UNITED STATES DISTRICT COURT
DISTRICT OF CONNECTICUT

CHRISTOPHER WILSON, Individually and on behalf of a class of persons similarly situated, et al., Plaintiffs, v. DIRECTBUY, INC., UNITED CONSUMERS CLUB, INC., and DIRECTBUY HOLDINGS, INC., Defendants.	Case No.: 3:09-CV-00590 (JCH)

OBJECTION OF CLASS MEMBER BRADLEY HEBERT
AND NOTICE OF INTENT TO APPEAR

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INTRODUCTION

Class member Bradley Hebert objects to the proposed settlement of this case because it would provide a windfall release to DirectBuy but little or no benefit to the class. Under the terms of the agreement, 405,735 class members will release their claims in exchange for nothing at all. The remaining 430,318 members of the class will receive an extended DirectBuy membership that will not provide value unless a class member makes a purchase from DirectBuy during the extended membership period. But the parties have not shown that class members have any need or desire to purchase products from DirectBuy during an extended membership period. Moreover, the settlement does nothing to remedy the alleged misleading practices on which the complaint is based. Indeed, to take advantage of the extended membership, class members would have to pay to DirectBuy the very fees that are the basis for the complaint.

In exchange for this dubious relief, the settlement would provide DirectBuy with a vastly overbroad release of the class's claims, including claims raised in other pending class actions that were neither alleged nor the subject of settlement negotiations here. Moreover, the settlement purports to release DirectBuy from liability even for wrongdoing that is not yet known to the class. Class members should not be required to waive their right to bring other actions for which they have not received representation or consideration.

Because the settlement provides no value, it is not "fair, reasonable and adequate" as required by Fed. R. Civ. P. 23(e), and the Court should deny final approval.

BACKGROUND

A. The Underlying Class Actions

Defendant DirectBuy, Inc. aggressively markets itself, through infomercials and other forms of advertising, as providing its members the opportunity to buy "direct" from the manufacturer without "hidden fees" or retail "markups." Doc. 1 ¶¶ 1, 29, 48; Doc. 107-2 ¶ 12; *see also* http://directbuy.com/faq/. DirectBuy lures customers to an "Open House" with promises of prizes and "guaranteed" free gifts but, according to the West Virginia Attorney General, does not honor those promises. Doc. 107-2 ¶¶ 17-20. Instead, the company subjects customers to a high-pressure ninety-minute sales presentation. *Id.* ¶¶ 21-26. Only at the end of the presentation does DirectBuy disclose its membership fees, which are at least several thousand dollars and in some states as high as nearly $7,000.[1] Customers are told that they must pay the fee before leaving the store or be barred from membership. *Id.* ¶¶ 27-37; *see also* Consumer Reports, *With DirectBuy, It Will Cost You a Lot to Save*, Sep. 13, 2007, *available at http://news.consumerreports.org/home/2007/09/with-directbu-1.html*.

Many people who join soon conclude that DirectBuy's selection and prices are not as good as the company's testimonials led them to expect. Doc. 107-2 ¶¶ 42-48. Despite the company's promises of "direct" pricing without "markups" or "hidden fees," members discover that DirectBuy in fact charges more for products than it pays manufacturers for those same products. Doc. 1 ¶ 49. DirectBuy also imposes various fees on purchases, including an 8% "handling fee." Doc. 137 at 19. Because DirectBuy does not pass on to members manufacturers'

[1] DirectBuy's fees are not publicly available. Mr. Hebert paid $5,000 for his membership in Louisiana. Exh. 1, attached. West Virginia alleges that DirectBuy charges up to $5,795.95 in that state. Doc. 107-2 ¶ 14. California consumers who attended open houses there have reported a fee of $6,990. *See* http://www.yelp.com/biz/directbuy-mountain-view.

discounts, rebates, and fees, members pay more for products purchased through DirectBuy than they would have paid had they purchased "direct" from the manufacturer.

This case challenges DirectBuy's practice of accepting manufacturers' discounts without disclosing them to members, raising RICO and unjust-enrichment theories. In addition, four other pending cases seek class-wide relief against DirectBuy based on the company's sales practices. Doc. 137-1 ¶¶ 23-26. These cases raise claims under a variety of theories, including breach of contract, fraud, unjust enrichment, and violation of various state unfair competition, false advertising, and discount buyers' club laws. Many of the practices challenged and theories asserted in the other cases were never raised here. Nevertheless, the proposed settlement would release DirectBuy from all these claims. Doc. 128-3 at 5. It also purports to release DirectBuy from *unrelated* claims based on anything DirectBuy has done "at any time before the Final Settlement Date." Doc. 64-1 ¶ III.B.1. The settlement's plain language even releases claims that are unknown to class members—class members "assume the risk" that they "may hereafter discover facts different from or in addition" to those asserted in the case. *Id.* Indeed, DirectBuy takes the position that the release forecloses actions by state attorneys general to enforce their consumer protection laws. On that basis, it has obtained an order from Judge Garfinkel enjoining a pending action by West Virginia seeking injunctive relief and restitution for its citizens. Doc. 89.

