

THE CY PRES DISTRIBUTION OF A CLASS ACTION RECOVERY SURPLUS: EQUITY OR INEQUITY?

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I. DESCRIPTION OF THE CY PRES PROBLEM

Imagine the settlement of a case involving the refund by Jefferson County, Alabama, of employee occupation taxes that the court finds to be illegal.¹ There are 350,000 claimants and about \$30 million to be refunded or about \$100 a head. In paying claims, as the Claims Administrator, you followed a Cadillac distribution plan, first asking the employers, who kept the payroll records for occupation taxes, to provide the information for you to pay the employees. Then, for the employees whose employers did not participate, you gave them notice and time to file their own claims. Throughout the process, you provided notice in the newspapers and news media and used the employer name and address data provided by Jefferson County. The dust has settled and you have paid claims to about 85% of the employees, with there being about \$2.5 million left. If you were to pay the remainder to the 85% of the claimants that you located, they

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1. This is an actual case. See *Edwards v. Jefferson Cnty. Comm'n*, No. CV-2007-900873, 2010 WL 4970980 (Ala. Cir. Ct. Jan. 15, 2010), *rev'd*, 49 So.3d 685 (2010).

would each get \$7. And it would cost about \$4 to prepare and send each check. Where should the money go?

Courts around the country have looked at four alternative solutions:

1. Pay the excess money to the claimants who appeared, no matter how expensive.
2. Give the money back to the defendant.
3. Give it to the state or federal government, depending on what court you are in.
4. Apply the cy pres doctrine, which would result in the money going to charity.

What seems to be the most fair?

II. HISTORY AND DEVELOPMENT OF THE CY PRES CONCEPT

The cy pres problem arose in 1966, when Federal Rule of Civil Procedure 23 was modified by adopting the “book of the month club” approach to class actions so that those named as members of a class who did not object were automatically in the class.² Those included in the class description who had made no choice to participate in the proceeding were included by default. Lawyers and courts then encountered the serious problem of paying a judgment or settlement award from the defendants to all of the class members, many of whom did not appear and could not be located. At the end of the day, there are therefore surpluses in settlement funds. This led to the development of the cy pres doctrine in class action settlements.

Cy pres first arose in the administration of charitable trusts. In *Jackson v. Philips*,³ a will of a Bostonian bequeathed to trustees monies to put an end to negro slavery in the United States. After slavery was abolished by the Thirteenth Amendment, the funds were applied, instead, to help poor blacks in Boston. Under the cy pres doctrine of charitable trusts, when the trust purpose fails, the money is applied as nearly as possible to the original intent, with cy pres meaning “as near as possible” in French.

The earliest use of cy pres for class action surpluses was in *Miller v. Steinbach*.⁴ Owners of four million shares in a company that had merged with another claimed that the terms of the merger were unfair. The relatively modest settlement fund of about \$4 million could not be realistically distributed to the shareholders at one dollar a head. The settlement therefore

2. See FED. R. CIV. P. 23 advisory committee’s note (“The ‘spurious’ action envisaged by original Rule 23 . . . was supposed not to adjudicate the rights or liabilities of any person not a party.”)

3. 96 Mass. 539 (1867).

4. 268 F.Supp. 255 (S.D.N.Y. 1974).

paid the fund to the company's retirement plan, calling it a variant of the cy pres doctrine of trusts at common law. Presumably, the logic of the decision was that many stockholders were retirement plan participants and vice versa. However, there is no analysis in the decision to that effect. In the *Miller* case, at least, there is some arguable overlap between the class members and those that got the surplus money, fulfilling cy pres' definition. This is not always the case, though, and sometimes the class members get nothing, with all of the money going to cy pres.

Does this sound like a court acting like a legislature and not resolving disputes between plaintiffs and defendants?

Consider *In re Compact Disc Minimum Advertised Price Antitrust Litigation*,⁵ where over half of the settlement amount resulting from a compact disc price antitrust case was in the form of free compact discs to be provided to schools, libraries and charities, who may not have been damaged by the compact disc prices complained of in the case.

