No. 10-16380

IN THE UNITED STATES COURT OF APPEALS
FOR THE NINTH CIRCUIT

SEAN LANE, et al.,

Plaintiffs-Appellees,

GINGER MCCALL, Class Member,

Objector-Appellant,

v.

FACEBOOK, INC., et al.,

Defendants-Appellees.

ON APPEAL FROM THE UNITED STATES DISTRICT
COURT FOR THE NORTHERN DISTRICT OF CALIFORNIA

REPLY BRIEF FOR APPELLANT GINGER MCCALL

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TABLE OF CONTENTS

TABLE OF AUTHORITIES

CASES

RULES

MISCELLANEOUS

INTRODUCTION

In 117 pages of briefing, Appellees malign the motives of Objector Ginger McCall, tout the extent of negotiations between class counsel and Facebook, and attack arguments of their own making. But this case does not turn on the number of the settling parties' mediation sessions or whether there exists a "*per se* prohibition on the defendant receiving a business benefit as a result of a settlement." Facebook 33. And the conflict of interest that should trouble this Court is not the one Appellees impute on McCall.

The Court can reject this settlement by embracing the unremarkable proposition that a defendant to a class action settlement should not retain unreviewable control over how settlement funds are distributed. Here, a director and co-president of the cy pres recipient is a high-ranking employee of defendant Facebook. The settling parties have not satisfied their burden to show that Facebook will not retain unacceptable control over the actions of the cy pres recipient.

Approval of this settlement would set a dangerous precedent. For defendants in class action settlements, the option to create a cy pres recipient controlled in part by the defendant would be irresistible. District courts in this Circuit have shown increasing concern about abuses of the class action device. *See, e.g.*, *True v. Am. Honda Motor Co.*, EDCV07-0287-VAP(OPX), 2010 WL

707338 (C.D. Cal. Feb. 26, 2010) (rejecting a coupon-based class action settlement); *In re TD Ameritrade Accountholder Litig.*, 266 F.R.D. 418, 422-23 (N.D. Cal. 2009) (same). This Court should set a bright-line rule prohibiting distribution of class action funds to an organization with any substantial connection to a defendant in the action.

As troubling as the cy pres recipient is the district court's failure to evaluate the class's claims. The $9.5 million settlement fund might ultimately prove to be reasonable. At this time, however, we simply do not know. Accordingly, the district court's judgment approving the settlement should be reversed.

ARGUMENT

I. The Settlement Is Not Fair, Reasonable, or Adequate.

A. The Cy Pres Recipient Is Unacceptable As a Matter of Law.

A court must carefully consider settling parties' choice of a cy pres recipient. Although the overarching standard by which a judge should review a settlement is whether the settlement is fair, reasonable, and adequate, *see Molski v. Gleich*, 318 F.3d 937, 953 (9th Cir. 2003) *overruled on other grounds by Dukes v. Wal-Mart Stores, Inc.*, 603 F.3d 571 (9th Cir. 2010), "where cy pres is considered, it will be rejected when the proposed distribution fails to provide the 'next best' distribution." *Six Mexican Workers v. Ariz. Citrus Growers*, 904 F.2d 1301, 1308 (9th Cir. 1990); *see also* American Law Institute, Principles of the Law of

Aggregate Litigation, § 3.07 (2010) ("The court, when feasible, should require the parties to identify a recipient whose interests reasonably approximate those being pursued by the class.").

The cy pres recipient here must be rejected because Facebook will retain significant control over its operations. Facebook's chief lobbyist, Tim Sparapani, is the co-president and director of the organization to receive the settlement funds. No matter how "carefully structured" are the bylaws "to ensure that no single point of view can or will predominate," Facebook 34, the co-president and director of the organization will have substantial influence over that organization's operations. Indeed, when Judge Seeborg asked Facebook's counsel about Sparapani's role in the organization, he responded: "And it wouldn't shock the court to know that if you're going to pony up 10 million dollars to facilitate some interest, you'd like to have at least a modicum of voice in that process." LER 26. At the very least, as Appellees concede, "Mr. Sparapani may reasonably be expected to exercise his influence against any actions that could clearly and directly harm Facebook." Facebook 34. Because a substantial threat to online privacy is social media sites such as Facebook, Facebook's control over the cy pres recipient creates a significant structural conflict of interest.[1] That conflict of interest should, as a matter of law, render the organization an unacceptable recipient. *Cf.* American

[1] For example, it is certainly possible that the best advice an online privacy organization could provide would be: do not use Facebook.

