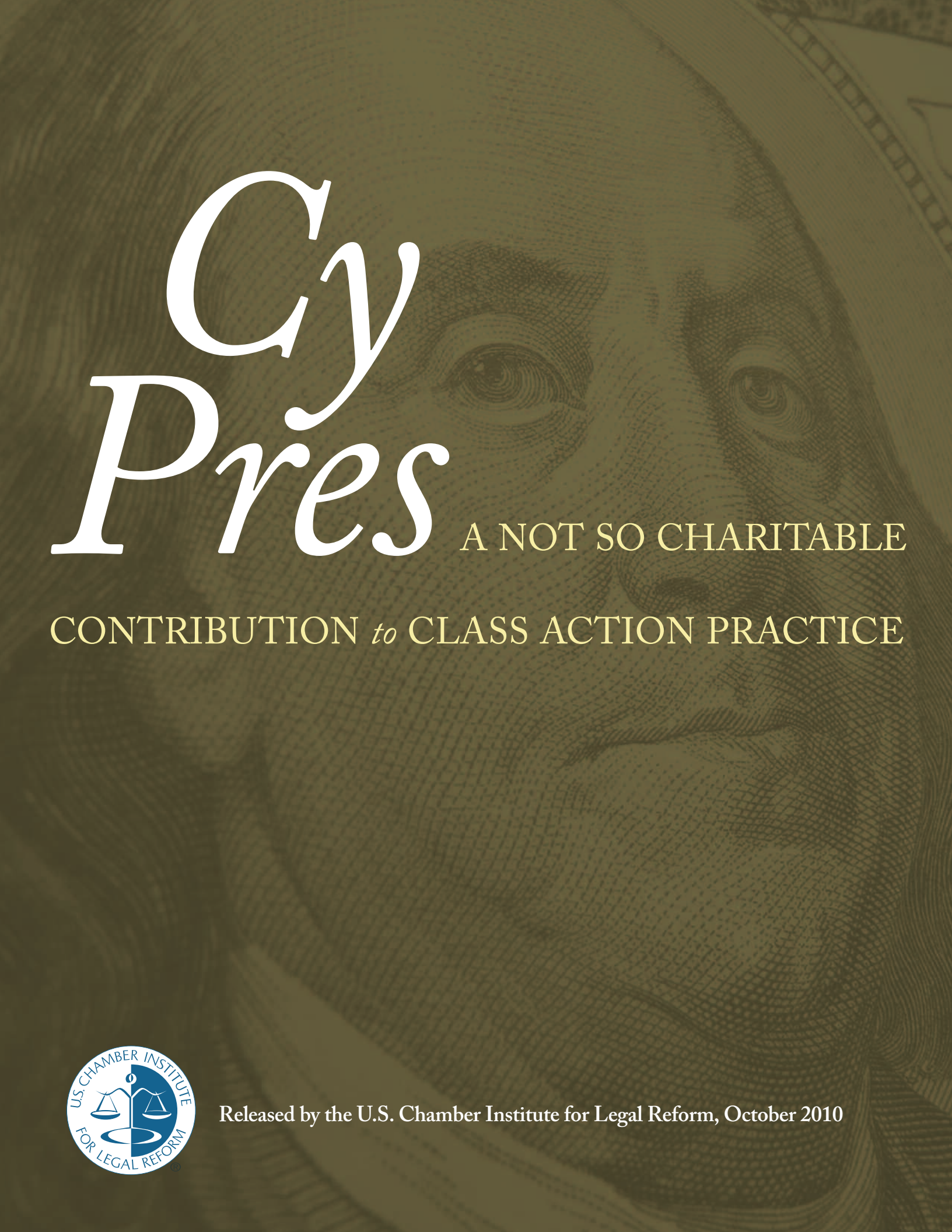

Cy Pres

A NOT SO CHARITABLE CONTRIBUTION *to* CLASS ACTION PRACTICE

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CY PRES

A Not So Charitable Contribution to Class Action Practice

Cy pres awards in class actions engender a multitude of ethical and conflict of interest problems for judges, defendants, plaintiffs and absent class members. Use of the *cy pres* doctrine in litigation also raises questions about whether courts should be making charitable contribution designations.

