MARK A. CHAVEZ (SBN 90858)
CHAVEZ & GERTLER, LLP
42 Miller Ave.
Mill Valley, CA 94941
Telephone: (415) 381-5599

RICHARD FRANKEL (SBN 229136)
LESLIE A. BRUECKNER (*pro hac vice*)
TRIAL LAWYERS FOR PUBLIC JUSTICE
1717 Massachusetts Avenue, NW
Suite 800
Washington, D.C. 20036
Telephone: (202) 797-8600

LESLIE BAILEY (SBN 232690)
TRIAL LAWYERS FOR PUBLIC JUSTICE
555 Twelfth Street, Suite 1620
Oakland, CA 94607-3616
Telephone: (510) 622-8150

Attorneys for Objector Mark Schallert

SUPERIOR COURT OF THE STATE OF CALIFORNIA

CITY AND COUNTY OF SAN FRANCISCO

UNLIMITED JURISDICTION

FRANK CHAVEZ, an individual, and California resident, on behalf of himself, those similarly situated, and the general public, Plaintiff, vs. NETFLIX, INC., a foreign corporation and DOES 1 THROUGH 10, Defendants.	Case No. CGC-04-434884 CLASS MEMBER MARK SCHALLERT'S OBJECTIONS AND OPPOSITION TO FINAL APPROVAL OF SETTLEMENT AND STATEMENT OF INTENT TO APPEAR AT FINAL APPROVAL HEARING. Date: January 18, 2005 Time: 2:00 p.m. Dept: 514 Judge: Hon. Judge Mellon

INTRODUCTION

Class member Mark Schallert, by and through his counsel, Trial Lawyers for Public Justice ("TLPJ") and Chavez & Gertler, LLP, objects to the proposed class action settlement in this matter. These objections also shall serve as notice that Mr. Schallert, through his counsel, intends to appear at the final approval hearing. TLPJ is a national public interest law firm headquartered in Washington, D.C. dedicated to utilizing the civil justice system to advance a more just society. TLPJ is the only public interest law firm that both litigates class actions and fights class action abuse. Class actions, when properly utilized, can be a powerful tool for the vindication of victims' rights. At the same time, when they are misused class actions can be a powerful tool for the elimination or infringement of victims' rights. In recent years, improper class action settlements have become a mechanism for companies that have harmed millions to cap their liability and avoid accountability without adequately compensating the victims of their misconduct. Accordingly, for the last ten years, TLPJ has operated a special project dedicated to monitoring, exposing, and fighting class action abuse across the country in cases such as this one.

This settlement is a striking example of the growing trend of class action settlements that provide substantial benefits to the defendants and class counsel but little or no relief to the class. Here, the parties' proposed Settlement Agreement gives defendant Netflix, Inc. ("Netflix") a broad release of liability and class counsel $2.5 million in attorneys' fees. By contrast, the class members receive nothing but non-cash vouchers of dubious value. They can redeem these vouchers only if they submit to a claims process that, because of the settlement's "automatic renewal" feature requiring class members to opt-out to avoid incurring additional charges from Netflix, threatens to leave the class worse off than if this case had never been brought. Because few class members will want to use these non-cash vouchers, the value of the settlement does not approach the $85 million figure trumpeted by class counsel. In actuality, Netflix has acknowledged in an SEC filing that the value of the relief provided to 2/3 of the class is less than $1.5 million. With class counsel standing to receive $2.5 million in attorneys' fees, this settlement will give class counsel 60% or more of the total relief paid out by Netflix.

The settlement amounts to little more than an elaborate marketing plan for Netflix – which benefits from the settlement by encouraging former customers to resubscribe and by getting current

members to upgrade their service to a higher-priced level – and a vehicle for class counsel to collect an outsized attorneys' fee. Although Netflix and class counsel stand to benefit, the class is left with a Hobson's choice: either they can submit a claim and risk losing more money from the automatic renewal than they gain from the voucher, or they can choose not to submit a claim and receive nothing at all. Either way, the class loses.

In addition, the proposed settlement violates the class members' constitutional due process rights because the parties did not provide adequate class notice. The notice sent to class members fails to disclose that the parties agreed that class counsel would receive $2.5 million in attorneys' fees. The notice violates the well-settled rule that class members must be informed of the parties' attorneys' fees agreement so they can determine the effect of the fee award on the class relief and can decide whether to object to the settlement. The notice also fails to adequately disclose the settlement's automatic renewal provision. The defective notice provides an independent ground for rejecting the settlement.

Because the number of claims actually submitted by class members bears heavily on the fairness of the proposed settlement, this Court should require the parties to provide both the Court and all Objectors with the number of claims submitted by class members five days prior to the hearing. Only when armed with that information can the Court and Objectors fully assess the fairness of the settlement.