Law Institute, Principles of the Law of Aggregate Litigation, § 3.07 ("A cy pres remedy should not be ordered if the court or any party has any significant prior affiliation with the intended recipient that would raise substantial questions about whether the selection of the recipient was made on the merits.").

Appellees have not satisfied their burden to show that, notwithstanding the cy pres recipient's structural conflict of interest, the settlement will adequately benefit the class. *See Hemphill v. San Diego Ass'n of Realtors, Inc.*, 225 F.R.D. 616, 623 (S.D. Cal. 2005) (citing 4 Alba Conte & Herbert Newberg, Newberg on Class Actions § 11:42 at 118-19 (4th ed. 2002)) ("[T]he proponents of the settlement," not the objector, "have the burden of sufficiently documenting that the settlement terms are fair, reasonable and adequate to the class."); *see also In re Katrina Canal Breaches Litig.*, 09-31156, 2010 WL 5128640 (5th Cir. Dec. 16, 2010) ("[T]he burden is on the settlement proponents to persuade the court that the agreement is fair, reasonable, and adequate for the absent class members who are to be bound by the settlement.").

The settling parties' burden is particularly difficult to satisfy when the proposed cy pres recipient is a new organization with no substantial record of service. *See Six Mexican Workers*, 904 F.2d at 1308-09. The cy pres recipient in *Six Mexican Workers* had two fatal shortcomings: it was not sufficiently limited in its choice of projects, and it had no substantial record of service. *See id.* As a

result of these shortcomings, the Court concluded that "there is no reasonable certainty that any member will be benefited." *Id.* at 1308. The case here nicely illustrates the reason for the *Six Mexican Workers* standard. If the cy pres recipient in this case had existed for a substantial period of time and had a track record of promoting online privacy, even when to do so ran counter to Facebook's interests, McCall's objections would ring hollow. But without a substantial record of service, Appellees simply cannot meet their burden to show that the cy pres recipient will not be unacceptably beholden to Facebook.[2]

The records of the individual directors, even if impressive in their own right, do not satisfy the *Six Mexican Workers* standard. Facebook argues that "although the Foundation is a newly created entity, it is built upon the expertise of three highly qualified individuals, and therefore had the benefit of an adequate track record." Facebook 36. The relevant record, however, is that which evidences how the organization will use its funds to benefit the class. It is insufficient that the directors might have distinguished careers promoting online privacy. Moreover, one of the three directors has a personal track record that includes working for

[2] Appellees attempt to distinguish *Six Mexican Workers* on the ground that the cy pres recipient in this case has a defined purpose. Facebook 35-36. But the second flaw of the organization in *Six Mexican Workers* was not that it had no defined purpose, but that it was not limited in its choice of projects. The only supposed limit on the funding choices of the cy pres recipient here is that the projects must educate on "critical issues" relating to the protection of identity theft. Facebook 36 (quoting the organization's articles of incorporation).

Facebook. It is precisely this personal track record that should disqualify him as a director.

Appellees' additional arguments are meritless. They first attempt to mischaracterize McCall's argument, claiming that there is no "*per se* prohibition on the defendant receiving a business benefit as a result of a settlement." Facebook 33. McCall's concern is not simply the benefit conferred upon Facebook, but the harm caused to the class. Specifically, as Appellees and the district court effectively concede, as a result of the cy pres recipient's conflict of interest, it might not take actions that would benefit the class because those same actions might harm Facebook.[3] Facebook 34; ER 18 (district court order).

Appellees efforts to analogize Facebook's role in the organization to the role settling parties usually have in selecting a cy pres recipient are misplaced. *See* Lane 37, 38; Facebook 34 n.13. Although settling parties frequently select a cy pres recipient by mutual agreement, that selection is then reviewed by a court. If the selected organization would likely be biased toward one of the settling parties, the court should not approve it. *See* American Law Institute, Principles of the Law of Aggregate Litigation, § 3.07. Here, by contrast, the potential biases would inhere in all of the organization's operations, including each of its funding

[3] Appellees' reliance on the general duty of loyalty, *see* Lane 42, provides small comfort. Certainly substantial space exists between the type of loyalty breach that would be actionable and the type of influence that would render the organization an unacceptable cy pres recipient.

decisions. Those decisions are not reviewable by a court and are therefore unlike the initial selection of the cy pres recipient.

