Litigation, Settlement and the Public Interest: Fluid Recovery and Cy Pres Relief

Symposium Report

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Symposium Convenors:

Joshua P. Davis, Director, Center for Law and Ethics
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Symposium Host:
University of San Francisco
Introduction

The “Fluid Recovery and Cy Pres Relief Symposium,” held at the University of San Francisco on October 30, 2010, brought together 130 judges, lawyers and recipients of cy pres funds to discuss how these remedies are being used today and to identify issues that have arisen as these remedies have unfolded. Most participants were from California and focused primarily on California law. However, there were also references to the growing importance of federal statutory and common law, and activity in federal courts.

Speakers and Presenters

Views from the Bench. Professor Josh Davis, University of San Francisco School of Law (moderator)
• Hon. Robert Freedman, Superior Court of California, County of Alameda
• Hon. Richard Kramer, San Francisco Superior Court
• Hon. Elizabeth Laporte, U.S. District Court, Northern District of California.
• Hon. William Pate (ret.), JAMS

Views from the Bar. Professor Jesse Markham, University of San Francisco School of Law (moderator)
• Don Baker, Baker & Miller PLLC
• Bill Bernstein, Lieff, Cabraser, Heimann & Bernstein, LLP
• Jessica Pers, Orrick, Herrington & Sutcliffe

Views from the Beneficiaries: Administrators, Recipients of Funds, and Facilitators of Distribution of Funds. Arthur Bryant, Public Justice (moderator)
• Kathryn Duke, Public Health Trust
• Bert Foer, American Antitrust Institute
• Judy Johnson, California Consumer Protection Foundation
• Brad Seligman, Impact Fund

Keynote Address: Professor Geoffrey Hazard, University of California, Hastings

Summary of Discussion

Background. “Cy pres is an imperfect solution to an impossible problem,” commented one of the judges at the symposium.

In the settlement of a class action suit where fluid recovery or cy pres is used, some or all of the beneficiaries are different individuals than the people who brought the suit and who would, ordinarily, have a legal right to direct compensation for the injuries they allege. The American Law Institute’s principles suggest that it is appropriate for a judge to make a cy pres award if individual class members cannot be identified through appropriate effort, or the distributions are not sufficiently large to make individual distributions economically viable. ALI Principles of the Law of Aggregate Litigation § 3.07 Cy pres settlements (2010). In these situations, some or all of the settlement may be awarded to a group that is not identical to the class but “whose interests reasonably approximate” those pursued by the class. Where a settlement reaches the same kind of people but not exactly the same members of the class that brought suit, that is considered a fluid recovery. This report uses the term “cy pres” as including fluid recovery.

Cy pres settlements may be anticipated or unanticipated as part of the resolution of a class action. Parties may agree to cy pres relief as part of a negotiation or mediation. Although negotiating or mediating parties may not think about how receptive a judge will be to a proposed cy pres distribution within their settlement agreement, they should do so or risk denial of settlement approval. Unanticipated cy pres relief can include residual funds from class members failing to cash settlement checks or failing to make sufficient claims to exhaust the money available in settlement.
A. Relevant law

Revisiting the law of trusts from which the cy pres doctrine originates

Professor Geoffrey Hazard, the keynote speaker, noted that the concept of cy pres in class actions is borrowed from the law of trusts. In a case where a trust instrument could not be executed in accordance with its terms, an adjustment could be made. The trust could be invalidated with a reversion, which is analogous to the residue in a class action settlement returning to the defendant. But in the case of a trust, one might also want to find a reasonably suitable substitute. The idea has been extended to the class context, with cy pres allowing funds to be allocated to worthy causes other than the class members.

A fundamental principle in trust law is that of the fiduciary responsibility of people who possess money to which they have no legitimate claim. The constructive trust doctrine gives rise to a fiduciary obligation to disgorge these monies rather than to retain ill-gotten gains.

Professor Hazard explored the relevance of the duty of disgorgement of illegitimately acquired funds to the class context. When one comes into possession of funds that are not one’s own, and one should not have them, there is a duty to disgorge those funds. Viewing class action settlements as part of a disgorgement plan supports a cy pres distribution of any residual rather than allowing it to revert to a defendant. Professor Hazard argued that using trust law to understand cy pres in class actions generates both a procedural and substantive understanding of cy pres.


All three cases can be analyzed in terms of trust law. Each involved defendants who obtained a sum of money, and after some time became obligated under the laws of trust to disgorge that money.

