

United States District Court
For the Northern District of California

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IN THE UNITED STATES DISTRICT COURT
FOR THE NORTHERN DISTRICT OF CALIFORNIA

IN re TD AMERITRADE ACCOUNTHOLDER
LITIGATION

Master File No

C 07-2852 VRW

ORDER

This Document Relates to: All
Actions

Class Action

This is a class action against TD Ameritrade for a security breach that exposed TD Ameritrade accountholder private information to "spammers" and rendered the same information vulnerable to others. Doc #60 at 1-6. The court granted preliminary approval of the class action settlement on May 1, 2009. Doc #93. The parties now seek final approval of the proposed settlement pursuant to FRCP 23(e). Docs #182-183. As discussed in greater detail below, the court DENIES final approval of the settlement.

I

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2 Plaintiffs originally moved for preliminary approval of
3 the class action settlement on May 30, 2008. Doc #53. On June 13,
4 2008, the court denied approval for several reasons, including the
5 failure of the parties to establish facts necessary for the court
6 to evaluate the settlement and the attorney fee request (Doc #61 at
7 2-3) and objections voiced by Matthew Elvey, one of the class
8 representatives. At a hearing the previous day, Elvey had
9 expressed numerous "reservations" about the settlement. Doc #61 at
10 3.

11 On August 29, 2008, attorney Mark Chavez entered his
12 appearance on behalf of Elvey. Doc #71. Subsequently, Elvey
13 submitted a memorandum opposing preliminary approval of the
14 settlement. Doc #73. Elvey argued that the proposed settlement
15 inadequately compensated the plaintiffs for their injuries related
16 to the security breach and mischaracterized the nature of the risks
17 associated with the breach. Id at 6.

18 At a hearing on October 7, 2008, the court granted
19 attorney Gregory Beck's application to represent Elvey on a pro hac
20 vice basis (Doc #83) and asked both Chavez and Beck if they would
21 be willing to represent the entire class in an effort to seek a
22 more favorable settlement or to go to trial. Doc #87 at 4-5. Both
23 attorneys declined to do so. Id. Instead, Chavez and Beck offered
24 to assist the parties in achieving adequate notice to the class.
25 Id at 30.

26 TD Ameritrade submitted the proposed settlement terms and
27 the proposed notice to be given to the class on October 20, 2008.
28 Doc #86. In return for the class dropping its claims against TD

1 Ameritrade, TD Ameritrade offered to (1) post a warning on its
2 website "regarding stock spam"; (2) "continue to retain independent
3 experts" to test TD Ameritrade's security vulnerabilities; (3)
4 continue "account seeding" to determine whether unauthorized
5 persons have acquired customer email addresses; (4) provide each
6 settlement class member with a unique identifier number that can be
7 used to obtain a one-year subscription to an anti-virus, anti-spam
8 internet security product; (5) retain a company to perform an
9 analysis to determine whether any incidents of organized misuse of
10 personal information had occurred involving data in the TD
11 Ameritrade database (four such analyses already had been performed)
12 and to inform settlement class members whose personal information
13 is discovered to be the subject of organized misuse; (6) donate
14 \$55,000 to specified cyber-security projects; and (7) pay claims
15 administration and notice expenses for the settlement. Doc #86,
16 Exh 5 at 9-12.

17 On November 13, 2008, the Texas Attorney General
18 submitted objections to the proposed settlement. Doc #93, Attach
19 1. The Texas Attorney General noted that approximately 415,089
20 Texans were included in the proposed settlement class and described
21 four objections to the proposed settlement: (1) the proposed
22 settlement agreement offered "no meaningful relief to the class
23 members"; (2) the award of proposed fees to class counsel was
24 excessive; (3) the proposed settlement failed to address the harm
25 of identity theft adequately; and (4) the proposed release was too
26 broad. Id. The Texas Attorney General contended that the
27 settlement was essentially worthless because the "warning" to be
28 placed on the TD Ameritrade website would largely go unseen by