And contrary to Appellees' argument, Facebook 35, including a Facebook employee on the board does not advance the organization's purpose. This situation is not, as the district court reasoned, analogous to a "discussion" in which we should hear from both sides. LER 74. To be sure, Facebook can use as much of its own money as it desires to engage in a public discussion of online privacy issues. Here, however, Facebook and the other defendants were alleged to have illegally invaded the privacy of the 3.6 million class members. The purpose of the cy pres recipient is to compensate, as near as possible, the injured class members by preventing future invasions of privacy. Giving the defendant a significant voice in the process—a voice funded by money belonging to injured class members—does not further this compensatory goal. Moreover, to the extent having a director with experience working for a social media company is relevant to the organization's purpose, Appellees could have found someone without ties to a defendant in the action.

Finally, McCall does not argue that the settlement funds should be given to any particular organization. Many organizations currently exist that would be well-situated to educate class members about online privacy issues. *See* McCall 36-37. Facebook has not provided any reason why these organizations are

inadequate or why it is in the class members' interests to give the money to an organization controlled in part by Facebook.

B. Appellees Have Provided No Evidence That Facebook's Promise to Terminate the Beacon Program Provides the Class Meaningful Relief.

A factual dispute exists over whether anything resembling the Beacon program that gave rise to this lawsuit existed at the time the settlement was reached. The burden is on the settling parties to present evidence that the settlement is fair and reasonable, and therefore that "terminating" the Beacon program provides the class meaningful relief. *See supra* pp. 3-4. The Beacon program that gave rise to this lawsuit was an opt-out program, meaning that unless users saw and clicked on a pop-up window that appeared for ten seconds on a user's computer screen, the program would go into effect. *See* McCall 5. The opt-out aspect of the program is critical to the VPPA claims. *See* McCall 30 (responding to Blockbuster's argument that consumers consented to the Beacon program). Accordingly, the relevant question is whether there existed at the time of the settlement an opt-out program resembling Beacon.

Facebook announced in December 2007 that it had "changed Beacon to be an opt-in system." ER 142. Although McCall experienced problems with the Beacon program as late as February 2008, her experience does not evidence that Beacon was functioning as an opt-out program two years later, when the parties reached a settlement. Appellees provide no evidence that Beacon continued to

function as an opt-out program at the time the settlement was reached. Indeed, only Lane's counsel even makes this claim. *See* Lane 6 (citing his own transcript testimony). Tellingly, Facebook's counsel relies on the claim of Lane's counsel that Beacon remained "operational" during the settlement negotiations. Facebook 40. Surely the unsupported statements of counsel for a settling party cannot satisfy the settling parties' burden.

Finally, contrary to Appellees' argument, Facebook 39, if the Beacon program has long ceased to exist, Facebook's promise not to restart it does not provide the class meaningful relief. Facebook has shown no intention of restarting Beacon. Its promise not to do something it has no demonstrated intention of doing can hardly form the basis of a fair settlement.

II. The District Court Did Not Sufficiently Evaluate the Class's Claims and Determine That a Cy Pres Remedy Is Necessary.

McCall does not contest that if $9.5 million is a reasonable settlement amount and 3.6 million is the size of the relevant class, a *cy pres* distribution to an acceptable recipient is appropriate because direct distribution would be infeasible. But the district court never properly decided that $9.5 million is a reasonable settlement amount or that 3.6 million is the size of the class. To have reached that conclusion, the district court would have to first evaluate the class's claims, which it did in only a conclusory manner.

A. Heightened Scrutiny of This Settlement Is Necessary.

This case involves an extraordinary remedy in which millions of individuals release claims without any direct compensation. *See* McCall 16-17 (discussing types of cy pres settlements). A district court must review settlements of this variety with heightened scrutiny. *See* McCall 21-24; *see generally Molski*, 318 F.3d 937. Although Facebook quibbles with the authorities on which McCall relies for this proposition, it concedes that, at the very least, "[s]ettlements that take place prior to formal class certification require a higher standard of fairness." *Molski*, 318 F.3d at 953; *see* Facebook 17 (quoting Judge Seeborg). Therefore, all parties agree that heightened scrutiny of this settlement is necessary.

B. The District Court Insufficiently Evaluated the Class's Claims.

Under any standard of review, the district court's analysis was inadequate. The district court did not individually evaluate any of the five causes of action and, in particular, failed to single out the stronger and more valuable VPPA claims. Rather, the district court's discussion of the claims' values consisted of no more than an acknowledgment that (1) the undifferentiated claims are "novel" and implicate facts that would be "vigorously disputed," and (2) $9.5 million is "substantial." ER 15-16; *see generally* McCall 27-28. This discussion is insufficient.