STATEMENT OF FACTS

On September 23, 2004, plaintiff Frank Chavez filed this putative class action alleging that Netflix falsely and deceptively advertised that it would deliver DVDs to its customers more quickly than they were actually delivered. Chavez alleged that Netflix's practices caused him to receive fewer DVDs than he would otherwise have been able to receive had Netflix's representations been accurate. Less than a year after the complaint was filed, and before the Court ever decided whether to certify the putative class, the parties reached a proposed settlement of the action.

The settlement does not provide any cash relief to the class. Instead, the settlement makes each class member eligible for a non-cash voucher. For current Netflix members, the voucher entitles them to a "free" one-month service upgrade that allows a class member to check out one more DVD at a time than is allowed under his or her current plan. Settlement Agreement, § 4.2. Former members are eligible for a voucher entitling them to one "free" month of Netflix service, but the voucher is

necessarily contingent upon former class members rejoining Netflix. *Id.*, § 4.1. Although the settlement makes the vouchers *available* to the class, class members are not *guaranteed* a voucher upon final approval. Instead, class members can obtain the voucher only if they fill out and return a claim form to Netflix. *Id.*, § 6.1. Additionally, the Agreement does not require Netflix to make any minimum payout to the class. Any unused class benefit remaining after the claims deadline will be retained by Netflix.

Although the settlement provides for a free month of upgraded or renewed service for those class members who do file claims, that benefit comes with a potentially significant cost. Unless class members affirmatively opt out by the end of their "free" month, Netflix will automatically extend their upgraded or renewed service at the higher level and will begin charging them the corresponding rates. *Id.*, §§ 4.1, 4.2. Thus, unwary class members who fail to opt-out after the "free" month will find themselves paying out as much or more to Netflix than they received in class benefit. The summary notice sent to class members describes neither (a) the process for class members to opt out of the service after a month, nor (b) the charge class members will incur if they do not opt out.

The Agreement also contains injunctive relief requiring Netflix to make minor modifications to its Terms of Use. *Id.*, § 3.1. With respect to any of Netflix's print, TV or radio advertisements, Netflix must include a disclaimer stating only: "See Terms of Use for Details." *Id.*, § 3.2. The time and placement of that disclaimer will be chosen by Netflix in its sole discretion. *Id.* The injunctive relief portions of the settlement will stay in place for only one year, at which point Netflix retains the freedom to change its Terms of Use and its advertisements in any manner it likes. *Id.*, § 3.3.

Unlike the class relief, which is non-monetary and which is contingent upon class members submitting claims forms, the settlement provides for class counsel to receive $2.5 million in attorneys' fees, regardless of how few class members submit claims forms. *Id.*, § 8.2. The Agreement also contains a "clear sailing" provision, whereby Netflix has agreed not to contest any fee award of $2.5 million or less. *Id.* The notice of proposed settlement sent to class members does not disclose the amount of the attorneys' fees requested by class counsel.

STANDARD OF REVIEW

Class action settlements, unlike typical settlements, require court approval for "the protection

of those class members . . . whose rights may not have been given due regard by the negotiating parties." *Dunk v. Ford Motor Co.*, 48 Cal App. 4th 1794, 1801 (1996). In order to protect the due process rights of absent class members, the Court cannot approve the settlement unless it independently evaluates the evidence and determines that the settlement is "fair, reasonable and adequate to all concerned." *Wershba v. Apple Computer, Inc.*, 91 Cal. App. 4th 224, 245 (2001). Heightened scrutiny is required here because the parties reached a settlement prior to class certification and are no longer in an adversarial posture. *See id.* at 240; *see also Amchem Prods., Inc. v. Windsor*, 521 U.S. 591, 620-21 (1997) (holding that the rights of absent class members "demand undiluted, even heightened, attention in the settlement context").[1] The parties seeking approval bear the burden of showing that the settlement is fair, reasonable and adequate. *Oldham v. Cal. Capital Fund, Inc.*, 109 Cal. App. 4th 421, 434 (2003). As explained below, they have failed to meet their burden.[2]

ARGUMENT

I. THE COURT SHOULD REFUSE TO APPROVE THE SETTLEMENT BECAUSE IT IS NOT FAIR, REASONABLE, OR ADEQUATE.

This settlement should not be approved. The settlement's non-cash vouchers are of minimal value and cannot be obtained unless class members participate in a claims process. Most class members will not submit claims and will not get any relief at all. Those class members, however, are the lucky ones. Because of the settlement's "automatic renewal" feature, those unfortunate class members who do submit claims are likely to end up paying more in increased charges than they gain from a free month, and may end up worse off than if this case had never been brought.

A. The "Automatic Renewal" Feature Threatens to Leave Class Members Worse Off Than If This Lawsuit Had Never Been Brought.

---

[1] California courts "may look to federal authority to determine whether settlement of a class action is fair and reasonable." *Garabedian v. Los Angeles Cellular Tel. Co.*, 118 Cal. App. 4th 123, 127 (2004).

