc.*, 696 F.3d 811, 832 (9th Cir. 2012).[10] "The very existence of a clear sailing provision increases the likelihood

[10] Where "the defendant agrees not to oppose an attorneys' fees claim, and defendants' payout will be the same no matter how high the fee is . . . both sides have an incentive to make the fee large enough to induce plaintiffs' counsel to sacrifice class interests to plaintiffs' attorneys' interests." *Id*.

that class counsel will have bargained away something of value to the class." *Jones v. GN Netcom, Inc.* (*In re Bluetooth Headset Prods. Liab. Litig.*), 654 F.3d 935, 948 (9th Cir. 2011).

This case illustrates the very problems discussed by these courts. As set forth above, class members lose under the proposed settlement. Specifically, it deprives the class of essentially all compensation, either because administration of the fund will deplete all monies available for redress or the notice procedure will ensure that virtually no class member responds.

In contrast, the defendants and plaintiffs' counsel win. The settlement would eliminate a substantial liability, significantly increasing the value of the company. EDP's owners could then sell the company for millions, and pocket a substantial sum free from class members' claims.[11] *See FTC v. EDebitPay et al.*, Case No. 2:07-cv-04880-ODW-AJW (C.D. Cal. March 5, 2013). The victims of

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[11] The Agreement falsely represents that "Defendants are presently unable to satisfy the $3.78 million judgment" against them in the FTC case. Agreement at p. 3. Similarly, the plaintiffs represent that the "[d]efendants have . . . produced confidential financial documents in this litigation confirming their inability to satisfy the $3.78 million contempt judgment." Pl. Mot. at 9-10. The defendants have paid the entire contempt judgment to the FTC, although creditors could attempt to claw back a substantial portion of that money through a subsequent bankruptcy process. Accordingly, the parties' claim that the defendants are unable to pay a larger settlement is without foundation.

EDP's unauthorized billing would receive none of this windfall.[12] Moreover, the Agreement guarantees the plaintiffs' lawyers' fees.

Accordingly, the settlement is fundamentally unfair, and the Court should reject it.

IV. Conclusion

Everyone involved in this settlement wins, except the class members, who would waive tens of millions of dollars in potential claims for little, if any, compensation. This result is not fair, adequate, and reasonable, and the settlement should not be approved.

Dated: August 9, 2013

Respectfully submitted,

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[12] The defendants' insurance policy has a $2 million limit, and the defendants represent that they have incurred $500,000 in legal fees. Thus, even the defendants' insurance company would benefit from the settlement by saving $500,000.

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