The district court's statements at the final fairness hearing, on which Appellees heavily rely, are no better.[4] The discussion at the hearing focused almost exclusively on the cy pres recipient and attorneys' fees. Indeed, other than a brief aside in which Judge Seeborg asked class counsel about the statutory per occurrence amount for the ECPA claim, LER 8, Judge Seeborg did not engage either of Appellees' counsel on the value of the claims. Later in the hearing, McCall's counsel mentioned the $2500 statutory damages amount for the VPPA claims. In response, Judge Seeborg mentioned that "there are significant defenses that Facebook can present with respect to, as I understand it, the VPPA claim." LER 58. McCall's counsel stated: "Correct. And frankly, I'm not entirely sure what the merits of those defenses are or are not. And one reason it's difficult to ascertain that is that there's no discernable record in any discovery that's taken place in this case." *Id.* Judge Seeborg then expressed skepticism about whether Facebook is a "video tape service provider," as that term is used in the VPPA. *Id.* at 59. McCall's counsel responded that although direct liability under the VPPA is one issue, Facebook might also be liable if it's required to indemnify Blockbuster for its VPPA violations. *Id.* Judge Seeborg asked no more questions about the value of the class's claims, including whether Blockbuster might be liable under

[4] Appelles criticize McCall for not including this transcript in her Excerpts of Record. *See* Lane 26. But Circuit Rule 30-1(a)-(c) does not require that hearing transcripts be included in the Excerpts of Record under these circumstances. And as explained above, the transcript is of little value.

the VPPA, or whether Facebook might be required to indemnify Blockbuster for its VPPA violations.

Appellees' disagreement with McCall is, at bottom, whether, under the circumstances of this case, a district court must evaluate the class's individual claims. *See* Facebook 23 ("The court was not required to separately analyze each cause of action."). But it is impossible for a court to determine the value of the class's claims without looking separately at each claim. And a court cannot assess the reasonableness of the settlement without having a rough approximation of the value of the class's claims. *See In re Traffic Executive Ass'n-E. R.R.s*, 627 F.2d 631, 633 (2d Cir. 1980) (noting that the district court is "required to explore the facts sufficiently to make an intelligent comparison between the amount of the compromise and the probable recovery"); *see generally* McCall 26 (citing cases). As this Court reasoned in *Molski*:

> The State of California estimates the number of disabled individuals living in California at 6.2 million. Assuming that one million of these individuals are mobility-impaired and that half of these individuals have experienced discrimination and have been deterred from going to ARCO-branded facilities, the consent decree permits ARCO to escape potential liability of $500 million (for statutory minimum damages of $1,000, not including actual or treble damages) in exchange for $195,000 in tax-deductible donations; $55,000 to the named plaintiff and class counsel; and the cost of making their facilities accessible as already required by federal law.

Molski, 318 F.3d at 954 n.23 (internal citations omitted).

The district court did not separately evaluate the VPPA claims, and Appellees do not contest McCall's analysis of the value of those claims. *See* McCall 28-31. Rather, Appellees' principal argument is that because of Blockbuster's financial problems, the class members could not have recovered from Blockbuster the full value of the claims, and therefore the settlement is fair. *See* Lane 27-28. For this proposition, Appellees rely on *Torrisi v. Tucson Electric Power Co.*, 8 F.3d 1370 (9th Cir. 1993). In *Torrisi*, however, the sole defendant was on the verge of bankruptcy, and the settlement was for all of the defendant's $30 million insurance policy. *Id.* at 1376. Here, by contrast, there are many defendants, one of which is worth $50 billion[5] and might have to indemnify the financially troubled defendant. *See* LER 59 (McCall's counsel arguing that discovery might reveal an indemnity agreement between Blockbuster and Facebook).[6] Although the ability of a defendant to pay might be a relevant factor in assessing the reasonableness of a settlement, a court should only consider that

[5] *See* Susanne Craig & Andrew Ross Sorkin, "Goldman Offering Clients a Chance to Invest in Facebook," The N.Y. Times, January 2, 2011, *available at* http://dealbook.nytimes.com/2011/01/02/goldman-invests-in-facebook-at-50-billion-valuation/?scp=10&sq=facebook&st=cse.