As one court recently noted, "[W]hile courts and the parties may act with the best intentions, the specter of judges and outside entities dealing in the distribution and solicitation of large sums of money creates an appearance of impropriety."[1] For these and other reasons, *cy pres* awards have been described as "an invitation to wild corruption of the judicial process."[2] They can also undermine core constitutional principles of separation of powers and due process.

Nevertheless, the use of the archaic *cy pres* doctrine in the class action context is becoming increasingly more frequent, particularly in settlements. Plaintiffs' attorneys are invoking this doctrine to distribute unclaimed class-wide awards and settlements to entities that often have only a tenuous relationship to the subject matter of the litigation. The result is that uninjured third parties are able to reap generous awards intended for purportedly injured class members. Because the chief aim of the *cy pres* doctrine is to "prevent the defendant from walking away from the litigation scot-free," and because "[t]here is no indirect benefit to the class from the

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1 *Securities & Exchange Comm'n v. Bear, Stearns & Co. Inc.*, 626 F. Supp. 2d 402 (S.D.N.Y. 2009).

2 Adam Liptak, *Doling Out Other People's Money*, N.Y. Times, Nov. 26, 2007, *available at* http://www.nytimes.com/2007/11/26/washington/26bar.html.

defendant's giving the money to someone else," Judge Richard Posner of the U.S. Court of Appeals for the Seventh Circuit has aptly noted that the use of *cy pres* in the litigation context is "purely punitive."[3] Part I of this Article provides a general background of the *cy pres* doctrine, with a primary emphasis on its historical roots in the trust and estate context. Part II recounts the expansion of the *cy pres* doctrine into the class action arena. Part III describes how *cy pres* has been used in class action settlements and points out some of the potential legal and ethical challenges that these settlements create. Part IV discusses the potential expansion of *cy pres* into the context of litigated class action cases, highlighting the serious legal consequences that would accompany such expansion. And Part V concludes that while *cy pres* has no place at all in class actions, it should—at the very least—be limited to settlements only, and subject to certain limitations. In addition, Part V concludes that if a settlement agreement includes a *cy pres* award, attorneys' fees should be based solely on the benefits actually received by class members, and the recipient of the award should be selected by the parties—not the court.

"Cy pres awards have been described as 'an invitation to wild corruption of the judicial process.'"

3 *Mirfasihi v. Fleet Mortg. Corp.*, 356 F.3d 781, 784 (7th Cir. 2004).

I The Origins of Cy Pres

The term *cy pres* developed from the French phrase *cy pres comme possible* which means "as near as possible"[4] and has its roots in the laws of trusts and estates. In its original form, *cy pres* operated to modify valid charitable trusts that specified a charitable gift that had been rendered impossible or impractical—for whatever reason. In such instances, early courts would modify the trust by putting the gift to the next closest use. For example, suppose a testator sought to donate funds to a local university, but that university no longer existed after the testator's demise. Invoking *cy pres*, a court could have directed that the funds be given to another university as the next closest use.

The *cy pres* doctrine has been around for such a long time that no one can pinpoint with any certainty the actual genesis of *cy pres*.[5] What we do know, however, is that the doctrine predated the advent of Christianity and played a significant role in Roman society under Justinian's Code.[6] That Code contained a passage directing that a charitable gift aimed at promoting illegal activities be put to legal use to keep the decedent's memory alive.[7] The *cy pres* doctrine was also a part of English common law, as well as French and Spanish civil law.[8]

The development of *cy pres* in England was largely the product of the strong connection between trusts and religion.[9] It was common for a dying man to discuss his estate with a priest and advise how he wanted to distribute his estate, which the Church was then responsible for administering.[10] If any property was left without a specific designation, the church would direct that the property be used "*pro salute animae*"—for the good of the testator's soul.[11] During the Middle Ages, English chancellors—who controlled the charities and who were ecclesiastics trained in Roman civil law—

4 Edith L. Fisch, The Cy Pres Doctrine in the United States 1 (1950).

5 Eric G. Pearson, *Reforming the Reform of the Cy Pres Doctrine: A Proposal to Protect Testator Intent*, 90 Marq. L. Rev. 127, 138 (2006).