B. Negotiation of the Proposed Settlement

The complaint in this action was based on the same claims that class counsel brought on behalf of a putative nationwide class but settled on behalf of the named plaintiffs on terms that have not been disclosed. *Ponzi v. DirectBuy, Inc.*, No. 08-1274 (D. Conn., dismissed Feb. 20,

2009). Less than two months after the dismissal of *Ponzi*, class counsel filed the complaint in this case, and the parties quickly agreed to enter mediation. Although counsel for plaintiffs in other cases against DirectBuy sought to participate in the negotiations, DirectBuy preferred to negotiate only with class counsel in this case. *See* Doc. 137 at 7 ("Defendants ultimately decided not to involve counsel from the Other Cases in the settlement process."). Class counsel engaged in no formal discovery, but apparently conducted some informal investigation consisting of interviews of DirectBuy executives and review of certain documents that DirectBuy made available under a strict confidentiality agreement. Based on this informal investigation, which class counsel characterizes as "confirmatory discovery," class counsel entered into the Settlement Agreement that was filed with the Court on December 9, 2010. Doc. 64-1.

C. The Proposed Settlement Agreement

There are 836,053 individuals or married couples in the settlement class, divided between 407,682 "Current DirectBuy Members" and 428,371 "Former DirectBuy Members." Doc. 137 at 23.[2] Under the terms of the proposed settlement, Current DirectBuy Members will release all of their claims against DirectBuy in exchange for a two-month extension of their membership and an opportunity to purchase a 28-month membership renewal for the price of a 24-month renewal, or a 13-month membership renewal for the price of a 12-month renewal. Former DirectBuy Members will release all of their claims against DirectBuy in exchange for two months of DirectBuy membership and a chance to renew their membership thereafter by paying $200 a year, but only if they submitted a completed registration form by March 14, 2011. Only "22,636 Former DirectBuy Members submitted timely Registration Forms." Doc. 137 at 26. Thus, if the

[2] On page 23 of the Memorandum in Support of Approval, class counsel states that "there are 407,682 Current DirectBuy Members," but on page 24, class counsel uses a figure of 407,862.

settlement is approved, the other 405,735 Former DirectBuy Members (48.5% of the total settlement class, and 95% of the Former DirectBuy Members) will receive nothing from the proposed settlement, although they will release all of their claims against DirectBuy.

The settlement also provides for an award of $816,000 to class counsel for attorney's fees and costs and incentive payments of $4,000 to each of the named class representatives. Mr. Hebert recognizes that reasonable incentive awards are sometimes appropriate to compensate class representatives for the time spent performing duties that are not undertaken by absent class members, including time spent in depositions and responding to other discovery. But because named plaintiffs "may be tempted to accept suboptimal settlements at the expense of the class members," *Weseley v. Spear, Leeds & Kellogg*, 711 F. Supp. 713, 720 (E.D.N.Y. 1989), courts must carefully scrutinize incentive awards. *Clement v. American Honda Finance Corp.*, 176 F.R.D. 15, 25 (D. Conn. 1997), citing *Holmes v. Continental Can Co.*, 706 F.2d 1144, 1147-48 (11th Cir. 1983). The size of the proposed incentive awards in this settlement underscore the unfairness of the settlement to the 405,735 absent class members who will release their claims in exchange for nothing, and to the other 430,318 class members who will release their claims in exchange for nothing more than an extended period of time in which to do business with DirectBuy.

IDENTITY OF OBJECTOR AND INTENT TO APPEAR

These objections are filed on behalf of class member Bradley Hebert. *See* Declaration of Bradley Hebert, attached as Exhibit 1. Mr. Hebert purchased a DirectBuy membership for $5,000. He was dissatisfied with DirectBuy and has never used his membership, yet DirectBuy refused to refund any portion of Mr. Hebert's initiation fee. Mr. Hebert's declaration contains all

of the information required by paragraph 14 of the preliminary approval order. Doc. 65. Mr. Hebert intends to appear at the Final Approval Hearing through counsel and present argument in support of his objections.

STANDARDS UNDER RULE 23(e)

A district court may approve a class action settlement "only after a hearing and on finding that it is fair, reasonable, and adequate." Fed. R. Civ. P. 23(e)(2). The settling parties bear the burden of showing that the settlement meets this standard. The purpose of this requirement is "the protection of those class members . . . whose rights may not have been given due regard by the negotiating parties." *Officers for Justice v. Civil Serv. Comm'n*, 688 F.2d 615, 624 (9th Cir. 1982). The proposed settlement here requires a higher level of scrutiny because it was reached prior to class certification, *see Amchem Prods., Inc. v. Windsor*, 521 U.S. 591, 620-21 (1997); *In re GM Corp. Pick-Up Truck Fuel Tank Prods. Liab. Litig.*, 55 F.3d 768, 787-88 (3d Cir. 1995); *Weinberger v. Great N. Nekoosa Corp.*, 925 F.2d 518, 520 (1st Cir. 1991), and because of the inherent tension attributable to class counsel's self-interest in achieving a settlement that, like this one, involves a substantial fee. *See Staton v. Boeing Co.,* 327 F.3d 938, 959-60 (9th Cir. 2003).

The Second Circuit has recognized nine factors to guide courts in evaluating the substantive fairness of a proposed settlement:

> (1) the complexity, expense and likely duration of the litigation, (2) the reaction of the class to the settlement, (3) the stage of the proceedings and the amount of discovery completed, (4) the risks of establishing liability, (5) the risks of establishing damages, (6) the risks of maintaining the class action through the trial, (7) the ability of the defendants to withstand a greater judgment, (8) the range of reasonableness of the settlement fund in light of the best possible

> recovery, (9) the range of reasonableness of the settlement fund to a possible recovery in light of all the attendant risks of litigation[.]