1 consumers most vulnerable to stock spam, the security measures TD
2 Ameritrade agreed to conduct should have been conducted by "any
3 reputable company" anyway and the coupon for security software was
4 of little value because similar software was largely available to
5 most internet users for free or at low cost. Id at 2. The Texas
6 Attorney General also noted that the class members were to receive
7 no monetary recovery while the proposed attorney fee award for
8 class counsel was substantial — \$1.87 million. Id at 2. The
9 proposed settlement agreement, according to the Texas Attorney
10 General, did not address adequately the potential harm to class
11 members from identity theft. Id at 3. The Texas Attorney General
12 further argued that the settlement agreement should make clear that
13 the individuals who engaged in the unauthorized access are not
14 "Released Parties," and "Releasing Parties" should be amended to
15 make clear that government entities such as the Texas Attorney
16 General has not released any claims to relief related to this
17 security breach. Id at 3-4.

18 On December 5, 2008, the Texas Attorney General's office
19 informed the court that it was "engaged in a promising dialogue
20 about its concerns with counsel for the plaintiffs and the class."
21 Doc #88-2 at 1. According to a supplemental filing by counsel for
22 the plaintiffs, over a period of four months the parties held a
23 series of discussions with the Texas Attorney General's office
24 addressing the objections to the proposed settlement outlined
25 above. Doc #90 at 2.

26 Then on March 2, 2009, the Texas Attorney General
27 notified the court that the parties proposed a list of amendments
28 to the proposed settlement agreement and notice to address the

1 Texas Attorney General's concerns. Doc #90, Exh A at 2-3. These
2 amendments included the following:

3 In the Settlement Agreement:

4 Broadening the carve-out for identity theft-related
5 claims in the "Released Claims" section to ensure that
6 Settlement Class Members are able to pursue future claims
7 that arise due to identity theft;

8 Removing the language that purports to release claims
9 that may be brought by a governmental entity and
10 explicitly stating that such claims are not released;

11 Excluding persons who participated in the security
12 breach or assisted those who did from the definition
13 of "Released Parties" and "Third Party
14 Beneficiaries," thereby preventing them from
15 receiving any benefit or protection from the
16 Settlement Agreement;

17 Ensuring that the opportunity for the Settlement
18 Class Members to take advantage of the Trend Micro
19 Internet Security Products granted under the
20 Settlement Agreement is extended until January 1,
21 2010;

22 Including a definition of the term "organized
23 misuse," in order to make the Settlement
24 Agreement more understandable, on its face, to
25 a Settlement Class Member;

26 Amending the section regarding the "Voluntary
27 Identity Theft Benefits" that TD Ameritrade may
28 extend to Identified Class Members to: (1)
eliminate confusion between that process and
claims that may be brought in court, and (2)
avoid the unintended release of such claims;

Under the Voluntary Identity Theft Benefits
program, expanding the window of time for an
Identified Class Member to respond to TD
Ameritrade regarding the Member's intention to
seek such benefits from 30 days to 90 days;

Under the Voluntary Identity Theft Benefits
program, clarifying that an Identified Class
Member's right to file suit against TD
Ameritrade for identity-theft related harm is
preserved up until the point that the
Identified Class Member submits a claim in a
binding arbitration process; and

TD Ameritrade agreeing to provide all

1 Settlement Class Members, not just Identified
2 Class Members, with dedicated customer support
3 for relating [sic] to the benefits provided
under the Settlement Agreement and questions
concerning spam and identity theft for a full
twelve months.

4 In the Notice and related correspondence:

5 Providing an explanation of the basis of the suit that
6 includes the fact that TD Ameritrade's computer database
7 suffered a data security breach and exposed the Class
8 Members to the risk of identity theft (as opposed to an
9 "unauthorized acquisition") so that Class Members have
more information on which to base their decision to
remain in the class, opt out, or object to the
settlement.

