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**SETTLEMENTS****CONSUMER**

Cy pres distributions can provide a practical method for dealing with unclaimed settlement funds, but cy pres distributions are not without critics and some courts have disapproved cy pres awards in class action settlement agreements, say attorneys Kathryn Harrigan Christian, D. Matthew Allen, and Jaret J. Fuente in this BNA Insight. The authors offer a primer on cy pres distributions, address key criticisms, discuss the principal legal tests for evaluating these distributions, and provide a list of suggested considerations for settlement agreements including a cy pre distribution.

**When the Cup Runneth Over: Cy Pres Distributions in Class Action Settlements**

BY KATHRYN HARRIGAN CHRISTIAN,  
D. MATTHEW ALLEN, AND JARET J. FUENTE

*Kathryn Harrigan Christian is an associate in the Tampa office of Carlton Fields. Christian is the associate editor of the Carlton Fields Classified Class Action Blog (<http://www.carltonfields.com/classactionblog/>), and can be reached at [khchristian@carltonfields.com](mailto:khchristian@carltonfields.com).*

*D. Matthew Allen is a shareholder at Carlton Fields, where he practices class action litigation, including antitrust law, deceptive trade practice law, insurance litigation, appellate law, and general business disputes. Allen is available at [mallen@carltonfields.com](mailto:mallen@carltonfields.com).*

*Jaret J. Fuente is also a shareholder, and represents businesses and professionals in commercial and tort litigation, including class actions, mass torts, and multi-district litigation in the construction and products manufacturing industries. Fuente can be reached at [jfuente@carltonfields.com](mailto:jfuente@carltonfields.com).*

Courts approving class action settlements often review how the parties have provided for settlement funds that either (1) cannot be distributed to individual class members because, for example, proof of individual claims is burdensome or distributing damages is costly; or (2) remain unclaimed following distribution to class members who make claims.<sup>1</sup> There are several ways in which such funds can be distributed, including pro rata distribution to class members; reversion to the defendant; escheat to the government; or cy pres distribution.<sup>2</sup> This article focuses on cy pres distribution.

**What Is a Cy Pres Distribution?**

A cy pres distribution is a distribution for the indirect prospective benefit of the class. Typically, the parties attempt to find the “next best use” of funds that remain after a class action settlement has been fully administered.<sup>3</sup> “The cy pres doctrine originated as a rule of construction to save a testamentary charitable gift that would otherwise fail, allowing ‘the next best use of the

<sup>1</sup> Alba Conte & Herbert Newberg, *Newberg on Class Actions* § 11:20 (4th ed. 2002).

<sup>2</sup> *Id.* at § 10:17; see also *Fogie v. Thorn Americas*, No. 3-94-359-MJD (D. Minn. Mar. 9, 2001).

funds to satisfy the testator's intent as near as possible.'"<sup>4</sup> The phrase "cy pres" comes from the Norman French expression "cy pres comme possible," meaning "as near as possible."<sup>5</sup>

## The Value of Cy Pres Distributions

Cy pres distributions provide a practical method for dealing with unclaimed settlement funds and can provide indirect compensation to the class through, for example, future price reductions or distribution of funds to entities that provide services to the class.<sup>6</sup> In cases where the recovery for each class member is so small that the class members may not take the time to make a claim against a settlement fund, or distribution is otherwise impractical, some courts have found that cy pres distributions can provide a compensatory remedy to the class.<sup>7</sup> Cy pres distributions can also serve the purpose of deterrence and voluntary compliance where, for example, parties cannot agree on a beneficiary of settlement funds.<sup>8</sup> For defendants, cy pres awards can provide compensation that simultaneously operates as a charitable contribution—a tax deduction in disguise. Further, courts and parties resort to cy pres distributions when they wish to avoid (i) returning the funds to a defendant who has been found liable, or who agreed it was liable; and (ii) increasing the pro-rata share of the class members who file claims, potentially giving those class members a windfall.<sup>9</sup>

Cy pres distributions also can serve to fund important charitable and social causes. Cy pres distributions to such diverse organizations as community development projects,<sup>10</sup> the American Red Cross,<sup>11</sup> legal aid enti-

ties,<sup>12</sup> and other charitable groups and organizations<sup>13</sup> have been approved. Several states specifically provide for legal services programs, among others, to receive cy pres distributions, either by court rule or statute.<sup>14</sup>