City of Detroit v. Grinnell Corp., 495 F.2d 448, 463 (2d Cir. 1974) (internal citations omitted). Other circuits rely on the same or similar factors. *See, e.g., In re Katrina Canal Breaches Litigation*, 628 F.3d 185, 194-95 (5th Cir. 2010) (listing six factors to guide a court's review of a class action settlement agreement). But no matter how the factors are set out, the essence of the inquiry is whether the settlement reflects a reasonable compromise in light of the prospects of further litigation. A critical element of this analysis, particularly in cases such as this one where the class seeks a monetary recovery, is consideration of the value of the proposed settlement in comparison to an appropriately discounted valuation of the possible recovery if the case were to proceed to judgment and the fairness of the distribution of any benefits among the class members.

Such an analysis is particularly difficult where the value of in-kind relief, like the extended membership periods provided by this settlement, is not apparent from the face of the agreement. Although class counsel claims that the settlement has value to class members who would otherwise pay a fee to extend their DirectBuy membership, an extended membership has value only if it is used in a way that benefits the member. Class members may not need or want to buy anything from DirectBuy during the short period during which their memberships are extended. And even class members who do make a purchase during that period will not necessarily enjoy any benefit, given that many products available from DirectBuy are no cheaper than the same products purchased from traditional or Internet-based retailers.

The Court has a responsibility to ensure that the settlement provides real value by offering relief that has value to the class. *See* 2003 Advisory Committee Notes, Fed. R. Civ. P. 23(h) ("Settlements involving nonmonetary provisions for class members also deserve careful scrutiny to ensure that these provisions have actual value to the class."); Class Action Fairness Act, 28 U.S.C. § 1712(e) (setting standards for judicial scrutiny of coupon settlements); *True v. American Honda Motor Co.*, 2010 WL 707338, *12 (C.D. Cal. Feb. 26, 2010) ("Although the 'fair, reasonable, and adequate' language used in section 1712(e) is identical to the language relating to settlement approval contained in Fed. R. Civ. Pro. 23(e)(2), several courts have interpreted section 1712(e) as imposing a heightened level of scrutiny in reviewing such settlements."). As explained below, the Court should deny final approval of the proposed settlement in this case because the settling parties have failed to demonstrate that the settlement will benefit the class, and because class counsel has overstated the weakness of the claims being released.

ARGUMENT

I. The Settlement Provides Little or No Benefit to Members of the Class.

A. The 405,735 Former DirectBuy Members who did not register will receive nothing.

About 48.5% of the total class, and 95% of the subclass of Former DirectBuy Members, will receive no benefit at all from the proposed settlement because they did not submit a registration form by the March 14, 2011, deadline. The settling parties provide no explanation for requiring the subclass of Former DirectBuy Members to submit a registration form to be eligible for relief while the subclass of Current DirectBuy Members had no such requirement,

and there is no principled reason for treating the subclasses differently.[3] A settlement that provides no benefit to nearly half the class is not fair and should be rejected.

It is not surprising that so few Former DirectBuy Members registered for the membership extension. First, registration rates may have been low because of problems with the notice. As described in the Declaration of Shannon R. Wheatman, Ph.D. (Doc. 107-4), the email notice is deficient because important information is missing. For example, although the email notice states that Former DirectBuy Members will receive two months of DirectBuy membership "upon filing a timely and complete Registration Form," the email notice did not mention the deadline for registration and did not give any indication that the registration period was open. *See* Doc. 107-4 at 19. Former DirectBuy Members could learn of the deadline only if they went to the password-protected website and waded through multiple pages of dense legalese, because the deadline for filing a registration form is not mentioned until page five of the long form notice.

Second, many Former DirectBuy Members may have chosen not to register for the membership extension because they view the available relief as having such little value that it was not worth the time or effort to submit the form. Indeed, as explained below, a membership extension is worthless to any class member who does not need or want to purchase particular kinds of products from DirectBuy during the extended membership period, and former DirectBuy Members who have let their memberships lapse are particularly unlikely to want to make such

[3] The creation of subclasses often raises serious conflict-of-interest issues that may require separate counsel for each subclass. *See, e.g., Diaz v. Romer*, 961 F.2d 1508, 1511 (10th Cir. 1992) (upholding district court's order creating subclasses with separate counsel where proposed consent order settling class action created a conflict of interest between two parts of the class); *see also* Fed. R. Civ. P. 23(c)(5) (allowing court to create subclasses "[w]hen appropriate"). The creation of de facto subclasses, especially without adequate explanation of the reasons for treating the subclasses differently, is yet another reason why the proposed settlement is not fair and should be rejected.

purchases. Thus, the low registration rate among Former DirectBuy Members likely indicates dissatisfaction with DirectBuy and a lack of interest in using the service again.