10 Doc #90, Exh A at 2-3. The Texas Attorney General's office
11 withdrew its objections to the proposed settlement provided that
12 the above amendments were implemented. Id at 3.

13 On March 19, 2009, the parties submitted a supplemental
14 statement with a revised proposed settlement agreement and forms of
15 notice. Doc #90. The revised proposed settlement agreement and
16 forms of notice incorporated the amendments urged by the Texas
17 Attorney General as a condition for withdrawing the objections on
18 behalf of the state of Texas. Doc #90, Exh B-E. The court granted
19 preliminary approval of the class action settlement on May 1, 2009.
20 Doc #93.

21 On August 20, 2009, the parties moved for final approval
22 of the proposed settlement pursuant to FRCP 23(e). Docs #182-183.
23 On August 28, 2009, class member Richard Holoher, identifying
24 himself and naming Gretchen M Nelson of the Kreindler and Kreindler
25 firm, filed notices of availability of new class representative and
26 substitute class counsel. Docs #184-185. A hearing addressing the
27 proposed settlement was held on September 10, 2009, at which time
28 Nelson addressed the court and stated her availability and

1 willingness to enter the case as substitute class counsel. Doc
2 #187.

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5 II

6 Federal Rule of Civil Procedure 23(e) requires court
7 approval for the settlement of any class action. In order to be
8 approved, a settlement must be "fundamentally fair, adequate and
9 reasonable." Torrisi v Tucson Elec Power Co, 8 F3d 1370, 1375 (9th
10 Cir 1993) (quoting Class Plaintiffs v Seattle, 955 F2d 1268, 1276
11 (9th Cir 1992), cert denied, 506 US 953 (1992)), cert denied, 512
12 US 1220 (1994). Because the purported benefits to the class remain
13 the problematic element of the settlement, the court first will
14 address whether in light of the objections concerning the purported
15 benefits of the settlement, the proposed settlement agreement
16 should be approved as fair, reasonable and adequate.

17
18 A

19 "Basic to [the process of deciding whether a proposed
20 settlement is fair, reasonable and adequate] * * * is the need to
21 compare the terms of the compromise with the likely rewards of
22 litigation." Protective Committee for Independent Stockholders of
23 TMT Trailer Ferry Inc v Anderson, 390 US 414, 424-25 (1968). Class
24 counsel contend that as a result of the novelty of plaintiffs'
25 claims, the likely rewards of litigation in this case appear
26 modest. Doc #183 at 12 ("Class Counsel are confident in the
27 strength of Plaintiffs' claims; however, they are also cognizant of
28 the legal uncertainty in this litigation."). But, even when

1 considering the relative uncertainty of plaintiffs' claims, it
2 appears that the proposed settlement seeks to confer no discernible
3 benefit upon the class.

4 Under the proposed settlement, TD Ameritrade agrees to:
5 (1) retain an independent expert who will conduct penetration tests
6 to determine whether TD Ameritrade's information security system
7 has any vulnerabilities; (2) retain ID Analytics to conduct an
8 additional analysis to determine whether the data breach may have
9 resulted in identity theft for any members of the settlement class;
10 and (3) provide each class member with a unique identifier number
11 that may be used to obtain a one-year subscription or a one-year
12 renewal for an anti-virus, anti-spam internet security product.
13 Docs #90-92; 182.

14 Of these purported benefits, the first and second seem to
15 benefit the company more than the class. The court's concern is
16 echoed by Elvey, who objects that "[t]he settlement does not
17 require Ameritrade to adopt any new [permanent] security measures
18 to remedy the problems giving rise to the lawsuit, or even to
19 reveal what those security problems were and how it has fixed
20 them." Doc #72 at 13.