[2] As a threshold matter, it is not clear that the settlement class can even be properly certified for purposes of settlement because it is overbroad. A class action settlement cannot be approved unless the court first finds that a class can be certified. *See Amchem*, 521 U.S. at 621-23. Here, the settlement class for which approval is sought is much greater in size than the class as defined in the original complaint. *Compare* First Amended Complaint, ¶ 44 (defining class as present or former Netflix customers who "rarely, if ever, received one day delivery of DVDs and or whose DVD rentals were limited by Defendants"); *with* Settlement Agreement § 2.2 (defining class to include all current and former Netflix members as of January 15, 2005, regardless of whether they ever experienced delayed delivery or limited DVD rentals). Thus, the settlement should not be approved unless the parties demonstrate that this broader class is appropriately certified. *See* Declaration of Robert M. Bramson in Support of Mark Schallert's Objections ¶¶ 21-30.

The most troubling aspect of the proposed settlement is its "automatic renewal" feature. Under the settlement, Netflix is entitled to impose monthly charges on class members who submit claims forms unless those consumers *affirmatively* take action to downgrade or cancel their service after one month. Settlement Agreement, §§ 4.1, 4.2. This feature threatens to transform the purported class benefit into a class detriment because participating class members may end up losing more money in higher charges than they gain from their free month if they fail to opt out. Companies use such automatic renewal strategies because they work: generally, far more customers will fail to opt out of a promotion than will choose to affirmatively opt in. *See* Declaration of Robert M. Bramson in Support of Mark Schallert's Objections ("Bramson Decl.") ¶¶ 9-11; Declaration of Stephen Gardner in Support of Mark Schallert's Objections ("Gardner Decl.") ¶ 34. Here, the inevitable result of the automatic renewal feature is that many class members will not take this affirmative action and will end up incurring charges that they neither wanted nor asked for. Bramson Decl., ¶¶ 8-12; Gardner Decl., ¶¶ 30-33. In just one month, class members who fail to opt out will have their class benefit wiped out by the additional charges that they will incur. After that month, class members will lose money because the higher charges will exceed the price of the original benefit. As a result, the settlement may make the class members worse off than if the case had never been brought.[3]

No justification exists, other than to line Netflix's own pockets, for requiring class members to affirmatively opt out after a month. Netflix could automatically downgrade current members to their previous service level and drop renewed customers unless they have affirmatively agreed to continue their service. Just as Netflix can automatically upgrade class members without difficulty once they submit their claims, Netflix should be able to automatically downgrade them at the end of the month without requiring an affirmative opt-out. From the class members' perspective, there is nothing advantageous about the automatic renewal feature and there is no reason to include it in the settlement.

The only party who benefits from such a feature is Netflix. Since class members obtain relief

[3] The fact that the settlement requires Netflix to send out an email reminder before charging customers for the upgrade (Settlement Agreement, § 4.3) does not adequately protect class members from the risk of being overcharged. First, Netflix sends numerous emails to its customers, many of which are promotional or contain other advertisements or sales offers, on a routine basis. Many class members may assume that any email from Netflix is promotional only and may delete it without first reading it. Second, there may be any number of reasons why class members are unable or otherwise fail to downgrade or cancel their service within the four day window provided by Netflix's reminder email, even if they do not want their service to continue. *See* Bramson Decl. ¶ 10.

only if they rejoin Netflix (former customers) or upgrade their service (current customers), the settlement enables Netflix to enhance its revenue stream by recapturing former customers and encouraging current customers to upgrade to a higher-priced service. Bramson Decl. ¶ 11; Gardner Decl. ¶ 35. Adding the automatic renewal feature on top of that means that Netflix likely will reap significant profits from those class members who fail to opt out of their expanded service after a month. Rather than punishing Netflix for its alleged wrongdoing, the settlement is simply a sophisticated marketing campaign, undermining both "the role of the class action in deterring and redressing wrongdoing," *Linder v. Thrifty Oil Co.*, 23 Cal.4th 429, 445-46 (2000) (quotation omitted), and the statutory purpose of the Consumers Legal Remedies Act – the Act upon which plaintiff bases several causes of action – which is to "protect consumers against unfair and deceptive business practices." Cal. Civ. Code § 1760; *Broughton v. Cigna Healthplans of Cal.*, 21 Cal. 4th 1066, 1077 (1999).