How big a problem is this cy pres distribution to charities and not class members? A famous *Florida Law Review* article attempted to answer this question in the 1991 to 2008 time frame.⁶

Comparing 1991 to 2000 with 2001 to 2008, the number of settlements in federal court with a cy pres component has tripled.⁷ If none of the settlement money goes directly to class members but to charities, instead, it is sometimes called a false or faux class action. Before 2001, eleven of thirty with cy pres cases were faux class actions, and between 2000 and 2008, twenty-four of sixty-five were.⁸

Is this a fair resolution of a case between plaintiffs and defendants? Clearly, cy pres monies go to good uses, such as defending poor people in litigation through legal defense funds. But isn't the money, in equity and fairness, meant to go to the class members who are allegedly hurt and whose injuries generated the money? The money we are talking about is not insignificant. Look at Figure 3 on the law review article. Over to the left is the total settlement fund amount that you normally see in federal court. As you can see, the average is \$51 million. Based on the study, \$5.8 million is the average cy pres amount of a settlement fund and it is usually about 30% of the overall settlement, so only 70% of the money actually goes to class members on average. The *Florida Law Review* article also states that there were ten cases where cy pres awards were 75% or more of the total damages. All ten of these were faux class actions, where

5. 216 F.R.D. 197 (D. Me. 2003)

6. Martin H. Redish, Peter Julian & Samantha Zyontz, *Cy Pres Relief and the Pathologies of the Modern Class Action: A Normative and Empirical Analysis*, 62 FLA. L. REV. 617 (2010).

7. *See id.* at 653-66.

8. *Id.* at 655.

almost all of the settlement money was earmarked up front to go to charity and not class members.⁹

Let's look at this issue more closely and see if we can suggest some reforms.

III. ALTERNATIVE SURPLUS DISTRIBUTION BUCKETS

A. *Pay the Surplus to Class Members*

This alternative is advocated strongly by Adam Liptak in *Doling out Other People's Money*, New York Times, Sidebar Column, November 26, 2007. Of course, the other people are the class members. He looked at a case where there was \$6 million in unclaimed money from the settlement of an antitrust case brought by fashion models. The judge awarded a half million dollars of the surplus to a substance abuse program, a million dollars for an eating disorder program, and so on. Mr. Liptak laments that this approach allows judges to choose how to spend other people's money, which is not a true judicial function and can lead to abuse. Doesn't the legislature decide how to spend our money and not the courts?

The American Law Institute weighed in in 2010 to try to solve the crisis by proposing a simple solution: Unless the plaintiffs cannot be found or the sums involved are too trivial to bother with, class actions settlement money must go to actual plaintiffs.¹⁰ The argument against this in the fashion model settlement described by Adam Liptak is that they would have received a windfall, maybe multiples of the amount by which they were hurt. But, at least the money would be going to the plaintiffs and not to third parties that had nothing to do with the case.

B. *Why Not Give the Money Back to the Defendant?*

This is an unpopular suggestion with many, because a lot of us prefer to talk about plaintiffs, who claim to have been hurt. The money was paid by the defendant based upon claimed injury to plaintiffs. If you give it back to the defendant, isn't that a windfall to the defendant? The defendant might counter that, if you don't return the excess money, you are forcing him to pay it to an uninjured charity, violating his right to procedural due process, in which you are only required to pay someone you've hurt.

Under this defendant claw back approach, unclaimed funds would go to the defendant on the theory that the defendant's money remains his unless it is awarded as damages and claimed by a plaintiff. Can we really say that

9. *Id.* at 660–61.

10. PRINCIPLES OF THE LAW OF AGGREGATE LITIGATION § 3.07: Cy Pres Settlements.

damage awards are made in the air and not awarded to a specific plaintiff? Unless a plaintiff recovers the money, this argument goes, doesn't the money remain the property of the defendant? If you don't give it back to the defendant, can you really say it is damages, because it didn't go to a plaintiff? Does it look more like a fine or penalty, which has to be pursuant to a statute or regulation? What statute or regulation? The creative mind of the court or of the lawyers?

C. *Why Not Let the State Have It?*

For an example of this approach, see *West Virginia v. Chas. Pfizer & Co.*,¹¹ where consumer class members were notified that, if they fail to make a claim to a settlement fund in 90 days, the money would go to the Attorney General as the representative for the benefit of the citizens of West Virginia. The underlying case was an antitrust suit involving antibiotic drugs, but the resulting projects using the money were drug abuse programs, community health clinics, lead poisoning and sickle cell anemia research, and other areas of need designated by the Attorney General.