6 *Id.*

7 DIG. 33.2.16 (Modestinus, Replies 9) (Alan Watson trans.).

8 Fisch, *supra* note 4, at 4.

9 Hamish Gray, *The History and Development in England of the Cy-Pres Principle in Charities*, 33 B.U. L. Rev. 30, 32 (1953).

10 *Id.* at 32.

11 *Id.* at 33.

invoked *cy pres* to save charitable gifts for religious purposes, thereby subjecting the property to church control.[12]

During the American Revolution, two kinds of *cy pres* existed in England: (1) judicial *cy pres* and (2) prerogative *cy pres*.[13] English chancellery courts exercised judicial *cy pres* to strictly carry out the intent of the testator as nearly as possible. If a charitable trust was rendered impossible, illegal or impracticable, chancellery courts could invoke judicial *cy pres* to modify the terms of the trust and direct that the gift be used for the next best alternative.

In carrying out judicial *cy pres*, English courts of equity seldom deviated from the donor's wishes.[14] For example, if a testator designated a gift to a science department at a university, but the department had closed before the testator's death, the chancellery court would invoke judicial *cy pres* and examine the testator's intent behind the gift. If the court concluded that the intent was really to benefit science, then the court would direct the money to a science department at another university. Conversely, if the court determined that the testator's intent was to give the money to the particular university, then the court would direct the money to another department at the same university.[15]

By contrast, prerogative *cy pres* was exercised by the king and could be invoked to modify the terms of a charitable trust that became impossible, illegal or impracticable—without any regard to the intent or wishes of the testator.[16] It was not uncommon for the king to direct that an estate be used for purposes contrary to those envisioned by the testator.[17] The case of *Da Costa v. De Pas*[18] illustrates the unfettered discretion that the English king had when it came to disposing of an estate through prerogative *cy pres*. There, a decedent had designated money to promote Jewish education in England. However, at the time of the decedent's death, it was illegal to promote any religion other than Christianity. As a result, the king exercised his power of prerogative *cy pres* and directed that the money be used to teach children Christianity.[19]

Cy pres was slow to develop in the United States out of fear that it vested too much power in the judiciary. Relying on England's experience with

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12 Fisch, *supra* note 4, at 4 (citing *Att'y Gen v. Ministers & Elders of the Dutch Reformed Protestant Church*, 36 N.Y. 452, 457 (1867)).

13 Robert E. Draba, *Motorsports Merchandise: A Cy Pres Distribution Not Quite as Near as Possible*, 16 Loy. Consumer L. Rev. 121, 126 (2003-2004).

14 Wendy A. Lee, *Charitable Foundations and the Argument for Efficiency: Balancing Donor Intent with Practicable Solutions through Expanded Use of Cy Pres*, 34 Suffolk U. L. Rev. 173, 183 (2000).

15 *Id.*

16 *Id.*

17 *Id.* at 183.

18 *Da Costa v. De Pas*, 27 Eng. Rep. 150 (1754).

19 Robert Birmingham, *Proving Miracles and the First Amendment*, 5 Geo. Mason L. Rev. 45, 63 (1996).

cy pres, American courts and legislatures were concerned that the doctrine would be radically and arbitrarily applied to alter bequests without any concern for the intent of the testator.