B. The membership extension provided to half the settlement class has little or no value.

1. In general, coupon settlements are disfavored.

Non-cash coupon settlements, which offer class members a chance to get a discount or rebate on future purchases from the defendant, have been widely criticized by Congress, courts, and commentators—and for good reason. As Congress noted when it enacted the Class Action Fairness Act of 2005: "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. 109-2, § 2(a)(3), *codified at* 28 U.S.C. § 1711, note (Findings and Purposes at (a)(3)); s*ee also True*, 2010 WL 707338, *12 (acknowledging "the wide range of judicial and scholarly criticism of coupon settlements" and listing "three common problems" with such settlements); *Kearns v. Ford Motor Co.*, 2005 WL 3967998, *1 n.1 (C.D. Cal. Nov. 21, 2005) (coupon settlements "produce hardly any tangible benefits for the members of the plaintiff class, but generate huge fees for the class attorneys"); *In re Compact Disc Minimum Advertised Price Antitrust Litig.*, 216 F.R.D. 197, 221 (D. Me. 2003) ("[A] settlement is not fair where all the cash goes to expenses and lawyers, and the members receive only discounts of dubious value."); *Clement*, 176 F.R.D. at 27 (disapproving settlement that provided coupons as a credit against class members' next purchase or lease of a Honda because "the coupons are essentially worthless to class members"); Miller &

Singer, *Nonpecuniary Class Action Settlements*, 60 Law & Contemp. Probs. 97, 108 (1997) (for many class members, "the right to receive a discount will be worthless").

As the National Association of Consumer Advocates explains in its *Standards and Guidelines for Litigating and Settling Consumer Class Actions*, 255 F.R.D. 215, 235 (2009), coupon settlements should be avoided because:

> 1. Except in unusual circumstances, there is usually no principled reason why delivery of cash settlements cannot be achieved, aside from the fact that the defendant prefers not to do so.
>
> 2. For most of the class, redemption may not be an option, because they are unwilling or unable to make a future purchase from the defendant. Thus the class members are not equally compensated—some get more, others get less. This situation is at its most aggravated when the certificate requires purchase of a new car or other "big ticket" item.
>
> 3. Even where the coupon is for a small ticket item or is freely transferable, the defendant may be able to use its specialized knowledge of the industry to recover the cost of the coupon in the marketing of the relevant product.
>
> 4. Policy considerations disfavor rewarding the wrongdoing defendant with new sales from the victims of its illegal practices.

All of these factors disfavor the approval of the proposed settlement in this case. Moreover, as discussed below, the membership extension program proposed here suffers from additional shortcomings.

2. The extended membership program cannot benefit class members who do not make a future purchase from DirectBuy, and, even for those who do, there is no evidence that the membership has value.

"In ascertaining the fairness of a coupon settlement, the Court is to 'consider, among other things, the real monetary value and likely utilization rate of the coupons provided by the settlement.'" *True*, 2010 WL 707338, *16 (quoting S. Rep. No. 109-14, at 31, as reprinted in

2005 U.S.C.C.A.N. 3, 31). The extended membership period available to about half the class lacks value unless the class member uses the membership to make a purchase, but class counsel has provided no estimate of how many class members can reasonably be expected to make a purchase from DirectBuy during the extended membership periods.

Furthermore, even for class members who make a purchase during the extended membership period, there is no evidence that they will receive any value from this settlement because there is no evidence that members—many of whom have expressed dissatisfaction with the prices and selection that DirectBuy offers and the fees that it charges—have any need or desire to purchase products from DirectBuy during the period during which their memberships are extended, or that they will save any money from these purchases. Indeed, offering class members nothing more than an opportunity to engage in further business with DirectBuy under the same conditions challenged as unlawful in the underlying lawsuits cannot possibly constitute a fair settlement.

Class counsel argues that the settlement has a value of at least $14.3 million based on an average membership renewal price of $16.67 per month and the two months of automatic membership renewal that will be provided to the 407,682 Current DirectBuy Members and the 22,636 Former DirectBuy Members who submitted registration forms. Doc. 137 at 24-26. Class counsel's valuation of the settlement is specious because it does not estimate the number of class members who will use the membership extension, and it does not acknowledge that those who do will not necessarily realize any savings on the products they purchase. Thus, contrary to class counsel's assertion, there is no evidence that the settlement has any value to the class.

Moreover, class counsel claims that the settlement is substantively fair by equating the consumer cost of a DirectBuy membership renewal with cash paid by defendants in other cases and comparing that figure with the dollar amount gained by DirectBuy as a direct result of the conduct alleged to be unlawful in this case. *See* Doc. 137 at 34-35, 40. The errors of class counsel's argument are plain. Extending membership for people who would otherwise have let membership lapse costs DirectBuy nothing, and any membership extensions used to make purchases will result in revenue for DirectBuy. Further, DirectBuy is not required to disgorge any of its ill-gotten gains; indeed, the settlement does not even require that DirectBuy change its practices. Nevertheless, as described in greater detail below, DirectBuy will receive a broad release from liability for any claims that could have been brought in this case, without having to pay a cent to any of the 836,053 absent class members. Such a result is not fair, reasonable, or adequate. *See In re Katrina Canal Breaches Litigation*, 628 F.3d at 195-96 (rejecting $21 million class settlement because there was no assurance that the class would receive any monetary benefit after costs were paid); *In re Compact Disc Minimum Advertised Price Antitrust Litig.*, 216 F.R.D. at 220-21 (rejecting settlement for discount coupons not shown "to have any significant benefit to the members of the class as a whole or any measurable detriment to the defendants"); *Clement*, 176 F.R.D. at 28 (rejecting settlement where the value of the coupons was "too speculative" and there was "a strong danger that the settlement will have absolutely no value to the class").