Class action settlements can be viewed as involving an obligation of disgorgement, not simply as a payment of damages to people who establish their right to recover compensation. This is an especially appropriate approach when not all class members can be identified. A trust-based approach to class action settlements can offer a coherent understanding of cy pres under substantive law and the law of remedies, in which the relevant determination is how much money the defendant unlawfully accrued. Such a determination can be distinct from how much damage was done to class members of the class, but the two determinations are not mutually exclusive. This approach can provide a substantive basis for cy pres, and also can clarify whether cy pres – disgorgement – is an appropriate remedy. (A fuller version of Professor Hazard’s presentation on a trust-based approach to cy pres will appear in Vol. 45, Issue 3 of the University of San Francisco Law Review).

State statutes

California has a statute that speaks directly to cy pres settlements: California Code of Civil Procedure § 384. There are some other states that have statutes directly addressing cy pres settlements, but the discussion did not include a systematic survey of those statutes, and instead focused on California’s statute, especially regarding two issues: (1) the required nexus, if any, between an underlying lawsuit and the use of settlement funds, and (2) applying the cy pres settlement concept both to settlement fund residuals and to the principal amount.

The three California cases most relevant to discussion of cy pres awards are Levi Strauss, 41 Cal. 3d 460 (Cal. 1986), In re Vitamins, 107 Cal.App.4th 820 (Ct. App, 1st Dist. 2003), and Microsoft, 135 Cal.App.4th 706 (Ct. App, 1st Dist. 2006).

In State v. Levi Strauss & Co., 41 Cal. 3d 460 (Cal. 1986), the court considered what to do with a sizable residue six years after a consumer class action suit against Levi Strauss for overcharges resulted in a substantial settlement. The court noted the importance of fluid recovery to the “policies of disgorgement or of deterrence” and to prevent the retention of “ill gotten gains.” Id. at 472. Various methods of
distribution of residue were considered: the rollback, consumer trust fund, earmarked escheat and general escheat. The case was remanded to the trial court to determine the appropriate method.

The *In re Vitamins Cases*, 107 Cal.App.4th 820 (Ct. App, 1st Dist. 2003), concerned the distribution of the corpus of the settlement to cy pres. This was a vitamin price-fixing class action suit brought under the Cartwright Act and Unfair Competition Law. The appeal sought to overturn the trial court’s decision to award the entire settlement to charitable or nonprofit groups instead of permitting individual claims. The appeals court upheld the decision, noting that the aims of Section 384 could not intend that individual claims must be permitted when their distribution and administration costs would exceed the recovery. They concluded that Section 384 does not require a court to allow individual claims.

Most recently the *In re Microsoft I-V Cases*, 135 Cal.App.4th 706 (Ct. App, 1st Dist. 2006), considered the distribution of the residuals of a settlement for a case brought under California’s Cartwright Act and Unfair Competition Law for overcharges for software. If less than the specified amount of $1.1 billion was claimed by class members, the residuals were to be distributed as cy pres funds to schools in a three-part disbursement program. The court of appeal held this was proper.

**Federal law**

Federal courts are less likely to permit an entire recovery to be allocated to cy pres with no recovery to the class members, although there was an exception to this in *Gammon v. GC Servcs. Ltd.*, 162 F.R.D. 313, 321 (N.D. Ill. 1995). But note plaintiffs requested approval of a settlement that would allocate all of the recovery to cy pres relief in *In re Google Buzz User Privacy Litigation*, Case No. 5:10-CV-00672-JW (N.D. Cal.).

Federal courts also tend to be relatively strict about requiring additional distributions of settlement funds to class members before or instead of allowing cy pres relief. *In re Holocaust Victim Assets Litig.*, 311 F.Supp.2d 407 (E.D. N.Y. 2004) ruled that residual funds in Holocaust victim cases should supplement the recovery of class members rather than be allocated to cy pres relief. *Master v. Wilhelmina Model Agency, Inc.*, 473 F.3d 423, 436 (2d Cir. 2007), required additional distributions to class members before the court would allocate funds to cy pres relief.

Federal courts may also be more likely to insist on a close connection between the claims in litigation and the recipients of cy pres relief. For example, *In re Airline Ticket Comm’n Antitrust Litig.*, 307 F.3d 679, 684 (8th Cir. 2002), reversed allocation of cy pres funds to the National Association of Public Interest Law on the grounds that better recipients of the funds would be travel agencies indirectly affected by the airline industry’s anticompetitive conduct.

Finally, federal courts appear reluctant to permit cy pres (including fluid recovery) to be a consideration in class certification by easing the burden on plaintiffs to identify which members of a potential class suffered harm. See *McLaughlin v. Am. Tobacco Co.*, 522 F.3d 215 (2d Cir. 2008).