## Critics of Cy Pres Distributions

Cy pres distributions are not without critics. Some have suggested that the concept of cy pres should not be extended from the testamentary context to the class action context because the "class action cy pres presents a dramatically different situation from the normal unclaimed property context."<sup>15</sup> Courts have noted that cy pres awards can provide a windfall to nonmembers of the class and members who have already recovered,<sup>16</sup> are sometimes considered punitive,<sup>17</sup> present possible judicial ethics problems;<sup>18</sup> can unreasonably inflate plaintiffs' attorneys' fee awards,<sup>19</sup> and may even be unconstitutional.<sup>20</sup> One court summarized its view of cy pres distributions as follows:

(i) class actions are disputes between parties and the money damages should remain among the parties, rather than be

<sup>12</sup> *Akaosugi v. Benihana Nat. Corp.*, No. C-11-01272 WHA (N.D. Cal. Jan. 24, 2013) (approving cy pres distribution to Lawyers' Committee for Civil Rights of Northern California or to escheat to the State of California Controller's Office's unclaimed property fund).

<sup>13</sup> *Franco v. Ruiz Food Products, Inc.*, No. 1:10-CV-02354-SKO (E.D. Cal. Nov. 27, 2012) (approving the selection of Ruiz-4-Kids and the Chicana Latina Foundation as the cy pres beneficiaries).

<sup>14</sup> *Cy Pres Funds for Legal Aid*, 69 Bench & B. Minn. 8 (Nov. 2012); Amanda Donlin & Ryan Caday, *Cy Pres Provision Added to Hawai'i Rules of Civil Procedure*, 15 Haw. B.J. 20, 20 (June 2011).

<sup>15</sup> Redish, *supra* n. 9.

<sup>16</sup> *Eisen v. Carlisle & Jacquelin*, 479 F.2d 1005 (2d Cir. 1973), *cert. granted*, 414 U.S. 908 (1973) and *judgment vacated*, 417 U.S. 156 (1974).

<sup>17</sup> *Mirfasihi v. Fleet Mortg. Corp.*, 356 F.3d 781, 784 (7th Cir. 2004) (stating "[t]here is no indirect benefit to the class from the defendant's giving the money to someone else," and noted that the badly named "'cy pres' remedy" is "purely punitive").

<sup>18</sup> *Adams v. CSX Railroads*, 84 So.3d 1289, 1290 (La. 2012) (noting that a judge declined to adopt a cy pres distribution to the Louisiana Bar Foundation, since he was a fellow of the LBF, due to the judge's concern that it would be a violation of the Code of Judicial Conduct); *Lane v. Page*, 862 F. Supp. 2d 1182, 1232-1233 (D.N.M. 2012) ("The Court also believes that distributions to third parties presents issues regarding the appearance of impropriety, because judges are engaging in the selective distribution of funds to parties not before it.").

<sup>19</sup> *In re Heartland Payment Systems, Inc. Customer Data Sec. Breach Litig.*, 851 F. Supp. 2d 1040, 1076-1078 (S.D. Tex. 2012) (cy pres award should not be valued as equal to direct payments to class members for purposes of attorneys' fee award, since the "class benefit conferred by cy pres payments is indirect and attenuated").

<sup>20</sup> *Compare Redish, supra* n. 9 (asserting that cy pres distributions violate the Rules Enabling Act and present an Article III problem) with *Newberg, supra* n. 1 at § 10:22 ("Cy pres is a substantive law principle. It is not a procedural rule that would be barred from enlarging, modifying or abridging substantive rights, contrary to the Rules Enabling Act."); *see also Thomas v. Baca*, No. CV-04-08448 DDP (C.D. Cal. Mar. 22, 2012) (suggesting cy pres award gave rise to "serious separation of powers concerns" where court was asked to apply the cy pres doctrine to fund new construction of Los Angeles County jail facilities).

<sup>3</sup> Thomas A. Doyle, *Residual Funds in Class Action Settlements Using "Cy Pres" Awards to Promote Access to Justice*, 57 Fed. Lawyer 26, 26-27 (July 2010).

<sup>4</sup> *In re Airline Ticket Com'n Antitrust Litig.*, 268 F.3d 619, 625 (8th Cir. 2001) (quoting *Democratic Cent. Comm. v. Washington Metro. Area Transit Comm'n*, 84 F.3d 451, 455 n. 1 (D.C. Cir. 1996)).

<sup>5</sup> *Id.*

<sup>6</sup> Newberg, *supra* n. 1 at § 10:23.

<sup>7</sup> *Fraser v. Asus Computer Int'l*, No. C 12-00652 WHA (N.D. Cal. Dec. 21, 2012) (noting that a cy pres distribution "would be fair" where class members may not take the trouble to fill out a form for the \$17 claim amount, since "if a class member with actual notice declined to submit a claim form, then he or she could do so in the realization that his or her seventeen dollars would go to a worthwhile consumer-protection cause").