Further compounding the deleterious effect of the automatic renewal is the fact that this feature was not adequately disclosed to the class. Automatic renewals – which also are known as "negative options" because a consumer's "negative" action or silence is interpreted as consent to be charged a higher price – have such great potential to deceive unwitting consumers into paying more than they bargained for that they are regulated by the federal government. *See, e.g.*, 16 C.F.R. § 425.1; 16 C.F.R. § 310.3. These federal regulations require that companies disclose the material details of their negative option plans "in a clear and conspicuous manner." *Id.* Here, however, the disclosure was anything but "clear and conspicuous." Although the beginning of the summary notice sent to the class tells class members that they can receive a "free one-month upgrade" or a "free one-month Netflix membership" and that "[t]here will be no price increase during the upgraded month," the disclosure that the relief may not truly be free and that class members may be subject to a "price increase" is buried near the bottom of the notice. *See* Gardner Decl. ¶¶ 31-33. Nor is that disclosure highlighted or otherwise marked in any way that distinguishes it from the rest of the language in the notice. Essentially, the notice gives class members the impression that they will receive "free" benefits with no further obligation, when such benefits are not truly free but instead require class members to affirmatively opt-out of higher charges. Moreover, the notice does not disclose (a) how much class members will be charged if they do not opt out, or (b) the manner and process for opting out. This failure to adequately inform the class of the

automatic renewal feature reduces the chance that class members will opt out after a month and therefore increases the likelihood that the settlement will cause them financial harm.

In similar circumstances, a court threw out a class action settlements that contained an "automatic renewal" feature. In *Erickson v. Ameritech Corp.*, No. 99 CH 18873 (Ill. Cir. Ct. Sept. 18, 2002) (Chavez Decl., Exhibit 1), the settlement agreement in a putative class action against a telephone company provided class members with one free month of speed dial service but also provided that class members would be charged after a month unless they affirmatively opted out. *See id.* at 6. The court rejected the settlement, finding that the speed dial portion of the relief "is likely to benefit [the defendant] more than the class and it smacks of a court-sponsored promotion gimmick." *Id.* at 15. Similarly here, Netflix's "automatic renewal" feature is entirely unnecessary and is a marketing tool that allows Netflix to improve its bottom line. The settlement should be rejected for this reason alone.

B. Most Class Members Will Not Submit Claims and Will Get No Relief At All.

Even assuming that the automatic renewal feature will not cause more harm than good, the settlement nonetheless is inadequate because most class members will end up with no relief at all. Simply making vouchers available to injured class members does not make a settlement fair. Rather, class counsel has a fiduciary responsibility "to ensure that the settlement provides real value" by offering relief that the class will actually use. *Sylvester v. Cigna Corp.*, 369 F. Supp. 2d 34, 49 (D. Me. 2005); *see also* 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."). Here, the non-cash vouchers are structured in such a way that few class members will go to the trouble of obtaining them, leaving the vast majority of the class with nothing at all. Because the value of any unclaimed class benefit is retained by Netflix, this demonstrates that the true beneficiary of the settlement is Netflix, not the class.

Initially, few class members will participate in the settlement's claims process because "[e]xperience has demonstrated that persons with modest or nominal individual potential recoveries will not bother to file a proof of claim form." 3 Newberg on Class Actions, § 8.41 at 289 (4th ed. 2002). Empirical evidence demonstrates that where, as here, class members have small individual claims,

claims submission rates typically are 10% or less.[4] Moreover, in settlements where the relief offered is nonpecuniary, the claims rate is usually even lower. *See* Judge Thomas A. Dickerson, *Consumer Class Actions and Coupon Settlements: Are Consumers Being Shortchanged?*, ADVANCING THE CONSUMER INTEREST at 6 (Sept. 2000) (noting that in food and beverage coupon settlements, the average redemption rate is between two and six percent). To date, the parties have not disclosed the number of claims submitted and have provided no evidence indicating that the submission rate here will deviate from historical experience. *See also* Bramson Decl., ¶ 16 (explaining why various features of this settlement make it unlikely that class members will submit claims). In light of these facts, the settlement likely will provide only minimal relief for the class. *See Dunk*, 48 Cal. App. 4th at 1805 n.13 (noting that redemption rate is a factor that courts should consider in evaluating class action settlements).

Additionally, this settlement contains several particular defects that appear designed solely to benefit Netflix and to minimize the likelihood that class members will obtain any relief.[5] First, the settlement's requirement that class members submit a claim form in order to obtain any relief has no purpose other than to limit Netflix's overall payout. Because current members already have active Netflix accounts, Netflix has all their relevant information, and could easily provide them with vouchers directly without requiring them to submit a claim. *See* Bramson Decl., ¶¶ 18-19; Gardner Decl. ¶ 40. The only apparent explanation for inclusion of a claims process is the existence of the automatic renewal provision. Requiring class members to submit claims forms allows Netflix to impose the automatic renewal without having to worry about failing to obtain the class members' consent. *See* Bramson Decl., ¶ 19; Gardner Decl., ¶ 41. In other words, the parties have included one bad settlement feature (the

