

Pennies From Heaven

Anne Marie Murphy
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Attorneys

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The *cy pres* doctrine plays a pivotal role in class action litigation by allowing courts to direct the use of leftover, residual settlement funds. Residual funds do an immense amount of good, helping to provide access to justice for thousands of low-income Americans served by legal aid providers and charitable organizations.

Education about the history, purpose and best practices associated with *cy pres* is badly needed. It is not just an issue for the plaintiffs' bar; it is a justice issue. *The cy pres* doctrine promotes settlement of cases and benefits society as a whole. (See Brief of Amici Curiae National Legal and Defender Association and the Association of Pro Bono Counsel in *In re BankAmerica Corporation Securities Litigation*, co-authored by McDermott Will & Emery) (explaining how association which includes the *pro bono* practices of 85 of the country's largest law firms supports the availability of *cy pres*.) While courts and commentators have been critical of the doctrine following recent decisions, the criticism is, in large part, unjustified.

To the recipients of *cy pres* the funds are "pennies from heaven." This is because, by its nature, the availability of *cy pres* funds is unpredictable since the funds are derived from the leftovers of a class action settlement or judgment once as much money as possible has been distributed to the class.

The funds are an important source of revenue for many charities and legal aid organizations. When they are awarded, *cy pres* dollars can mean the difference between a legal aid clinic being able to serve indigent clients and having to turn them away at the door. Recent criticism of *cy pres* could not come at a worse time, as federal and state funds for legal aid have dried up with the economic recession and the decline in IOLTA (Interest on Lawyers' Trust Accounts) funds.

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Understanding the history of *cy pres* is important.

Cy pres is a truncated version of the French phrase "cy pres comme possible," or "as near as possible," and is the doctrine by which residual funds can be devoted to a next-best use when there is an impediment to the funds being distributed directly to the intended recipient. The *cy pres* doctrine got its start not in class actions, but in trust and probate. In that context, for example, a decedent may have left a portion of his estate to the Boys' Clubs of America, but because that organization no longer exists the court could direct the funds to the Boys & Girls Clubs of America.

Not all jurisdictions have adopted the *cy pres* doctrine, although most have. *Cy pres* is a frequent component of class action settlements in California - in both state and federal court litigation.

California, like a growing number of states, has a statute that provides for *cy pres* distributions and mandates distribution of the unpaid residue of class action settlement funds. Code of Civil Procedure Section 384 specifically allows residuals to be distributed "to nonprofit organizations or foundations to support projects that will benefit the class or similarly situated persons, or that promote the law consistent with the objectives and purposes of the underlying cause of action, to child advocacy programs, or to nonprofit organizations providing civil legal services to the indigent." The statute also provides safe harbor for designating *cy pres* to the State Bar, which through the Justice Gap Fund distributes the funds to legal aid organizations throughout the state.

In the class action context, the *cy pres* doctrine was first employed in federal court in 1974. *Miller v. Steinbach*, 1974 U.S. Dist. LEXIS 12981, at *3 (S.D.N.Y. Jan. 3, 1974). By the 1990s *cy pres* was a frequent component of class action settlements. It is now commonly accepted that a federal district court "does not abuse its discretion by approving a class action settlement agreement that includes a *cy pres* component directing the distribution of excess settlement funds to a third party to be used for a purpose related to the class injury." *In Re Baby Prod. Antitrust Litig.*, 708 F.3d 163, 172 (3rd Cir. 2013); see also 3 Alba Conte & Herbert B. Newberg, "Newberg on Class Actions" Section 10:17 (4th ed. 2012) ("When all or part of the common fund is not able to be fairly distributed to class members, the court may determine to distribute the unclaimed funds with a *cy pres* ... approach.")

When used properly, *cy pres* advances important public policies. The doctrine is grounded in the principle that a corporation which has harmed consumers should not keep ill-gotten spoils just because it is difficult or impossible to identify victims. When the harm that is the subject of a class action affects a specific segment of the population, even if the class members cannot all be identified, they may benefit from funds being carefully and thoughtfully directed to a charity that is likely to provide services to the harmed individuals or others with similar problems.

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After all, if there are residual funds there are only three options: (1) reversion to the defendant; (2) escheat to the state; or (3) a *cy pres* award. Reversion to a defendant provides no benefit to the harmed class, and undermines the deterrent effect of litigation. If anything, reversion perverts the process and incentivizes defendants to insist on cumbersome claims processes. Escheat to the state provides a negligible benefit to a harmed class since the benefit is spread over the entirety of a state's population. *Cy pres*, if properly targeted, can in fact be the next best thing to putting money directly into class members' pockets.

The mechanics of *cy pres* are as follows: Suppose a corporation defrauds 100,000 consumers in California and damages are pegged at \$10 million (\$100 per consumer). The case is settled for \$10 million. Further assume that the defendant has poor records upon which to identify the harmed consumers. In this hypothetical it makes sense to get as much of the available settlement fund to the harmed consumers as possible. Typically this would be accomplished by a combination of sending notices to known customers and some type of publication notice intended to identify other customers. However, assume that after a round or two of distributions to the class there is \$300,000 left, either because customers could not be identified and mailed settlement checks, or because some class members failed to cash their checks. If most or all of this \$300,000 residual would be eaten up by mailing another round of very-low value checks, then the *cy pres* doctrine allows the funds to be directed to the next best use, which may be legal aid or a consumer protection organization.

Potential trouble arises when a given class action settlement is not large enough for any distribution to be economically made to the class. (See Chief Justice John G. Roberts' written statement in *Marek v. Lane*, 13-136.) Still, going back to the principle that bad actors should not retain their ill-gotten spoils, it makes sense that the defendant be separated from its gain. See *Nachshin v. AOL, LLC*, 663 F.3d 1034 (9th Cir. 2001) (consideration of class action settlement that included business practices changes plus a *cy pres* component when AOL's maximum liability would have been \$2 million and there would have been a class of 66 million members making distribution to the class cost prohibitive, 9th Circuit remanded for selection of charities more closely aligned to the purposes of the case).

The bench and bar need to be mindful of best practices with respect to *cy pres*. First, all efforts should be made to distribute funds to class members. This must be the paramount goal of class action settlements. Second, *cy pres* recipients should be chosen carefully and support projects that will benefit the class or similarly situated individuals. Third, care should be used to select *cy pres* recipients who will make the greatest impact. In California state court litigation, Section 384 provides a safe harbor for selection of certain nonprofit organizations. Every member of our society benefits from access to justice, which can be aided through *cy pres* distributions.

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Anne Marie Murphy is a principal at Cotchett, Pitre & McCarthy, LLP. She can be reached at AMurphy@cpmlegal.com.