<sup>8</sup> *In re Motor Fuel Temperature Sales Practices Litig.*, No. 07-MD-18400-KHV (D. Kan. Nov. 20, 2012) (determining that where parties could not agree on a third-party beneficiary for a cy pres distribution, allowing unused funds to escheat to the states "will help serve the deterrence and enforcement goals of the underlying state statutes"); *see also Six (6) Mexican Workers v. Ariz. Citrus Growers*, 904 F.2d 1301, 1308 (9th Cir.1990); *Newberg, supra* n. 1 at § 10:23.

<sup>9</sup> *Lane v. Page*, 862 F. Supp. 2d 1182, 1231 (D.N.M. 2012) (citing Martin H. Redish, Peter Julian, & Samantha Zyontz, *Cy Pres Relief and the Pathologies of the Modern Class Action: A Normative Empirical Analysis*, 62 Fla. L. Rev. 617, 619 (July 2010)).

<sup>10</sup> *Johnson v. Brennan*, No. 10-CV-4712 (CM) (S.D.N.Y. Dec. 21, 2012) (approving settlement with cy pres beneficiary of the Urban Justice Center's Community Development Project).

<sup>11</sup> *Elliot v. Leatherstocking Corp.*, No. 3:10-CV-0934 (N.D.N.Y. Dec. 4, 2012).

distributed to some third party; (ii) it is unseemly for judges to engage in the selection of third party beneficiaries and to distribute class action damages to third parties; (iii) judges are often not in the best position to choose a charitable organization that would best approximate the unpaid class members' interests; and (iv) the doctrine encourages charitable organizations, and plaintiffs' lawyers, to lobby the court for cy pres awards.<sup>21</sup>

Citing these and other concerns, some courts have disapproved proposed cy pres awards in settlement agreements.<sup>22</sup>

## Legal Tests for Evaluating Cy Pres Distributions

Cy pres beneficiaries must be carefully chosen to account for (1) the nature of the lawsuit, (2) the objectives of the underlying claims; and (3) the interests of silent class members, including their geographic diversity.<sup>23</sup> For example, the Ninth Circuit requires a cy pres award be "guided by (1) the objectives of the underlying statute(s) and (2) the interests of the silent class members, and must not benefit a group too remote from the plaintiff class."<sup>24</sup> In the Ninth Circuit, there must be a nexus—an actual connection—not just between the class and the cy pres beneficiary, but between the claims alleged in the case and the cy pres beneficiary.<sup>25</sup>

That is, the cy pres award must bear "a direct and substantial nexus to the interests of absent class members and thus properly provide[ ] for the 'next best distribution' to the class."<sup>26</sup> Some courts consider factors such as the cy pres beneficiary's history of sound fiscal management, the strength of its governance and leadership, and the extent of services performed and number of people served, as well as any red flags such as adverse publicity or governmental investigations.<sup>27</sup>

Some have suggested that a uniform test needs to be adopted for determining the standards to be applied in formulating cy pres distributions.<sup>28</sup> For example, Section 3.07 of the American Law Institute's November 18, 2008, Council Draft No. 2 of the Principles of the Law of Aggregate Litigation provides that a court may ap-

prove a settlement that proposes a cy pres settlement subject to three criteria:

(a) If individual class members can be identified through reasonable effort, and the distributions are sufficiently large to make individual distributions economically viable, settlement proceeds should be distributed directly to individual class members.

(b) If the settlement involves individual distributions to class members and funds remain after distributions (because some class members could not be identified or chose not to participate), the settlement should presumptively provide for further distributions to participating class members unless the amounts involved are too small to make individual distributions economically viable or other specific reasons exist that would make such further distributions impossible or unfair.

(c) If the court finds that individual distributions are not viable based upon the criteria set forth in subsections (a) and (b), the settlement may utilize a cy pres approach only if the parties can identify a recipient involving the same subject matter as the lawsuit that reasonably approximates the interests being pursued by the class.<sup>29</sup>

Some courts have referred to these principles in evaluating cy pres distributions.<sup>30</sup> One district court within the Eleventh Circuit set forth the following approach:

(1) determine that a reasonably diligent effort has been made to locate class members who are the direct beneficiaries of the class action settlement; (2) assure that existing identified class members have been fully compensated; (3) have the attorneys who represented the parties in the action that produced the settlement fund present recommended recipients of the left-over cy pres funds; (4) scrutinize the recommendations to reasonably assure that the recipients are legitimate and established organizations with a track record demonstrating that they can accomplish the purpose of the distribution; and (5) approve distributions that will, as closely as reasonably possible, accomplish the purposes of the class action that produced the settlement remainder fund.<sup>31</sup>