C. The settlement does not remedy the misleading practices on which the claims in the complaint are based.

Not only does the proposed settlement provide class members with little or no compensation, but it provides no injunctive relief that would address the practices giving rise to this case. DirectBuy now concedes that it often charges its members for products at rates that are *higher* than the prices it pays for those products because DirectBuy receives "early-pay" discounts from manufacturers and suppliers that reduce the actual cost of products by 1-2%. Doc. 137-2, Exh. 1 ¶ 11. These discounts are "standardized and set by each supplier and are generally available to all customers of a particular supplier." *Id.* ¶ 4. But although DirectBuy requires customers to pay in full at the time of purchase, it charges them the higher price that would have applied had they paid late and pockets the difference in price. Moreover, DirectBuy accepts fees from manufacturers and suppliers as "promotional allowances" that it does not pass on to its members. *Id.* ¶ 10. DirectBuy admits that it has earned $53 million in early-pay discounts and promotional allowances during the class period. Doc. 137-2, Exh. 3 ¶¶ 3-4. The settlement does nothing to prevent DirectBuy from continuing to pocket a portion of its members' payments. Indeed, class members who take advantage of the extended memberships offered by the settlement would, if they made use of the memberships, have no choice but to pay DirectBuy the fees that are at the heart of the complaint in this case. The settlement would thus further the alleged wrongdoing on which the complaint is based.

Moreover, the settlement fails to require DirectBuy to disclose the practice to members. As DirectBuy has itself contended, the desire to avoid "traditional retail markup . . . is the fundamental reason on which people rely in deciding to join DirectBuy." Doc. 1 ¶ 26. Yet

DirectBuy now concedes that it "did not uniformly disclose that it received and kept" early-pay discounts and promotional fees until early 2009. Doc. 137-2, Exh. 1 ¶ 7. The settlement does not require that DirectBuy provide better notice. Rather, class counsel relies on DirectBuy's voluntary, mid-litigation decision to disclose the practice in its "Membership Guide," a voluminous collection of materials that is "incorporated by reference" into the membership agreement. Doc. 137 at 16, 18; *see also* Doc. 107-2 ¶¶ 39-40. But members receive the guide only at the end of DirectBuy's high-pressure sales presentations, and because they are pressured to decide whether to join before leaving the store, they are not given an opportunity carefully to review it before making their decision. Doc. 107-2 ¶¶ 39-40. Indeed, contrary to the membership agreement's representation that the member has received and reviewed the guide, West Virginia's complaint alleges that members do not receive the guide until *after* they have already signed the agreement. *Id.* At the same time, DirectBuy continues to blanket the media with advertisements of "direct" prices and "no markup." *See* https://franchise.directbuy.com/resource_center/ad_campaigns.html (examples of DirectBuy's advertising).

Even assuming DirectBuy's voluntary disclosure were adequate, it would not render the settlement fair. Although DirectBuy admits that it did not begin making the disclosure until mid-2009, after the complaint was filed, the settlement releases the claims of anyone who was a DirectBuy member at any time since October 2002. The settlement would thus release the claims of members who never received the disclosure. Moreover, because the proposed settlement includes no injunctive relief, nothing would stop DirectBuy from removing the disclosure as soon as the settlement is approved.

II. The Parties Have Not Demonstrated that the Claims Lack Merit.

A. Class counsel devotes much of its briefing in support of the settlement to its position that the case would "arguably face substantial hurdles" based on DirectBuy's anticipated defenses. Doc. 137 at 14. Class counsel first argues that DirectBuy does not keep promotional pricing fees or shipping or handling charges as "profit," but uses the money to pay for mailings to its members and "to offset the franchisees' cost of operations." *Id.* at 12, 19. Class counsel does not explain how DirectBuy's claims, even if true, would be a defense to allegations that the company falsely advertised that it does not charge *any* markup.

DirectBuy itself recognizes fees from manufacturers as a form of markup and thus prohibits its franchisees from accepting manufacturer fees, rebates, discounts, or other payments. Doc. 1 ¶ 29. DirectBuy also recognizes that raising prices to cover the cost of operations is a form of markup, and advertises the lack of such markup as an advantage of membership. *See* DirectBuy Informercial, https://franchise.directbuy.com/resource_center/ad_campaigns.html ("Infomercial" link) ("That's money coming right out of your family's pockets and going toward the retailer's overhead, advertising, and their sales people, as well as their profit. DirectBuy members skip all that."). Indeed, in *Manufacturer Direct LLC v. DirectBuy, Inc.*, DirectBuy defended its termination of its contract with a franchisee on the ground that the franchisee had "defrauded the public" by marking up prices on kitchen cabinets to cover overhead expenses. Def.'s Mem. Opp. Mot. Prelim. Inj. at 1, No. 05-451 (N.D. Ind. Jan. 31, 2006) (Doc. 21). In response to the franchisee's argument that it charged the higher price only to defray payroll expenses and pay other bills, DirectBuy's General Counsel C. Joseph Yast wrote that paying bills is "just what retailers do with the markups they add to the merchandise they sell." DirectBuy's

Post-Hearing Reply Br. at 2 n.3, *Manufacturer Direct*, No. 05-451 (Feb. 7, 2006) (Doc. 33). The court agreed with DirectBuy, noting that "markup" is defined as "an amount added to the cost price to determine the selling price" and finding a "substantial likelihood that [DirectBuy] could prove at a trial that [the franchisee] did indeed charge its members 'markups' on custom cabinets." *Manufacturer Direct*, 2006 WL 319254, at *3.