**Nexus**. There was some disagreement among the panel members regarding the nexus required by California C.C.P. § 384. Does its language require a connection between the class and the cy pres beneficiaries “to further the purposes of the underlying causes of action”? Or is it sufficient that the cy pres funds be used to “promote justice for all Californians”? The latter, broader, approach appears to find some support in the statutory language specifically allowing cy pres awards to “child advocacy programs, or to nonprofit organizations providing civil legal services to the indigent.”

Panelists agreed that in many cases there should be a geographical nexus between the litigation and the cy pres recipients. For example, a cy pres award for a case brought by a class of Californians should ordinarily focus on California. In addition, the judges urged counsel to be prepared to suggest additional connections between the class members and any proposed cy pres fund recipients.

**Residuals.** The language of Cal. C.C.P. § 384 refers directly to distribution of “unpaid residuals of class action litigation.” The *Vitamins* decision clarified that a cy pres distribution of the principal is also permissible and does not run afoul of C.C.P. § 384. *In re Vitamins Cases*, 107 Cal.App.4th 820 (Ct. App, 1st Dist. 2003).
Panelists also discussed the American Law Institute’s Principles of the Law of Aggregate Litigation, which suggest that any class action settlement that has made an initial distribution to class members, and that has unclaimed funds, should make a further distribution 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.”  ALI Principles of the Law of Aggregate Litigation § 3.07 Cy pres settlements (2010).

B. Selecting Recipients of Cy Pres Settlements

A recurring theme of the symposium was the proper distribution of cy pres settlement funds. A related question is who should be responsible for selecting cy pres recipients. Strategies for use of cy pres awards include:

a) Creating or sustaining an organization with funds for an endowment, or
b) Creating a new project or organization to take novel approaches to an issue related to the underlying lawsuit, or
c) Providing core support for a specified organization’s ongoing work. This type of funding award has often been used to support programs providing legal services for low-income people.

The panelists agreed that a sitting judge can accept or reject a proposed recipient, but some panelists indicated that a judge should not ordinarily suggest a beneficiary. No ethical guidance appears to address this question directly. The American Law Institute’s Principles of the Law of Aggregate Litigation speak solely of “the court” as the party applying specified criteria for deciding whether a cy pres award is appropriate. ALI Principles of the Law of Aggregate Litigation § 3.07 Cy pres settlements (2010). The symposium discussion acknowledged this language and the thinking behind it, while also raising questions about perceived conflicts of interest that could undermine confidence in the judicial award process if a judge were to suggest cy pres recipients.

Some symposium discussants favored disclosure of connections between any organization that is a proposed funds recipient and the settling parties or judge. There was discussion of specifically naming settlement beneficiaries of a proposed cy pres distribution in the class notice. Doing so would allow any interested parties to check for possible connections between the counsel or judge and the proposed beneficiary and to assess whether there might be a conflict of interest or questions about the beneficiary selection process. This information and opportunity for follow-up inquiries could be relevant at a fairness hearing. On the other hand, various practical considerations—including the timing of deciding to distribute cy pres funds and of selecting cy pres recipients—might render some or all of these steps impractical.

Some speakers suggested that defendants should have no role in choosing cy pres beneficiaries or administering cy pres funds. This approach would minimize the risk, for example, of a defendant directing settlement funds to an entity it controls, such as its own consumer education fund, or of using the cy pres funding to displace charitable contributions it would otherwise make. Other measures, however, may be adequate to avoid these possibilities.

There was also some discussion of a possible fiduciary duty on the part of plaintiff’s counsel to ensure proper distribution of cy pres funds, although the law does not generally recognize any such duty as opposed to the fiduciary obligations of class counsel to the class.

As awareness of cy pres settlements has grown, there are reports of organizations petitioning parties involved in class action settlements, particularly class counsel, to request cy pres distributions. Some speakers suggested that an independent party should recommend cy pres recipients, either instead of the settling attorneys doing so or based on a list of potential recipients provided by counsel. Sometimes the settling attorneys choose this approach, recommending the court appoint an outside party with cy pres fund experience. The outside party, at times called a fund administrator, may recommend recipients to the parties or directly to the court, or may even receive funds and develop and conduct a grant-making process based on guidance from the parties or court. Administrators are likely to have: the resources to suggest or
make awards connected to the underlying lawsuit; policies to avoid conflicts of interest; and a transparent decision-making process. An administrator ordinarily would be expected to ensure accountability by reporting to the court and the settling parties. Some panelists questioned whether fund administrators may at times give rise to unnecessary expense and bureaucracy, particularly in cases involving limited cy pres funds.

C. Overseeing use of cy pres settlement funds

Judge and settling attorney oversight

Some panelists suggested that it is important not only to have appropriate guidance and rules for selecting cy pres funds recipients, but also to have oversight of how those funds are actually used after they are awarded.