This is like putting the money in the general fund for a state. At least this approach prohibits courts from doing whatever they want with the funds, and the money would go for the general public, unguided by the preferences of a judge or the attorneys in the settlement. But, it certainly doesn't go for the purpose intended in the lawsuit, paying class members.

In summary, none of these alternatives to cy pres is completely appealing. Below are some more creative and perhaps radical ideas.

IV. ALTERNATIVE SOLUTIONS AND USES FOR SETTLEMENT FUND SURPLUSES

A. *Fluid Recovery*

In contrast to cy pres, this concept has had a difficult time in the courts, such as in the early California case of *Blue Chip Stamps v. Superior Court*,¹² where it was disallowed. Fluid recovery is a three-step process: you still calculate the total damages, then pay them out to those class members who appear and file claims, and you distribute the remainder to the class as a whole or to an entity that will benefit the class as a whole to provide future relief that approximately addresses the injury that occurred in the past.

11. 314 F. Supp 710 (S.D. N.Y. 1970), *aff'd* 440 F.2d 1079 (2d Cir. 1971), *cert denied*, 404 U.S. 871 (1971).

12. 556 P.2d 755, 760 n.2 (Cal. 1976).

The assumption is that the class of future users will likely overlap with the injured class of past users.

In *Blue Chip*, even though it was disapproved, there seemed to be an exquisite fluid recovery remedy. To compensate consumers who redeemed blue stamps (similar to green stamps) for paying too much sales tax upon redemption, the sales tax collected on future blue stamp redemptions was to be reduced. In denying this “fluid recovery” request, the court observed that “the instant case provides no correlation between those who paid excess tax and those who might reap the benefit of a future reduction in redemption price.”¹³ But doesn’t fluid recovery sound like *cy pres*, in matching a remedy as nearly as possible to the original claim?

Fortunately, the hard line against fluid recovery is melting, with courts beginning to see that it is a creative effort to provide compensation to a class of plaintiffs which may otherwise be impossible.

Amason v. Kangaroo Express allowed what seemed to be a sound fluid recovery remedy in a class settlement of a Federal Fair and Accurate Credit Act case where convenience stores had more than five credit card digits on customer receipts.¹⁴ A \$1.5 million settlement surplus was used to give customers \$2 off each convenience store sale until the surplus was used up, as the customers were likely class members. In *Amason*, the fluid recovery was roughly enjoyed by the class members, much as it would have been in *Blue Chip*.¹⁵

B. A More Radical Suggestion: Deny Class Certification If You Can’t Find the Class Members or Pay Them?

This alternative was raised with the Supreme Court, which denied certiorari to an unnamed plaintiff protesting the Facebook Beacon settlement in November 2013.¹⁶

Facebook had been sued over its Beacon feature, under which, when you bought an item from a participating store, the information was shared with all your friends. The named plaintiff in the underlying suit had bought

13. *Id.* at 759.

14. *See Amason v. Kangaroo Express*, No. 7:09-CV-2117-RDP, 2013 WL 987935 (N.D. Ala. Mar. 11, 2013).

15. *See also*, *Democratic Cent. Comm. of D.C. v. Wash. Metro. Area Transit Comm’n*, 84 F.3d 451, 454 (D.C. Cir. 1996) (citing *Bebchick v. Public Utils. Comm’n*, 318 F.2d 187, 204 (D.C. Cir. 1963)) (recognizing fluid class recovery as “effective for remedying overcharges on items which are repeatedly purchased by the same individuals,” such as public bus tickets by public bus passengers); *The Agent Orange Product Liability Litigation*, 597 F. Supp. 740, 860 (E.D.N.Y. 1984) (approving a portion of the settlement fund to provide program benefits—such as post-traumatic stress syndrome counseling for the class as a whole—because the recipients were found to be equivalent to the class that they claimed injury from Agent Orange).

16. *Marek v. Lane*, 134 S.Ct. 8 (2013).

a surprise ring for his spouse, and she and his other 500 friends found out about it ahead of time, spoiling the surprise.¹⁷ A lawsuit was filed by nineteen named plaintiffs on behalf of several million unnamed class members.¹⁸ The settlement was for \$9.5 million—or about 30 cents each.¹⁹ The unnamed class members did not get any of the money; it went to a charity to protect consumer rights that was run by Facebook and the plaintiffs' lawyer.²⁰ The plaintiff's lawyer got \$3 million in fees.²¹ This appeared to be a faux class action settlement.