---

[4] *See, e.g.*, *In re Compact Disc Minimum Advertised Price Antitrust Litig.*, 370 F. Supp. 2d 320, 321 (D. Me. 2005) (2% submission rate); *Buchet v. ITT Consumer Fin. Corp.*, 845 F. Supp. 684, 695 (D. Minn. 1994), *as amended* 858 F. Supp. 944 (rejecting settlement where similar settlement had only a 3% redemption rate); *Strong v. Bellsouth Telecomm., Inc.*, 173 F.R.D. 167, 169 (W.D. La. 1997), *aff'd*, 137 F.3d 844 (5th Cir. 1998) (4.3% claims rate); *Burch v. United Cable TV of Baltimore Ltd. Partnership*, 732 A.2d 887 (Md. 1999) (9.7% response rate to claims process); *Union Life Fidelity Ins. Co. v. McCurdy*, 781 So.2d 186 188 (Ala. 2000) (observing that only 113 of 104,000 class members submitted claims, for a rate of 0.1%); *see also* Declaration of L. Stephens Tilghman, Settlement Administrator, April 27, 2005, *Sylvester v. Cigna Corp.* (D. Me.), ¶¶ 4, 13 (stating that he has administered more than 175 class action settlements and that "claim-return rates are generally 10% or less in the vast majority of settlements that require the filing of a notice of claim") (Chavez Decl., Exhibit 3); Gardner Decl. ¶¶ 36-37; Bramson Decl. ¶¶ 14-17.

[5] For a comprehensive discussion on how restrictions on coupon redemption exacerbate the unfairness of non-cash settlements, *see generally* Christopher R. Leslie, *A Market-Based Approach to Coupon Settlements in Antitrust and Consumer Class Action Litigation*, 49 UCLA L. REV. 991 (2002).

claims process) solely for the purpose of justifying a second bad feature (the automatic renewal). This should not be allowed.

A second major flaw of the proposed relief is the fact that the non-cash vouchers provided in the settlement are not transferable. Only the class member who submits a claim can use the voucher; it cannot be transferred or sold. This non-transferability eliminates the opportunity for the creation of a secondary market, which would give an incentive for class members who are unlikely to use the voucher to submit claims and then sell their vouchers for cash at whatever price the market allows. The parties' refusal to make the vouchers transferable therefore will dramatically reduce the claims submission rate. *See, e g.*, James Tharin & Brian Blockovich, *Coupons and the Class Action Fairness Act*, 18 GEO. J. LEGAL ETHICS 1443, 1445 (2005) (providing evidence showing that in the absence of a secondary market, voucher redemption rates typically are 1-3%); Bramson Decl., ¶ 16(b). Indeed, transferability generally is regarded as a critical component of any non-cash settlement, and several courts have rejected non-cash settlements that did not allow for the growth of a secondary market. *See, e.g.*, *In re Gen'l Motors Corp. Pick-Up Truck Fuel Tank Prods. Liab. Litig.* ["*In re GM Trucks*"], 55 F.3d 768, 809-10 (3d Cir. 1995) (rejecting settlement vouchers as worthless where there was little chance of a secondary market developing); *Clement v. Am. Honda Fin. Corp.*, 176 F.R.D. 15, 27 (D. Conn. 1997) (rejecting settlement in part because "the coupons in this case are not transferable to third parties and thus have no cash value"); *see also Petruzzi's, Inc. v. Darling-Delaware Co.*, 880 F. Supp. 292, 298 (M.D. Pa. 1995) (rejecting settlement that created obstacles to the growth of a secondary market).[6]

The pernicious effects of these structural defects are compounded by the fact that the settlement does not guarantee any minimum payment to the class. Instead, the settlement includes a reverter allowing Netflix to retain the value of all unclaimed class benefits. The reverter is particularly improper here because a minimum payment could be easily accomplished in one of two ways. First, instead of offering class members a one-time-only voucher that they will lose if not redeemed, the parties could

[6] Consumer groups and others have described transferability as an essential characteristic of any non-cash settlement. *See, e.g.*, Geoffrey P. Miller & Lori S. Singer, *Nonpecuniary Class Action Settlements*, 60 LAW & CONTEMP. PROBS. 97, 126 (1997) ("Severe restrictions on transferability usually counsel against approval except in unusual circumstances, because such restrictions reduce coupon utilization and discriminate, within the class, between members who have a use for the product and ones who do not."); National Association of Consumer Advocates, *Standards and Guidelines for Litigating and Settling Consumer Class Actions*, 176 F.R.D. 375, 384 (1998) (stating that non-cash relief "should have some form of guaranteed cash value" or in the alternative, should be saleable on a secondary market).