21 Concerning the first purported benefit, the parties
22 assert that the class is benefitted by penetration tests performed
23 to determine whether TD Ameritrade's information security system
24 has any vulnerabilities. TD Ameritrade contends that this test
25 will give class members "another objectI've basis to have
26 confidence that TD Ameritrade's information security system is
27 sound," (Doc #182 at 13), while class counsel argues that
28 "[p]enetration testing is a reliable method to detect security

1 weaknesses that would allow an outside hacker to penetrate
2 databases such as the one at issue in this litigation." Doc #183
3 at 22.

4 Regarding the second purported benefit, the parties state
5 that the tests performed by ID Analytics would make class members
6 aware if they were victims of identity theft (Doc #182 at 13), at
7 which time victims would have access to dedicated customer support
8 "trained to help remediate any harm from identity theft" (Doc #183
9 at 22).

10 To quote the Texas Attorney General's former objection,
11 these measures should be conducted by "any reputable company"
12 anyway. Doc #93, attach 1. While it is obvious that, as a large
13 company that deals in sensitive personal information, penetration
14 and data breach tests should be routine practices of TD
15 Ameritrade's department that handles information security, it is
16 not clear that such tests benefit the class. Even if, in the words
17 of the company, the tests will give class members "another
18 objective basis to have confidence that TD Ameritrade's information
19 security system is sound," confidence in this instance does not
20 provide any real value to the class. In short, these two - very
21 temporary - fixes do not convince the court that the company has
22 corrected or will address the security of client data in any
23 serious way, let alone provide discernable benefits for the class.

24 The third purported benefit, a one-year subscription or
25 extension of anti-spam software, also confers little to no benefit
26 upon the class. On this point, the Texas Attorney General
27 initially argued that this software is of little value because
28 similar software is available to most internet users for free or

1 very little cost. Doc #93, attach 1. Elvey builds upon this
2 argument in his objection:

3 Although spam is only one aspect of this case, it is the
4 target of the only relief of any possible value: a one-
5 year subscription to Trend Micro Internet Security Pro
6 anti-spam software. The provision of this software does
7 not render the settlement fair. The Court has a
8 responsibility "to ensure that the settlement provides
9 real value" by offering the relief that the class will
10 actually use. * * * Here, the settlement would leave many
11 class members who already have anti-spam software or who
12 use popular online email clients like Gmail, Yahoo!, and
13 Hotmail that are free of charge and have anti-spam
14 capabilities built in [with no discernable benefit].
15 Moreover, many class members will have already changed
16 their email addresses, either because they have been
17 deluged with spam related to the data breach or for some
18 other reason [such as change of employment].

12 Doc #72 at 19 (citations omitted). Elvey's objection correctly
13 states that three broad groups of class members will receive no
14 benefit from the software: Group one is comprised of those
15 individuals who own anti-spam software. A one-year subscription
16 for another anti-spam package would confer no real benefit to such
17 class members, nor would a one-year "extension" in a situation in
18 which a class member owned a similar software package of extended
19 length. Group two is composed of class members who utilize anti-
20 spam email services such as Gmail, Yahoo! or Hotmail. As a part of
21 these services, spam messages are directed to a separate "spam"
22 folder without the assistance of individually-acquired software.
23 Group three is made up of those class members who, for one reason
24 or another, changed email addresses. For these members, the
25 software may not be valueless on paper, but they will no longer be
26 able to use the software for its intended purpose: to block the
27 fraudulent spam caused by Ameritrade's alleged data breach.

28 TD Ameritrade summarily dismisses Elvey's objection,

1 arguing that since Elvey could not achieve his ultimate objective
2 of receiving a large cash payment for the class if he continued to
3 litigate, his objection is groundless. Doc #182 at 17. Meanwhile,
4 class counsel attempts to put a numerical figure on the cost of the
5 software to TD Ameritrade. Doc #183 at 14. But as class counsel
6 acknowledges the standard is not how much money a company spends on
7 purported benefits, but the value of those benefits to the class.
8 Id (citing O'Keefe v Mercedes-Benz United States, LLC, 214 FRD
9 266, 304 (MD Pa 2003) (settlements should be valued according to
10 their "benefit to the class and not the cost to defendant"). See
11 also FRCP 23(h), 2003 Advisory Committee Notes ("Settlements
12 involving nonmonetary provisions for class members also deserve
13 careful scrutiny to ensure that these provisions have actual value
14 to the class.").