B. Class counsel argues that DirectBuy relied on a 2007 memorandum from its counsel—ironically, the same C. Joseph Yast who characterized raising prices to cover overhead as a form of "markup"—concluding that taking prompt-pay discounts and advertising allowances was "acceptable." Doc. 137 at 14. Although the memorandum has not been made public and class counsel does not disclose the reasons for Yast's advice, the portion of the memorandum quoted by class counsel does nothing to undercut the claims in the complaint. Like the complaints in the other pending cases, the complaint here does not allege that accepting discounts and fees is itself illegal. Rather, it alleges that DirectBuy misled consumers by accepting such discounts and fees while advertising that it does not charge a markup. Moreover, even assuming that advice of counsel is a defense to civil liability under RICO, it would not be a defense to the claims of unjust enrichment, unconscionability, and violations of consumer-protection statutes alleged in the pending class actions.

C. Class counsel next argues that the misrepresentations regarding prompt-pay discounts and advertising allowances alleged in the complaint may not have been material to DirectBuy members because the amounts were de minimis. Doc. 137 at 14-15. But DirectBuy concedes that it has earned about $53 million from these fees—hardly a "de minimis" amount. *Id.* at 11, 12, 14. Given that, even assuming substantial savings, DirectBuy members must purchase tens of

thousands of dollars of merchandise before saving enough to recoup the several-thousand-dollar membership fee, an individual member paying undisclosed fees of 1% or 2% could easily have paid hundreds of dollars extra. Consumer class actions are commonly brought over much smaller loss per class member. Indeed, a central purpose of the class action device is to allow class members to vindicate their interests in claims that would be too small to support individual actions. *See* Doc. 1 ¶ 21 ("A class action is superior to all other available methods . . . because the damages suffered by the individual Class members are relatively small (as compared to the cost of litigation) . . . .").

The claim by DirectBuy's CEO that he is "not aware" of any members who declined to join or sought to revoke their memberships after learning of the fees, Doc. 137-2, Exh. 1 ¶ 14, is not evidence that members consider the fees immaterial. Members are unlikely to have learned about the fees before joining because DirectBuy did not disclose the fees before mid-2009 and, since then, has disclosed them only as part of a voluminous handbook that is presented following a high-pressure sales presentation. Doc. 107-2 ¶¶ 39-40; Doc. 137-2, Exh. 1 ¶ 7. Moreover, members who discovered the fee *after* joining could not cancel their memberships because DirectBuy does not allow cancellations. In any event, whether undisclosed fees retained by DirectBuy were material to particular members' decisions to join is beside the point because those members still have a claim for reimbursement of money that DirectBuy fraudulently earned at their expense.

D. Class counsel's conclusion that DirectBuy's defenses are strong is based on evidence that is shrouded in secrecy. As noted in footnote one of class counsel's memorandum in support of approval (Doc. 137 at 1), "[a]ll of the documents cited in this memorandum, which DirectBuy

contends contain proprietary and confidential information of DirectBuy, are in Plaintiffs' Counsel's possession and are available for an *in camera* review[,]" but the class members and counsel for plaintiffs in all the other actions are apparently supposed to defer to class counsel's conclusion that "Defendants produced significant evidence during the [informal and strictly confidential] discovery process that a jury could believe that, if credited, would greatly weaken Plaintiffs' claims." *Id.* at 10. Similarly, class counsel asserts that "DirectBuy has produced evidence to Plaintiffs' Counsel which a jury arguably could conclude undermine the merit of the[] allegations" made in the other cases (*id.* at 16), but, again, class counsel cannot share that information. With respect to allegations that DirectBuy marked up the prices it charged to club members from the prices DirectBuy paid to its suppliers, class counsel concludes that the claims are without merit, but drops a footnote admitting that "[t]here are two types of minor price adjustments that sometimes occur between invoice price and the price charged to members. Although DirectBuy will not allow Plaintiffs to submit this information to the Court under the Confidentiality Agreement, Plaintiffs have reviewed this evidence and it supports approval of the Settlement as a jury could reasonably accept that it cannot reasonably be construed to be evidence of improper merchandise charges which benefit DirectBuy." *Id.* at 22, n.7. The Court should not approve a settlement in this case, which releases claims made in other cases, based on evidence that is not open to scrutiny by the Court or counsel in other cases that the parties here seek to dismiss.

Indeed, the entire process of settling this case has proceeded in the dark. The documents produced during informal discovery are confidential, DirectBuy refused to negotiate with any counsel other than class counsel in this case, and the settlement agreement requires that counsel

"not issue any press releases, post information on any website or blog, or initiate any contact, direct or indirect, with the public media, (i.e. traditional print media, television or other broadcast media, electronic, or internet media) in any way related to the Action and/or the Settlement." Doc. 64-1 at 26. Inexplicably, even the settlement website is password protected. *See* Wheatman Declaration, Doc. 107-4 at 5 ("I have reviewed over a thousand class action notices over the past 11 years and I have never seen a password protected case website."). Given the extraordinary level of secrecy, class counsel's assertions that the risks of litigation justify such a paltry settlement must be taken with a grain of salt.