structure the settlement to require Netflix to keep issuing vouchers until a specified number are redeemed, thereby guaranteeing that the class receives some minimum benefit. *See, e.g.*, Dickerson, *supra*, (explaining that "[t]o prevent . . . emasculation of the settlement concept," defendants should have to reissue coupons until a threshold redemption level is reached); Bramson Decl., ¶ 20. In the alternative, the settlement could be structured to require Netflix to pay a *cy pres* award to a charitable organization if the value of the vouchers actually redeemed falls short of a minimum threshold. Bramson Decl, ¶ 20. The current settlement, however, incorporates neither option. Instead, the settlement's particular characteristics militating toward an extremely low claims rate along with a reverter clause illustrates that the primary beneficiary of this settlement is Netflix, not the class. In similar situations, courts have rejected settlements that combined low claims-submission rates with a reverter to the defendant. *See, e.g.*, *Sylvester*, 369 F. Supp. 2d at 53, (finding that a claims rate of less than 20% combined with a reverter clause "work[ed] in concert to produce a settlement that is unfair, inadequate and unreasonable and that in practice yields comparably little for the Class"); *Buchet v. ITT Consumer Fin. Corp.*, 845 F. Supp. 684, 696 (D. Minn. 1994), *as amended* 858 F. Supp. 944 (finding settlement unreasonable due to low claims rate and "the lack of any form of guaranteed minimum value"). This Court should do the same.

These defects demonstrate that what class counsel heralds as an $85 million settlement is really worth less than $2 million. Class counsel's estimate relies on the improbable assumption that *every single one* of the more than six million class members will submit a claim. In actuality, based on Netflix's own estimates, the true amount of relief that will go to the class is approximately $1.75 million. In Netflix's 10-Q Statement that it filed with the Securities and Exchange Commission on September 30, 2005, Netflix estimates that "the total cost of the settlement," *including attorneys' fees and expenses*, will be $3,980,000. Netflix SEC 10-Q Statement, at 15 (Chavez Decl., Exhibit 2). Since the settlement calls for $2.5 million in attorneys' fees, that leaves just under $1.5 million going to the four million members of the former-customer subclass.[7] Dividing $1.5 million by the claimed value of a free month

[7] Netflix is unclear whether it is estimating that the total cost of the settlement will be $3.98 million, or whether that estimate excludes the cost of relief going to the current-member subclass. Netflix estimates that "the *total cost* of the settlement will be $3,980[,000]," which appears to include all relief that Netflix will have to pay out. Exhibit 5, at 15 (emphasis added). Later in that same paragraph, Netflix states that it is recording a charge against earnings of $3.98 million for legal fees and relief for former class members, but that the charge for the free month upgrade for current

of Netflix service ($17.99) and then further dividing that by the approximately four million members of the former-customer subclass reveals that Netflix estimates a claims submission rate for former class members of just over two percent. If current class members submit claims at the same rate, that adds another $250,000 in relief for them (2 million current members multiplied by the claimed value of $6.00 for a one-month upgrade multiplied by .02), for a total settlement value of $1.75 million. In other words, the true value of the settlement is a minuscule 2.05% of the $85 million claimed by class counsel. The inadequacy of this tiny sliver of class relief is all the more apparent when compared with class counsel's request for $2.5 million in attorneys' fees, which according to Netflix, accounts for 60% of its total settlement payout. Such a result is indefensible and should be rejected on its face.

In short, this settlement is a prime example of one that benefits the defendant and class counsel at the expense of the class. While each of this settlement's questionable features on its own raises suspicions about the settlement, when evaluated cumulatively, the settlement's unfairness is clear. The combination of (a) the automatic renewal feature, (b) an unnecessary claims process, (c) vouchers that are not transferable, (d) a likely low claim-submission rate, and (e) the lack of any guaranteed minimum payout to the class while class counsel are guaranteed $2.5 million in attorneys' fees, amply demonstrates the inadequacy of this settlement.

C. The Class Relief Is Inadequate in Light of Class Counsel's $2.5 Million Fee.

That the parties agreed to pay class counsel $2.5 million in attorneys' fees when the class is likely to receive less than that further cements the inadequacy of the class relief. The amount of requested attorneys' fees is an important factor in assessing the reasonableness of the class relief, since every dollar that goes to class counsel is a dollar less that is available to compensate class members:

> Although under the terms of [a] settlement agreement, attorneys' fees technically derive from the defendant rather than out of the class recovery, in essence the entire settlement amount comes from the same source. The award to the class and the agreement on attorney fees represent a package deal. Even if the fees are paid directly to the attorneys, those fees are still best viewed as an aspect of the class recovery.

Apple Computer v. Superior Court, 126 Cal. App. 4th 1253, 1269 (2005) (quoting *Lealao v. Beneficial Cal., Inc.*, 82 Cal. App. 4th 19, 33-37 (2000)); *see also Lealao*, 82 Cal. App. 4th at 37 ("The value of

---

members will be recorded in future quarters when the customers actually utilize the upgrade. *See id.* Giving the parties the benefit of the doubt, Objector will assume that Netflix's estimate does not include relief for current Netflix members.

the benefit a settling defendant is willing to confer on the class . . . will . . . invariably be influenced by the amount of fees it would be obliged, or estimates it would be obliged to pay class counsel . . . .").