Although the Supreme Court denied certiorari, Chief Justice Roberts issued this stern warning:

I agree with the Court's decision to deny the petition for certiorari. Marek's (the plaintiff) challenge is focused on the particular features of the specific *cy pres* settlement at issue. Granting review of this case might not have afforded the Court an opportunity to address more fundamental concerns surrounding the use of such remedies in class action litigation, including when, if ever, such relief should be considered; how to assess its fairness as a general matter whether new entities may be established as part of such relief; if not, how existing entities should be selected; what the respective roles of the judge and parties are in shaping a *cy pres* remedy; how closely the goals of any enlisted organization must correspond to the interests of the class; and so on. This Court has not previously addressed any of these issues. *Cy pres* remedies, however, are a growing feature of class action settlements. See Redish, Julian, & Zyontz, *Cy Pres Relief and the Pathologies of the Modern Class Action: A Normative and Empirical Analysis*, 62 Fla. L. Rev. 617, 653-656 (2010). In a suitable case, this Court may need to clarify the limits on the use of such remedies.²²

Chief Justice Roberts has thrown down the *cy pres* gauntlet: a class action settlement with a *cy pres* centerpiece will be on thin ice.

CONCLUSIONS

There are some important conclusions to draw from the current status of *cy pres*.

17. Verdict & Settlement Summary, *Jane v. Facebook Inc.*, No. 08CV03845(RS), 2010 WL 3071995 (N.D. Cal. May 27, 2010) [hereinafter *Jane* settlement]

18. *Id.*

19. *Marek*, 134 S.Ct. at 8–9.

20. *Id.*

21. *Jane* settlement.

22. *Marek*, 134 S.Ct. at 9 (emphasis added).

First, our class action structure is in jeopardy. If the Supreme Court gets the right case, it might challenge the validity of any settlement involving cy pres unless it is managed better. The worst downside is to risk the reversal of the 1966 Rule 23 modification to have class action settlements on a book of the month basis, which would jeopardize class action practice. When a court decides whether a class action can be brought, it should look at the unclaimed fund issue in determining whether to certify the class. If meaningful relief can't be provided to the majority of class members, it may not be a good class action in the first place. For example, consider the results of the Facebook Beacon case.

For class action settlements that are substantially paid to class members, with a residue of only 10–20%, the classic approach to cy pres could be followed. Under that approach, you first pay the recovery to the class members who appear to the extent it is not a windfall. Then, you might consider a fluid recovery or other approximate payment for the benefit of the whole class. Lastly, you could invite charities to apply for the monies, while attempting to have the charities' purposes approximate the theory of the case or at least the class members' location.

For example, in the Jefferson County Occupation Tax Case we started this article with, we first determined whether the \$2.5 million residue could be paid as a refund to the class members. It was decided that \$7 a head was not practicable, when it cost \$5 to prepare and mail a check. We then looked at the closest possible alternative relief.

We thought a sales tax holiday in the cities of Jefferson County for school books might be a good idea. However, the Alabama legislature is required to approve sales tax holidays, making this solution unviable. We then looked at charities serving Jefferson County, and prepared a request for proposals, providing newspaper and media notice. Under the request for proposals, each applicant would describe how many persons it served in the county and the purpose of the cy pres award. We then interviewed all the charities who applied, and made the awards. All charities participating pretty much received a ratable award. This is not a perfect solution to cy pres in the Occupation Tax Case settlement, but the Occupation Tax Case is the opposite of a faux class settlement. Eighty-five percent of the claimants were paid—a large percentage for these types of cases. We also tried to tailor the cy pres award as near as possible to its French definition.

Finally, in each proposed class action settlement, the court should consider the other alternative uses of the surplus, such as paying the money to the defendant or the state, depending on the circumstances.

Due to these new developments in the law, we may expect a new group of lawyers to challenge all class action settlements with a cy pres component as going beyond judicial procedure and evolving into

unconstitutional legislation. The best way to preserve the class action system under this crisis is to develop and apply some concrete rules of due process for cy pres distributions, as has been described here.