Judges at the symposium agreed they do not have the time or expertise to run cy pres distributions as would a foundation. At the federal level, the court could potentially appoint a special master to address these issues.

Panelists expressed mixed views about the appropriate type and amount of reporting back to the court from cy pres funds recipients. Some participants worried that without effective oversight from the court or a court-designated party, cy pres distributions could be a “scandal waiting to happen.” One judge stated that judges would not be unusually burdened if they took on a greater administrative role in overseeing the use of cy pres funds. He reported that he had approved cy pres settlements for which he later received reports, and that reading these reports did not take up much of his time. Another judge noted that the court retains discretion over the administration of the settlement funds, and judges receive signed statements regarding the disposition of the funds, and sees no need for personally reviewing reports. He knew of no abuses by recipients of cy pres funds and reasoned that if recipients are selected with care, there should be little concern about the veracity of the reports they provide. The judges agreed that while they were aware of cases in which courts have awarded funds to recipients with a questionable nexus to the underlying legal action, they had never had a situation involving misuse of cy pres funds by a recipient brought to their attention.

Defendants are sometimes involved in administration of cy pres funds. An attorney with direct experience in the cy pres settlement activities of the Microsoft case described Microsoft’s role in several stages of cy pres fund distributions to a large number of public schools. A panelist noted that defendants should consider the good publicity they can get out of a cy pres settlement.

Third Party Administrators; Other Mechanisms for oversight

The symposium included speakers from different organizations that have received cy pres settlements funds and then used them to award grants to other nonprofit organizations or public entities, or to support their own activities.

For the three major California cases cited as important to the development of case law regarding cy pres distributions, both the Levi Strauss and Vitamins cases used administrators to select funds recipients and oversee the millions of cy pres dollars awarded. In the Levi Strauss settlement, part of the funds went to create a new consumer protection foundation plus a new research center within the University of California at Berkeley. With the Microsoft settlement, class counsel and Microsoft designed the settlement, which was approved by the Court. The Court then appointed a Settlement Claims Administrator that was not involved in shaping the settlement distribution plan, but was charged with the mechanics of claim filing, review, and similar administrative matters.

One audience member reported their experience of being a “micro organization” awarded cy pres funds. Before receiving those funds, they were required to prove that the funds would be spent appropriately. After receiving funds, there was a lot of oversight. However, because their own organizational processes
already require this kind of accounting, it was no burden to send this information to someone outside their organization overseeing the fund distributions. Another participant reported that the activity and financial reporting expected of their organization seemed excessive for the relatively small amount of cy pres funding they had received. A third participant asked about addressing cy pres administration concerns by setting up those distributions as a trust, with trustees and an obligation of reporting. Comments at the symposium suggested this is a possibility, but probably practical only for very large settlements.

D. Next Steps

There was general agreement that this day-long symposium brought to light valuable information and perspectives on a number of important issues connected to cy pres settlements. People attending saw many positive aspects of cy pres settlements as an option for dealing with “an impossible situation.” Some worried that a few inappropriate cy pres awards or misuses of awarded funds could undermine the ongoing availability of cy pres, although there seemed to be no clear consensus regarding how serious a risk this poses.

Cy pres settlements are rare. As a result, only a few judges have direct experience with them. There was a general agreement that public education and discussion through events such as this symposium are useful to raise professional awareness and understanding about cy pres as a potential element in class action proceedings. One judge also noted that discussion of the issues raised at the symposium would be an appropriate focus for one of the periodic meetings held by complex litigation judges in California.

Not many states are known to have statutes specifically addressing cy pres settlements. One panelist urged standardization of the cy pres settlement award and administrative procedures by creating some kind of foundation to provide oversight and guidance, perhaps under control of the federal judiciary or a national nonprofit or educational organization. Such an effort could perhaps also address a topic mentioned by other participants: the federal Class Action Fairness Act and its effect to date on cy pres settlements of class actions.

Another specific suggestion was for some organization to create and operate a web site designed to facilitate the matching of potential cy pres fund recipients with pending and possibly relevant class actions.

Finally, talk continued of developing a set of written “best practices” that would guide the work of judges, settling attorneys, and potential cy pres fund recipients and administrators in state and federal courts across the U.S. The Symposium organizers are not aware of any organization committed to working with diverse stakeholder groups to develop broadly accepted guidelines or to reaching out to and educating judges and litigating attorneys on such proposed guidelines and the underlying issues they address. However, the attached bibliography contains attempts by several organizations and individuals to set forth best practices, as well as addressing other issues related to cy pres.
Bibliography

Statutory Law and Related Proposals

- American Law Institute’s 2009 Principles of Aggregation Litigation, § 3.07 (Westlaw through April 2010).

Scholarly Articles & Reports


**News Articles**