The parties' agreed-upon $2.5 million attorneys' fee raises even greater suspicions about the adequacy of the class relief than in a typical settlement. First, the parties' negotiation of a "clear sailing provision," whereby Netflix agrees not to challenge class counsel's request for $2.5 million in attorneys' fees, *see* Settlement Agreement ¶ 8.2, triggers heightened scrutiny of the settlement's fairness because of the risk that class counsel may have bargained away valuable relief for the class "in exchange for red-carpet treatment on fees." *Weinberger v. Great N. Nekoosa Corp.*, 925 F.2d 518, 524-25 (1st Cir. 1991). Second, the proposed attorneys' fee is distinct from the class relief, which decouples class counsel's interest from that of the class. Because class counsel seek to justify their attorneys' fee by reference to the face value of the vouchers, and because class counsel will get paid regardless of whether class members actually submit claims, class counsel only has an incentive to create an appearance of valuable relief, so as to justify their attorney fee, but no incentive to ensure that the class actually obtains any relief. *See Polar Int'l Brokerage Group v. Reeve*, 187 F.R.D. 108, 119-20 (S.D.N.Y. 1999); *see also* Dickerson, *supra* ("Considering the low redemption rate of coupon settlements, defendants may be willing to pay inordinately high cash fees to class counsel in return for support in promoting a non-cash settlement in which the class receives near worthless coupons.").

Here, class counsel's $2.5 million attorneys' fee likely represents almost 60% of the total relief paid out by Netflix and thus demonstrates the inadequacy of the class relief. Netflix's own estimates of the cost of the settlement indicate that while it has agreed to pay out $2.5 million in attorneys' fees, it is likely to pay out only $1.75 million in relief to class members because so few class members will submit claims. *See* Exhibit 2 at 15. Thus, class counsel's fee represents close to 60% of the total relief. Whatever the total value of the class members' claims may be, an allocation of relief that gives the class only 40% of the relief and class counsel 60% of the relief is unfair, unreasonable, and inadequate.

C. The Injunctive Relief is Inadequate.

The problems inherent in the settlement's provision of a class benefit cannot be salvaged by the settlement's paltry injunctive relief. As a threshold matter, even if the injunctive relief did benefit the class, it still would not justify the settlement's automatic renewal provision, the low-claims rate, the non-

transferability of the voucher, and the reverter to Netflix. Even putting aside those concerns, however, the settlement's injunctive component, which requires Netflix to change its "Terms of Use" and to refer to its Terms of Use in its advertisements, is as flawed as its damages counterpart, for several reasons.

First, the injunctive relief only lasts one year. Settlement Agreement, § 3.3. After a year, Netflix is free to make the same representations in its advertisements and on its website that it did before this lawsuit was ever filed. This effectively eviscerates the value of the injunctive relief. *See Schwartz*, 157 F. Supp. 2d at 573 (finding the value of settlement's injunctive relief to be "minimal at best" where it would remain in place for only 1-2 years). Second, the settlement does not require Netflix to change its DVD delivery practices that gave rise to this lawsuit, but only to make disclosures about those practices on its "Terms of Use" page. Those required changes to the Terms of Use page are minor and not materially different from its previous Terms of Use. *See* Gardner Decl., ¶ 47. Third, altering the Terms of Use does not correct the problem of Netflix's misleading advertisements. The only changes required with respect to advertising is that Netflix must include "See Terms of Use for Details" somewhere in its ads, and the exact time and location of that disclosure rests with Netflix's own discretion. There is no requirement that the disclosure be conspicuous (in print or TV), or audible (on the radio), and no requirement that Netflix change its internet advertisements at all. *See* Gardner Decl. ¶ 43. Not only will a simple footnote referring to Netflix's "Terms of Use" fail to rectify any deceptive statements made in its ads, to the extent that the potential customers respond to Netflix's reference to its "Terms of Use" page by visiting the company's website, Netflix gets what it wants: more traffic on its website. *See id.*, ¶¶ 44-45. The notion that the addition of "See Terms of Use for Details" will give potential customers any real awareness of Netflix's delivery practices is wholly unrealistic. Thus, like the damages relief, the settlement's injunctive relief does not support approval of the settlement.

II. THE COURT SHOULD REFUSE TO APPROVE THE SETTLEMENT BECAUSE THE CLASS NOTICE IS DEFECTIVE.

Even aside from the adequacy of the relief, the settlement must be rejected for the separate and independent reason that the class notice was defective for failing to disclose class counsel's requested attorneys' fee of $2.5 million and for failing to adequately disclose the automatic renewal provision. Due process requires that absent class members receive notice of material terms of class settlements. *Mullane v. Cent. Hanover Bank & Trust Co.*, 339 U.S. 306, 313 (1950). "The Notice must be structured

to enable class members rationally to decide whether to intervene or object, 'opt out,' or accept the settlement." *Trotsky v. Los Angeles Fed. Sav. & Loan Ass'n*, 48 Cal. App. 3d 134, 152 (1975).