III. The Release Is Vastly Overbroad and Releases Claims Not Alleged in the Complaint Without Consideration.

In addition to this case, DirectBuy's sales practices are the subject of four other pending class action lawsuits and a suit by the Attorney General of West Virginia.[4] These cases do not raise the RICO claims central to this case, but instead allege violation of various state unfair competition, false advertising, and discount buyers' club laws, as well as breach of contract, fraud, and unjust enrichment. In addition to the prompt-pay discounts and promotional allowances challenged here, the cases challenge four general categories of marketing practices that have not been raised in this case:

1. Claims that DirectBuy failed to disclose various fees, including fees for shipping and "handling," or disclosed those fees in a misleading way. *West Virginia* Compl. ¶¶ 60-70; 93-98; *Randall* Compl. ¶ 36; *Vance* Compl. ¶¶ 28-30; *Gazener* Compl. ¶ 16.

[4] The cases are *Ganezer v. DirectBuy, Inc.*, No. 08-8666 (C.D. Cal., filed Dec. 2, 2008); *Swift v. DirectBuy, Inc.*, No. 09-4067 (E.D.N.Y., filed Sept. 21, 2009); *Vance v. DirectBuy, Inc.*, No. 09-1360 (S.D. Ind., filed Oct. 20, 2009); *Randall v. Evamor, Inc.*, No. 09-03852 (Cir. Ct. St. Louis County Mo., filed Oct. 29, 2009); and *West Virginia v. DirectBuy, Inc.*, No. 11-140 (Cir. Ct. Kanawha County W. Va., filed Jan. 26, 2011).

2. Claims that DirectBuy's high-pressure sales tactics—including its demand that members sign the membership agreement immediately or be barred from membership—are false, misleading, coercive, or unconscionable. *West Virginia* Compl. ¶¶ 71-83, 85-92; *Randall* Compl. ¶¶ 10-13, 23; *Swift* Compl. ¶ 64; *Ganezer* Compl. ¶¶ 10-17.

3. Claims that DirectBuy falsely advertised a free 30-day trial membership and falsely promised free gifts and promotions for attending an "Open House." *West Virginia* Compl. ¶¶ 99-110.

4. Claims that DirectBuy's contracts are unconscionable because they provide little savings to members or savings that are disproportionate to the exorbitant membership fee. *West Virginia* Compl. ¶¶ 60-70; *Vance* Compl. ¶¶ 28-30; *Randall* Compl. ¶ 54(a); *Swift* Compl. ¶¶ 62-63, 66-67, 77, 81, 93.

Like the claims in this case over early-payment fees and promotional allowances, none of these alleged wrongful practices are remedied by the settlement. Nevertheless, the settlement would release *all* claims against DirectBuy that "could have" been included in the class action. It would thus release claims in other pending class actions that were neither alleged nor the subject of settlement negotiations here. Doc. 128-3 at 5. Moreover, the settlement purports to completely release DirectBuy from liability to class members based on anything it has done "at any time before the Final Settlement Date," even for claims a class member "does not know or suspect to exist." Doc. No. 64-1 ¶ III.B.1. According to the settlement, class members "assume the risk of the possible discovery of such additional or different facts. *Id.* If, for example, it is later revealed that DirectBuy has engaged in massive, previously undisclosed fraud against its members, the plain language of the settlement would foreclose any remedy against the company, even if class

members could not have known about the fraud at the time the agreement was entered. Class members should not be required to waive their right to bring other actions against DirectBuy for which they have not received representation or consideration. *See* Rossman & Edelman, *Consumer Class Actions* § 12.3.3 at 165 (2006) ("Plaintiffs' counsel should not allow any release phrased in vague terms, such as 'all claims which could have been brought.'"). Class counsel did not purport to represent the class on these claims, and therefore should not be allowed to release them. *See Nat'l Super Spuds v. N.Y. Merc. Exchange*, 660 F.2d 9, 18-20 (2d Cir. 1981). *Cf. Amchem Prods., Inc.*, 521 U.S. at 628 (1997) (questioning whether notice of released claims can be adequate when class members are not aware of those claims).

In addition, DirectBuy takes the position that the settlement forecloses even actions by states to enforce their consumer protection laws, and on that basis obtained an injunction from Judge Garfinkel prohibiting the West Virginia action from proceeding. Indeed, DirectBuy apparently regards the foreclosure of state actions to be an essential element of the settlement, writing that it would have no incentive to settle the case if states remained free to litigate claims against it. Doc. 86 at 7. Objector agrees with the positions of class counsel and West Virginia that state enforcement actions are not foreclosed by the settlement. At the very least, however, the settlement should be clarified to avoid the impression that it is intended to prevent states from enforcing their laws.

IV. The Reaction of the Class to the Proposed Settlement Militates Against Approval.

Class counsel asserts that the response of the class as of two weeks before the objection deadline "indicates strong approval of the Settlement among Settlement Class Members" (Doc. 137 at 38), because there have been 717 opt-outs, a five percent registration rate among Former

DirectBuy Members, and 45 objections filed at least two weeks early. Contrary to class counsel's assertion, the reaction of the class thus far does not support approval.