## Considerations in Framing a Class Action Settlement With a Cy Pres Distribution

So what is a litigant to do when framing a cy pres distribution in a class action settlement agreement? Here are some considerations in light of recent cases:

■ Absent agreement on a cy pres beneficiary, consider fashioning a settlement agreement without a cy pres distribution,<sup>32</sup> including, for example, reallocating

<sup>21</sup> *Lane v. Page*, 862 F. Supp. 2d 1182, 1231 (D.N.M. 2012).

<sup>22</sup> See, e.g., *Nachshin v. AOL, LLC*, 663 F.3d 1034 (9th Cir. 2011); *Supler v. FKAACS, Inc.*, No. 5-11-CV-00229-FL (E.D.N.C. Nov. 6, 2012); *Campbell v. First Investors Corp.*, No. 11-CV-0548 BEN (S.D. Cal. Oct. 29, 2012).

<sup>23</sup> *In re Motor Fuel Temperature Sales Practices Litig.*, No. 07-MD-18400-KHV (D. Kan. Nov. 20, 2012) (citing *Nachshin v. AOL, LLC*, 663 F.3d 1034, 1039 (9th Cir. 2011); *In re Lupron Mktg. & Sales Pract. Litig.*, 677 F.3d 21, 33 (1st Cir. 2012); *In re Airline Ticket Comm'n Antitrust Litig.*, 307 F.3d 679, 682 (8th Cir. 2002)).

<sup>24</sup> *Dennis v. Kellogg*, Nos. 11-55764, 11-55706 (9th Cir. Sept. 4, 2012).

<sup>25</sup> *In re Groupon, Inc. Mktg. & Sales Practices Litig.*, Case No. 11-MD-2238 DMS (RBB) (S.D. Cal. Sept. 28, 2012); see also *Nachshin v. AOL, LLC*, 663 F.3d 1034, 1036 (9th Cir. 2011).

<sup>26</sup> *Lane v. Facebook*, Nos. 10-16380, 10-16398 (9th Cir. Sept. 20, 2012); *In re Lupron Mktg. & Sales Pract. Litig.*, 677 F.3d 21, 33 (1st Cir. 2012) (although upholding the class settlement, expressing its "concerns" that the recipients of cy pres distributions must "reasonably approximate" the interests of class members).

<sup>27</sup> *Heekin v. Anthem, Inc.*, No. 1:05-CV-01908-TWP-TAB (S.D. Ind. Nov. 9, 2012).

<sup>28</sup> *Newberg*, *supra* n. 1 at § 10:22.

<sup>29</sup> Albert A. Foer, *Enhancing Competition Through the Cy Pres Remedy: Suggested Best Practices*, 24 *Antitrust* 86, 88 (Spring 2010).

<sup>30</sup> *In re Motor Fuel Temperature Sales Practices Litigation*, No. 07-MD-18400-KHV (D. Kan. Nov. 20, 2012); *In re Lupron Mktg. & Sales Pract. Litig.*, 677 F.3d 21, 32-33 (1st Cir. 2012); *Klier v. Elf Atochem N. Am., Inc.*, 658 F.3d 468, 475 (5th Cir. 2011); *Perkins v. Am. Nat'l Ins. Co.*, No. 3:05-CV-100 (CDL) (M.D. Ga. July 10, 2012).

<sup>31</sup> *Perkins v. Am. Nat'l Ins. Co.*, No. 3:05-CV-100 (CDL) (M.D. Ga. July 10, 2012).

<sup>32</sup> *In re Thornburg Mortg., Inc. Securities Litig.*, No. CIV-07-0815 JB/WDS (D.N.M. July 24, 2012) (denying approval of the cy pres award and ordering the parties to remove that provision).

the funds to class members who make claims;<sup>33</sup> or having the funds revert back to the defendant, or escheat to the government.

- Consider specifically naming the cy pres beneficiary in the settlement agreement, if possible.<sup>34</sup>

- If the defendant wants to maintain some control over the cy pres funds, consider creating, to administer the funds, a new charitable entity over which the defendant maintains full or partial control.<sup>35</sup>

- Consider whether there is an actual connection between the class and the cy pres beneficiary, and between the claims alleged in the case and the cy pres beneficiary.<sup>36</sup>

- Consider providing specifically in the settlement agreement what the cy pres funds will be used for.<sup>37</sup>

<sup>33</sup> *Lane v. Page*, 862 F. Supp. 2d 1182, 1199 (D.N.M. 2012) (refusing to create a cy pres distribution that was not in the settlement agreement but was requested by objectors where the settlement agreement provided that if, after six months, there is any remaining balance, the defendant “will reallocate the balance among the authorized claimants”).