American courts viewed English *cy pres* as "a rule of arbitrary disposition, giving the chancellor power to make deeds and wills and to allocate capital or income according to his own social or religious views."[20] This sentiment was echoed in a Kentucky state court ruling in 1867: "[u]nder the British statu[t]e, the *cy pres* doctrine became so arbitrary and latitudinary as to prevent the evident object of donors," diverting funds "to charities which they never contemplated and to which they would never have contributed."[21]

Despite American society's deep-rooted resistance to *cy pres*, the doctrine began to take hold in the United States as the number of charitable trusts increased during the nineteenth century. The increase in the number of charitable trusts during this period led American courts to gradually accept *cy pres* as a mechanism for evaluating donor intent in the trust and estate context.[22] An example of judicial *cy pres* in the nineteenth century was the case of *Jackson v. Phillips*, in which a court reinterpreted the terms of a charitable trust that had been created to abolish slavery in the United States to instead provide money to poor African-Americans.[23]

Although states continually rejected prerogative *cy pres*, they began enacting statutes that codified judicial *cy pres* for use in the trust and estate arena. Importantly, these statutes did not contemplate the use of *cy pres* in litigation; they were aimed only at administering trusts and estates that could not be administered pursuant to the express wishes of the decedent.

Today, forty-eight states and the District of Columbia have codified judicial *cy pres* as a means of modifying charitable trusts through statute or by judicial decision.[24] Eighteen of those states adopted the Uniform Trust Code version of *cy pres*.[25] As set forth in the Uniform Trust Code, courts must exercise *cy pres* discretion judiciously—always in a "manner consistent with the testator's charitable purposes."[26]

Although there are variations from state to state regarding the contours of *cy pres* law, states generally apply a three-prong test before

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20 George Gleason Bogart et al., *The Law of Trusts and Trustees* § 433 (rev. 2d ed. 2003).

21 *Cromier's Heirs v. Louisville Orphans' Home Soc'y*, 66 Ky. (3 Bush) 365, 374 (1867).

22 Lee, *supra* note 14, at 183.

23 *Jackson v. Phillips*, 96 Mass. 539 (1867).

24 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, 628 (2010).

25 *Id.* at 628-29 (citing Uniform Trust Code § 413 (2005)).

26 Uniform Trust Code § 413(a).

invoking the doctrine to modify a charitable trust. The three prerequisites that must be satisfied are: (1) the gift must constitute a valid charitable trust, (2) the designated gift must be impossible or impractical, and (3) the testator must have had a charitable intent in making the gift.[27] To satisfy the first requirement, the trust must have been created, and it must also qualify as a valid instrument. A trust is invalid if it is impossible to determine who the intended recipient is supposed to be or if execution of the trust would be illegal.[28] With regard to the second requirement, a court may not find that execution of the designated gift is impossible or impractical merely because its execution would be inconvenient or because the number of beneficiaries is declining.[29] Once it becomes apparent that executing the designated gift will inevitably be impossible or impractical, the second requirement has been satisfied.[30]

Although courts generally have little difficulty evaluating the first two prerequisites, they are often challenged by the third element, which requires that the testator have a charitable intent. Determining whether a testator had a charitable intent requires a court to engage in an "exercise [of] mind reading."[31] The challenges posed by this third element have led some states to limit the charitable intent requirement or to discard it entirely.[32]

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27 Redish *supra* note 24 (citing Fisch, *supra* note 4, at § 5.00).

28 *Id.* (citing Fisch, *supra* note 4, at § 5.01).

29 *Id.* (citing Fisch, *supra* note 4, at § 5.02).

30 *Id.*

31 *Id.* (citing Fisch, *supra* note 4, at § 5.03(b)).

32 *Id.* For example, in Pennsylvania, the state legislature removed the requirement of charitable intent. Similarly, the Connecticut Supreme Court eliminated this requirement for invoking *cy pres. Id.* (citing *Yale Univ. v. Blumenthal*, 621 A.2d 1304 (Conn. 1993)).

