



How to Avoid “Coupon Settlements” in Class Actions

January 8, 2024

Introduction

Businesses embroiled in class action litigation regularly approach their counsel with a “great” settlement idea: “Let’s offer the class members a gift card for a discount on their next purchase!” Use of non-cash payments such as gift cards and credits have obvious potential benefits. For defendants, they can defer and lower the cost of settlement; for plaintiff’s counsel, they can help pave the way to settlement and recovery of an attorneys’ fee award.

But federal courts, tasked with protecting the interests of the absent class members during settlement, are skeptical of so-called “coupon settlements.” Class action settlements can still involve the use of non-cash payments—whether they are traditional coupons, gift cards, or credits—but the parties must structure settlements carefully to obtain court approval and avoid costly objections and appeals.

Background: Heightened Scrutiny of Coupon Settlements

In the Class Action Fairness Act of 2005 (“CAFA”), Congress found that “Class members often receive little or no benefit from class actions, and are sometimes harmed, such as where . . . counsel are awarded large fees, while leaving class members with coupons or other awards of little or no value. . . .” Pub. L. No. 109-2, § 2, 119 Stat. 4 (2005).

Supporting this conclusion, Congress cited an array of patently unfair settlements in class action cases, such as where class members received coupons for a \$30 discount on a future cruise, a \$5 voucher for future purchases of computer products, and a \$55 credit toward the future purchase of a crib from a manufacturer that allegedly sold defective cribs.

After CAFA, approval of a proposed settlement involving non-cash payments to class members consists of two separate inquiries. First, the district court must decide whether the settlement is fair to the class members in general. Second, the court must determine whether the non-cash payments are of such a nature that the settlement rises to the level of a “coupon settlement”; if it does, the court must apply specific rules that govern the award of attorneys’ fees.

As discussed below, it benefits counsel for both plaintiffs and defendants to present the court with a settlement that is not only fair, but one where non-cash components are structured so that the settlement does not amount to a “coupon settlement.”

Is the Settlement Fair, Reasonable, and Adequate?

Under CAFA, if a proposed settlement involves an award of “coupons” the district court may approve it “only after a hearing to determine whether, and making a written finding that, the settlement is fair, reasonable, and adequate for class members.” 28 U.S.C. 1712(e). Although CAFA’s text added little to the existing standard in Federal Rule of Civil Procedure 23, courts in the Ninth Circuit and elsewhere have routinely held that CAFA requires heightened judicial scrutiny of class action settlements based on “coupons.” *See, e.g., In re HP Inkjet Printer Litigation*, 716 F.3d 1173, 1178 (9th Cir. 2013).

After CAFA, it is a near guarantee the district court will closely scrutinize settlements involving any non-cash payments to class members, whether such payments look like coupons, gift cards, or credits. The court will analyze factors such as whether the non-cash benefit is transferable, can be converted to cash, and is likely to be used by class members. The same settlement may be fairer in cases with unique factors, such as where the defendant is in financial distress and the ability to make cash payments to a settlement fund are limited.

Consequences of a “Coupon Settlement”

Assuming the settlement is fair to the class, the district court must then determine whether the settlement amounts to a “coupon settlement” under CAFA. Counsel for both plaintiffs and defendants should structure settlements to avoid such a characterization if at all possible. Coupon settlements are typically less enticing to plaintiffs’ counsel, will require additional work and expense to push through, and open the door for class members to object to the fee calculations involved.

The main consequence of “coupon settlements” is that they require the court to employ a specific set of rules to determine the amount of attorneys’ fees awarded to plaintiffs’ counsel. Specifically, CAFA requires that any fee “attributable to the award of the coupons [] be based on the value to class members of the coupons that are *redeemed*.” 28 U.S.C. § 1712(a) (emphasis added).

As a result of this provision in CAFA, if the settlement is deemed to be a “coupon settlement” the acceptable amount of attorneys’ fees awardable to plaintiff’s counsel will almost certainly be lower. Coupon settlements also make fees more complex and expensive to calculate. In establishing the actual redemption value of the coupons, gift cards, or other non-cash components, counsel for both parties will typically need to engage in additional analysis and may need to present expert testimony.

Is the Settlement a “Coupon Settlement”?

While CAFA does not define the phrase “coupon settlement,” the Ninth Circuit in *In re Online DVD-Rental Antitrust Litigation*, 779 F.3d 934, 950-951 (9th Cir. 2015), adopted a three-part test to assess whether a settlement fit that description. The test asks the following:

1. whether class members have to hand over more of their own money before they can take advantage of a credit;
2. whether the credit is valid only for select products and services; and
3. how much flexibility the credit provides, including whether it expires or is freely transferable.

In *Online DVD*, for example, the Ninth Circuit held that the district court did not err in finding that a proposed settlement was not a “coupon settlement” under CAFA. The settlement provided each class member \$12 which they could elect to receive in cash or in the form a gift card to Wal-Mart. The gift cards were freely transferable and had no expiration date.

In the most recent published decision from the Ninth Circuit on this issue, *McKnight v. Hinojosa*, 54 F.4th 1069, 1075 (9th Cir. 2022), the court again applied the *Online DVD*

factors to hold that the district court did not err in concluding that a settlement was not a “coupon settlement” under CAFA. There, the plaintiffs asserted that Uber had misled customers about its safety measures and driver background checks, inducing them into paying a “Safe Rides Fee” when using its services. The parties eventually proposed a \$32.5 million settlement that was likely to pay about \$1.07 to each class member.

The settlement had a non-cash component. Class members had the option to receive an up-front payment in cash by submitting a claim form. However, class members that did not do so would receive a credit to their Uber account. If the credit went unused for one year, Uber agreed to make a one-time attempt to remit payment in cash to the class member.

The *McKnight* Court concluded that the proposed settlement met the first and third *Online DVD* factors. The ability of the class members to receive the payment in cash and the fact the credit automatically became cash after one-year figured prominently in the court’s analysis. The court held that the settlement did not meet the second factor, since the credit could only be used for Uber’s products. However, since the settlement met two out of three *Online DVD* factors, the Ninth Circuit held the district court did not err in concluding the settlement was not a “coupon settlement” under CAFA.

Recommendations

To avoid the characterization of a proposed settlement as a “coupon settlement,” counsel should seek to meet as many of the following criteria as possible:

- Class members should have the option of choosing between the non-cash benefit and cash.
- The benefit should be transferable to third persons.
- The benefit should be convertible to cash, either directly with the defendant or through a third party.
- The benefit should have no expiration or a long expiration period (three years has been held to be appropriate).
- The benefit should be something that is likely to be used by class members.
- Class members should be able to purchase more than one product with the benefit.
- Class representatives should receive the same non-cash award as other class members. (They may additionally receive incentive awards in cash.)

In some cases, it is inadvisable to propose a settlement involving non-cash benefits since it will draw too many red flags. This is particularly true in cases where the plaintiffs have alleged that the defendant’s product is defective, dangerous, or worthless, and the

gift card or other coupon can only be used by class members to purchase more of the defendant's products.

Conclusion

The parties and their counsel can take advantage of the benefits of non-cash payments and still avoid a ruling that a settlement is a "coupon settlement." The best way to do so is by structuring non-cash payments in ways that make them as cash-like, user-friendly, and flexible as possible. While what is appropriate in a given case will depend on the specific facts and the nature of the claims, common sense plays a prominent role in predicting what settlements will avoid classification as coupon settlements.

William P. Keith is a trial attorney at Klein & Wilson in Newport Beach, CA. He represents businesses of all sizes in class actions and business litigation matters.