15 Furthermore, despite the parties' best efforts, the fact
16 that the Texas Attorney General was involved in the process of
17 reaching the proposed settlement does not convince the court that
18 the proposed settlement is fair, reasonable and adequate. While
19 the Texas Attorney General's office brought a well-needed
20 adversarial component to these proceedings, its efforts largely
21 resulted in changes to the nature and scope of the notice, rather
22 than altering the purported benefits to the class.

23 In deciding to participate in these proceedings, the
24 Texas Attorney General's office cited its concern that "no
25 meaningful relief [was to be provided] to the class members." Doc
26 #93, attach 1. The court shares this concern. From the
27 perspective of the class, the worst-case scenario may be realized
28 if following this denial of final settlement approval the case were

1 to fail on dispositive motion. But in that event, class would end
2 up essentially in the same situation it would be if final
3 settlement approval were approved: with nothing. Because the
4 purported benefits to the class do not warrant settlement approval,
5 the court DENIES final approval of the proposed settlement.

6
7 III

8 Denial of final approval of the proposed settlement
9 presents an unusual situation. The May 1, 2009 order of
10 preliminary approval granted "provisional certification of the
11 settlement class" and confirmed Kamber Edelson LLC, Parisi & Havens
12 LLP, Scott A Kamber and Ethan Mark Preston ("Kamber et al") as lead
13 counsel. Doc #93 at 10. As the certification was provisional and
14 preliminary to final approval, denial of final approval abrogates
15 provisional class certification and the interim appointment of
16 Kamber et al as class counsel. Hence, no class has been certified
17 and no appointment of class counsel has been made under FRCP 23(g).

18 On August 28, 2009, class member Holober suggested
19 Gretchen M Nelson of the Kreindler and Kreindler firm to the court
20 as substitute class counsel. Docs #184-185. The "selection and
21 activity of class counsel are often critically important to the
22 successful handling of a class action." FRCP 23(g), 2003 Advisory
23 Committee Notes. The court has considered Nelson's experience in
24 handling class actions and other complex litigation, her work in
25 investigating potential claims in the action, her knowledge of the
26 applicable law and the resources she will commit to representing
27 the class. FRCP 23(g) (1) (C). Having considered these factors, it
28 appears that Nelson is fully capable of fairly and adequately

1 representing the interests of a class of TD Ameritrade
2 accountholders. FRCP 23(g) (1) (B). The court recognizes that the
3 denial of final approval changes how this litigation will proceed.
4 In order to give the parties and counsel an opportunity to consider
5 their respective positions and present their views to the court,
6 this order schedules a case management conference in the near
7 future.

8
9 IV

10 In light of the court's reservations about the purported
11 benefits of the proposed settlement, the court cannot find that the
12 proposed settlement is fair, reasonable or adequate. Final
13 approval of the proposed settlement, (Docs #182-183) therefore is
14 DENIED.

15 IT IS FURTHER ORDERED that the provisional class
16 certification and lead counsel appointment as part of this court's
17 May 1, 2009 order are set aside.

18 IT IS FINALLY ORDERED that on December 10, 2009, at 3:30
19 PM, Kamber et al, Nelson and TD Ameritrade are to attend a case
20 management conference to discuss scheduling and other matters,
21 including the possible addition of Nelson to these proceedings as
22 substitute counsel.

23
24 IT IS SO ORDERED.

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26 

27 VAUGHN R WALKER
28 United States District Chief Judge