About 95% of the class members have done nothing in response to the notice, but class counsel speaks as if silence is tantamount to acceptance. In fact, "[t]he vast majority of class members have no ability to evaluate the fairness of the proposed settlement. The court must thus rely upon its own investigation and the input of the few objecting class members who do have the resources to provide the court with pertinent information." *In re Ford Motor Co. Bronco II Prods. Liab. Litig.*, 1994 WL 593998, at *5 (E.D. La. 1994). "[A] combination of observations about the practical realities of class actions has led a number of courts to be considerably more cautious about inferring support from a small number of objectors to a sophisticated settlement." *In re GM Corp. Pick-Up Truck Fuel Tank Prods. Liab. Litig.*, 55 F.3d at 812. Indeed, "a low number of objectors is almost guaranteed by an opt-out regime, especially one in which the putative class members receive notice of the action and notice of the settlement offer simultaneously." *Ellis v. Edward D. Jones & Co., L.P.*, 527 F. Supp. 2d 439, 446 (W.D. Pa. 2007).

As Christopher R. Leslie explains in *The Significance of Silence: Collective Action Problems and Class Action Settlements*, 59 Fla. L. Rev. 71, 119-20 (2007):

> If silence were acceptance, then we would expect the silent class members to actually participate in the settlement after it is approved. We do not see this . . . . There are so many examples of shockingly low participation rates that what used to be extreme is becoming ordinary . . . . Response rates are particularly low in coupon-based settlements, where settlement coupon redemption rates are as low as 0.002%. In most coupon settlements, the vast majority of class members received absolutely nothing from the class action settlement. It would simply be irrational to infer that these class members embraced the settlement.

Thus, the number of objections already submitted weeks before the deadline actually militates against approval. *See Clement*, 176 F.R.D. at 25 & n.16 (rejecting coupon settlement, in part, because of "the fervent objections filed in response to the settlement agreement," even though "the court only received nineteen written objections to the settlement"). Further, as discussed in part I.A., above, only 5% of Former DirectBuy Members registered to participate in the settlement, indicating dissatisfaction with the settlement, or problems with the notice, or both.

V. Absent Class Members Were Not Provided Adequate Notice of the Settlement.

The Federal Rules of Civil Procedure require that notice of a proposed class action settlement be sent to "all class members who would be bound by the proposal." Fed. R. Civ. P. 23(e)(1). In addition to Rule 23's stringent requirements, notice must also satisfy constitutional standards imposed by the Due Process Clause. As the Supreme Court stated in *Mullane v. Central Hanover Bank & Trust Co.*, "when notice is a person's due, process which is a mere gesture is not due process. The means employed must be such as one desirous of actually informing the absentee might reasonably adopt to accomplish it." 339 U.S. 306, 315 (1950); *accord Phillips Petroleum Co. v. Shutts*, 472 U.S. 797, 812 (1985). This standard implicates two concerns: the dissemination of notice (that is, ensuring that the notice reaches class members) and the content of the notice (that is, devising a notice that informs the class members of the content of the settlement and how it affects them).

The notice program in this case failed in both respects. With regard to dissemination, the notice was sent only by email to those class members for whom DirectBuy had an email address, and follow-up letters by regular mail were sent to such class members only if the initial email was returned as undeliverable. Doc. 137 at 29. DirectBuy assumes that, where an email was not

returned, that the class member received the notice. Such an assumption is unwarranted for several reasons. First, the email may have reached an unattended mailbox or have been caught in a spam filter. Even where the email arrived in a mailbox attended by a class member, the class member may have refrained from opening it because it may have appeared to be spam from an unknown sender. Even where the email was received and opened, the class member would not necessarily have received adequate information about the settlement, because reaching the long form notice required that a class member click a link to a web site, manually enter a member number, and then manually enter a password contained in the email. Each of these steps imposes a burden on the class member that likely diminishes the chances of the class member actually reading the long form notice. Moreover, many class members may have opted not to access the settlement website, and thus did not receive adequate notice, because consumers are often advised to refrain from opening unsolicited emails or following links in such messages to avoid the risk of downloading a virus or spyware to their computers. *See* Doc. 147 at 9-10 (providing examples of warnings against opening unsolicited advertising email or following links in such messages). These concerns highlight the problems with email-only notice. Indeed, several courts have rejected email-only notice as inadequate and have required direct mail notice when the names and last known addresses of class members are known to the parties. *See, e.g., West v. Carfax, Inc.*, 2009 WL 5064143, at *3 (Ohio Ct. App. 2009); *Karvaly v. eBay, Inc.*, 245 F.R.D. 71, 91 (E.D.N.Y. 2007); *Reab v. Electronic Arts, Inc.*, 214 F.R.D. 623, 630 (D. Colo. 2002); *Thompson v. Midwest Found. Indep. Physicians Ass'n*, 124 F.R.D. 154, 157 (S.D. Ohio 1988).

The notice was also deficient in terms of content. As explained in the declaration of class action notice expert Shannon Wheatman, the email notice omitted important information, and the

long form notice contained legalese that would be incomprehensible to a lay person. Doc. 107-4. The deficiencies were so severe that Dr. Wheatman concluded that the notice program failed to satisfy due process. *Id.* ¶ 15.

CONCLUSION

The Court should deny final approval of the proposed class action settlement.

Respectfully submitted,

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CERTIFICATE OF SERVICE

I hereby certify that on this 12th day of April, 2011, a copy of foregoing Objection of Class Member Bradley Hebert and Notice of Intent to Appear was filed electronically and served by mail on anyone unable to accept electronic filing. Notice of this filing will be sent by e-mail to all parties by operation of the Court's electronic filing system or by mail to anyone unable to accept electronic filing as indicated on the Notice of Electronic Filing. Parties may access this filing through the Court's CM/ECF System.

/s/ Daniel S. Blinn
Daniel S. Blinn