[6] Even independent of an indemnity agreement, the opt-out nature of the Beacon program might have constituted a breach of contract between Facebook and Blockbuster. In a letter to advertisers and affiliates preceding the launch of Beacon, Facebook stated that to protect user privacy, "[t]he user must proactively consent to have a story from your website published." ER 133. Critical to this case, that turned out not to be true. *See* Lane 5 (noting that Beacon's "consent mechanism did not work properly").

factor after it has evaluated the class's claims and assessed the ability of defendants to pay. Here, the district court did neither.

C. The Settling Parties Have Not Shown That a Cy Pres Remedy Is Necessary.

Appellees have not satisfied their burden to show that distribution of a fair settlement amount to an appropriately sized class would be infeasible. Distribution might be feasible for two related reasons: (1) the value of class member's claims, discounted by the risks and costs of litigation, might be significantly higher than $1.12, and (2) the size of the class with significantly more valuable claims might be substantially smaller than the 3.6 million people currently composing the class. As discussed in the previous subsection, and argued in the opening brief, *see* McCall 28-31, the VPPA claims are far from frivolous. And in light of the VPPA's $2500 per occurrence statutory damages, those claims are likely worth significantly more than $1.12 per class member. Only a fraction of the 3.6 million-person class has VPPA claims, however. Accordingly, there might be a subclass of people with VPPA claims for which distribution of a fair settlement amount would be feasible.

Appellees' contention that a subclass is unnecessary because "[e]ight of the nineteen representative class plaintiffs actually *had* VPPA claims," Lane 47, misconstrues McCall's subclass argument. McCall does not argue that the class representatives are atypical of the class, but that the class member's interests are

not aligned if the VPPA claims are significantly more valuable than the other claims and direct distribution to those with VPPA claims is feasible but direct distribution to the entire class is not. Under these circumstances, the typicality of the class representatives is not dispositive. *See Amchem Prod., Inc. v. Windsor*, 521 U.S. 591 (1997). In *Amchem*, which involved a pre-certification class action settlement arising out of asbestos exposures, the Court held that the class should have been divided into subclasses. It reasoned that "named parties with diverse medical conditions sought to act on behalf of a single giant class rather than on behalf of discrete subclasses." *Id.* at 626. Specifically, it found to be very different the interests of the "currently injured" and the "exposure-only plaintiffs," even though half of the class representatives had already suffered exposure-related injuries and half had not. *Id.* at 626, 603; *see also id.* at 627 ("The class representatives may well have thought that the Settlement serves the aggregate interests of the entire class. But the adversity among subgroups requires that the members of each subgroup cannot be bound to a settlement except by consents given by those who understand that their role is to represent solely the members of their respective subgroups." (quoting *In re Joint E. & S. Dist. Asbestos Litigation,* 982 F.2d 721, 742-43 (2d Cir. 1992))). As in *Amchem*, the typicality of class representatives here does not absolve the need for a subclass.

Finally, Appellees' argument that the settlement is fair because "all of the named Plaintiffs' and Settlement Class Members' claims arise from the operation of the Beacon program," Lane 46-47, is frivolous. The factual centrality of the Beacon program might be a basis for class certification, *see* Fed. R. Civ. P. 23(a)(2), but it has no bearing on whether the settlement is substantively unfair to some class members because those class members have significantly more valuable claims. *See, e.g.*, *Mirfasihi v. Fleet Mortg. Co.*, 356 F.3d 781, 786 (7th Cir. 2004) (discussing a "district judge's duty in a class action settlement situation to estimate the litigation value of the claims of the class and determine whether the settlement is a reasonable approximation of that value").

CONCLUSION

For the foregoing reasons, the district court's judgment approving the settlement should be reversed.

Respectfully submitted,

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January 18, 2011

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CERTIFICATE OF COMPLIANCE WITH RULE 32(a)(7)(C)

Pursuant to Federal Rule of Appellate Procedure 32(a)(7)(C), I certify that the foregoing brief is proportionately spaced, has a type-face of 14 points, and as calculated by my word-processing software (Microsoft Word) contains 4,147 words.

January 18, 2011

/s/ Michael H. Page
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Michael H. Page

CERTIFICATE OF SERVICE

I hereby certify that I electronically filed the foregoing with the Clerk of the Court for the United States Court of Appeals for the Ninth Circuit by using the appellate CM/ECF system on January 18, 2011.

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Michael H. Page

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9th Circuit Case No. 10-16380

I, Michael Page, certify that this brief is identical to the version submitted electronically on January 18, 2011.

January 20, 2011

/s/ Michael H. Page

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Michael H. Page