<sup>34</sup> Compare *Esslinger v. HSBC Bank Nevada, N.A.*, No. 10-3213 (E.D. Pa. Nov. 20, 2012) (stating that the court would withhold judgment on approving the cy pres distribution “until after it receives submissions outlining the suggested cy pres charities and the amount of the proposed donation”) with *In re Vitamin C Antitrust Litigation*, No. 06-MD-1738 (E.D.N.Y. Oct. 23, 2012) (approving settlement that did not name the cy pres beneficiary).

<sup>35</sup> *Lane v. Facebook, Inc.*, 696 F.3d 811, 821-822 (9th Cir. 2012) (approving settlement where cy pres funds went to a newly created grant-making entity where one of the defendant’s representatives would sit on the initial board of that entity).

<sup>36</sup> *Eddings v. Health Net, Inc.*, No. CV-10-1744-JST (C.D. Cal. Jan. 16, 2013) (in action where the plaintiff alleged that defendant violated the Fair Labor Standards Act (“FLSA”) and various California state labor laws by failing to employ for all time worked, approving cy pres award to the Legal Aid Society–Employment Law Center); *Shapira v. City of Minneapolis*, No. 06-CV-02190-MJD-SRN (D. Minn. April 26, 2012) (having the unclaimed portion of the settlement funds in a lawsuit arising out of a city’s use of a camera program and ordinance intended to ensure driver compliance with intersection traffic control signals be provided in a cy pres distribution to fund a Driver’s Education program for its students of the state public schools).

<sup>37</sup> *Lane v. Facebook, Inc.*, 696 F.3d 811, 821-822 (9th Cir. 2012) (noting the settlement agreement provided exactly how

- When used as a substitute for nominal damages, consider whether the cy pres award bears a reasonable relationship to the estimated actual damages, particularly in actions seeking both damages and injunctive relief.<sup>38</sup>

- Structure the settlement such that each class member receives full compensation before the cy pres distribution is made.<sup>39</sup>

- Consider the application and effect of state property laws.<sup>40</sup>

- If there are subclasses, consider the impact of distributions where one class is receiving funds and the other is to receive a cy pres distribution.<sup>41</sup>

- Consider discounting the amount of “credit” the cy pres award receives towards the plaintiff’s attorneys’ fees, such as having only 50 percent of the cy pres award considered toward attorneys’ fees.<sup>42</sup>

the funds would be used, i.e., to “fund and sponsor programs designed to educate users, regulators[,] and enterprises regarding critical issues relating to protection of identity and personal information online through user control, and the protection of users from online threats”).

<sup>38</sup> *Fraley v. Facebook, Inc.*, No. C 11-1726 (N.D. Cal. Aug. 17, 2012) (stating that “[a]lthough it is not a precise science, plaintiffs must show that the cy pres payment represents a reasonable settlement of past damages claims, and that it was not merely plucked from thin air, or wholly inconsequential to them, given their focus on prospective injunctive relief”).

<sup>39</sup> *Nelson v. Mead Johnson & Johnson Co.*, 484 Fed. Appx. 429, 435 (11th Cir. 2012); *Klier v. Elf Atochem North America, Inc.*, 658 F.3d 468, 475 (5th Cir. 2011); *McClintic v. Lithia Motors, Inc.*, No. C11-859RAJ (W.D. Wash. Jan. 12, 2012).

<sup>40</sup> *All Plaintiffs v. All Defendants*, 645 F.3d 329, 269 Ed. Law Rep. 455, 79 Fed. R. Serv.3d 1149 (5th Cir. 2011) (holding that a trial court’s discretion to distribute unclaimed funds through the application of cy pres does not authorize the court to disregard State property laws); see also *State v. Highland Homes, Ltd.*, No. 08-10-00215-CV (Tex. Ct. App. June 13, 2012).

<sup>41</sup> *Klier v. Elf Atochem N. Am., Inc.*, 658 F.3d 468, 475 (5th Cir. 2011).

<sup>42</sup> *In re Heartland Payment Systems, Inc. Customer Data Sec. Breach Litig.*, 851 F. Supp. 2d 1040, 1076-1078 (S.D. Tex. 2012) (concluding that discounting the payment of attorneys’ fees based on cy pres distribution by 50 percent “best values the benefit conferred on the class”).