It is well-established that the parties' attorneys' fees agreement must be included in the class notice so that class members can consider the effect of the proposed fee on the relief provided to the class and so they can decide whether they are being shortchanged and should object to the settlement. *See In re Gen'l Motors Corp. Engine Interchange Litig.*, 594 F.2d 1106, 1130-31 (7th Cir. 1979) (without a "clear estimate of attorneys' fees and expenses," class members "could not determine the possible influence of attorneys' fees on the settlement in considering whether to object to it"); *Gen'l Motors Corp. v. Bloyed*, 616 S.W.2d 949, 957 (Tex. 1996) ("[T]he settlement must be set aside because the class members did not receive adequate notice of all the material terms of the proposed settlement, specifically the projected amount of attorneys' fees"); *Staton v. Boeing*, 327 F.3d 938, 963 n.15 (9th Cir. 2003); *Piambino v. Bailey*, 610 F.2d 1306, 1328 (5th Cir. 1980); *Goldenberg v. Marriott PLP Corp.*, 33 F. Supp. 2d 434, 441 (D. Md. 1998) ("Notice of the potential extent of attorneys fee awards is deemed essential because it allows class members to determine the possible influence of the fees on the settlement and to make informed decisions about their right to challenge the fee award."); *State v. Homeside Lending, Inc.*, 826 A.2d 997, 1009-10 (Vt. 2003); *Dotson v. Bell Atl.-Md., Inc.*, 2003 WL 23508428 at *6-7 (Md. Cir. Ct. Nov. 13, 2003). By failing to disclose the parties' attorneys' fees agreement, the class does not have enough information "to decide whether to intervene or object, 'opt out,' or accept the settlement." *Trotsky*, 48 Cal. App. 3d at 152.

Here, the summary notice is fatally defective because it fails to disclose that the parties agreed that class counsel would seek $2.5 million in attorneys' fees without objection from Netflix. *See also* Gardner Decl. ¶¶ 18-24. The summary notice includes no information about attorneys' fees whatsoever.[8] Nor is there any reason why it would have been impracticable to include the requested attorneys' fee in

[8] The fact that the last line of the summary notice refers class members to www.netflixsettlement.com, where links are provided to the settlement agreement and the "Long Form Notice," does not remedy this defect. A notice that does not provide necessary information for class members but merely directs class members to somewhere else for relevant information is no notice at all. In *Dotson v. Bell Atl.-Md., Inc.*, the court found that a notice which did not itself describe the attorney's fee, but instead referred class members to a settlement website for attorney fee information, was facially invalid. 2003 WL 23508428 at *6. Additionally, the notice's lone reference to the settlement website does not mention where class members should look to find information about attorneys' fees, but leaves class members to comb through the settlement documents themselves in the hope that they may come across some information on attorneys' fees. *See* Gardner Decl., ¶ 21. To legitimize such a bare-bones process would be to undermine the concept of notice altogether.

the class notice. *See Hypertouch, Inc. v. Superior Court*, 128 Cal. App. 4th 1527, 1539 (2005) (notice "must be the best practicable" under the circumstances (*quoting Phillips Petroleum Co. v. Shutts*, 472 U.S. 797, 812 (1985))). Since the summary notice was sent primarily by email, which does not have any inherent length or space limitations, adding a single sentence describing the amount of requested attorneys' fees would have required only negligible cost. Gardner Decl., ¶ 19. Moreover, "any contention that providing fee information in a class action notice would be impracticable is belied by the routine inclusion of such information in class action notices." *Bloyed*, 916 S.W.2d at 958 (citing cases). Finally, the failure to disclose the attorney's fee is particularly glaring because the settlement's inclusion of a clear sailing provision makes notice of the attorneys' fees all the more important so that the class can consider the effect of the fee negotiations on their own relief. Thus, the failure to disclose the attorneys' fee renders the class notice defective on its face and requires disapproval of the settlement.

Additionally, the parties' failure to adequately disclose the settlement's automatic renewal feature renders the notice defective. The notice's description of the class relief gives class members the impression that their upgraded or renewed service is "free," while burying at the bottom of the notice the disclaimer that class members must affirmatively opt-out before the end of the "free" month in order to avoid a price increase. Also, the notice fails to inform class members of either (a) the cost of the higher charges if they fail to opt out, or (b) the process for opting out of the automatic renewal.

CONCLUSION

For the foregoing reasons, this Court should refuse to approve the proposed settlement and should issue an order requiring the parties to serve on both the Court and Objectors the number of claims submitted by the class five days prior to the scheduled fairness hearing.

Respectfully submitted,

CHAVEZ & GERTLER, LLP
TRIAL LAWYERS FOR PUBLIC JUSTICE

By: _____

RICHARD FRANKEL (SBN 229136)

Attorneys for Objector Mark Schallert