II Courts Have Expanded Cy Pres into the Class Action Arena as a Means for Disposing of Unclaimed Class Awards and Settlements

Cy pres was confined to the context of trusts and estates until the latter part of the twentieth century, when amendments to Federal Rule of Civil Procedure 23 spawned a growing number of class actions, and plaintiffs' attorneys and courts were forced to grapple with the problem of unclaimed class awards and settlements.

The rapid increase in federal class action suits can be traced to the 1966 amendments to Federal Rule of Civil Procedure 23.[33] One of the defining changes to Rule 23 was that in non-mandatory classes,[34] absent class members who failed to opt out of the class would be included in the class.[35] The corresponding increase in the number of federal class actions brought to the forefront the problem of disposing of unclaimed class awards and settlements. If a class-wide award is made or a class-wide settlement is approved, the class members are generally compensated out of a fund that is established with the losing or settling defendant's money. However, in many cases, much of the fund remains unclaimed either because it is too difficult to locate the class members or because the class members are uninterested in filling out a claim form for an award that is only worth a few cents or a few dollars.[36] The traditional approach to unclaimed class funds was to return the unclaimed money to the defendant.[37] This

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33 Fed. R. Civ. P. 23.

34 Classes that are certified under Rule 23(b)(1) or (b)(2), which seek declaratory or injunctive relief, are mandatory. This means that class members cannot opt out of the class. It is only in Rule 23(b)(3) classes, which seek money damages, that class members may opt out and therefore be excluded from the class.

35 *See* Redish, *supra* note 24, at 630.

36 *Id.* at 631.

37 *Id.*; *see also* Kerry Barnett, *Equitable Trusts: An Effective Remedy in Consumer Class Actions*, 96 Yale L.J. 1591, 1594-95 (1987); Steward R. Sheperd, *Damage Distribution in Class Actions: The Cy Pres Remedy*, 39 U. Chi. L. Rev. 448, 448 (1972).

approach was criticized by some advocates, however, as undermining the deterrent effect of a successful class action suit. Another approach, distributing the remainder of the unclaimed class funds to those class members who did submit claims forms, was similarly criticized for over-compensating a small number of motivated class members.[38] Still other courts disposed of residual class funds by escheating the residual money to the state, which met resistance as a hidden form of taxation.[39] The concerns surrounding these alternative approaches led courts and scholars to develop an alternative method for disposing of unclaimed class funds, which took the form of *cy pres*.

The earliest use of judicial *cy pres* in the context of a class action occurred in 1974 in *Miller v. Steinbach*.[40] In that case, plaintiffs brought a putative class action on behalf of shareholders of the Baldwin-Lima Hamilton Corporation (BLH), which had merged with another company. Plaintiffs alleged that the terms of the merger were unfair and that they contravened federal securities laws.[41] In approving the proposed class settlement, the district court sanctioned the parties' agreement to "pay the fund to the Trustee of the [BLH] Retirement Plan." In so doing, the court recognized that it was "applying a variant of the *cy pres* doctrine at common law."[42] The court explained that "while neither counsel nor the Court has discovered precedent for the proposal," neither had it "been made aware of any precedent that would prohibit it."[43] According to the court, "no alternative [was] realistically possible," and therefore the court approved the settlement as "fair and reasonable."[44]

Miller exemplifies the fundamental deficiency underlying *cy pres* application to class actions—namely, that awarding class-wide funds to charities does little to compensate absent, injured class members. In that case, the court did not conduct any analysis as to whether awarding the proceeds of the settlement fund to

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38 *Id. But see Principles of the Law of Aggregate Litigation* § 3.07 (A.L.I. Council, entitled "Cy Pres Settlements") ("This Section rejects the position urged by a few commentators that a *cy pres* remedy is preferable to further distributions to class members" because "in most circumstances distributions to class members better approximate the goals of the substantive laws than distributions to third parties that were not directly injured by the defendant's conduct.").

39 *See* Sam Yospe, *Cy Pres Distributions in Class Action Settlements*, 2009 Colum. Bus. L. Rev. 1014, 1046 (2009). Although escheat has not been commonly used by courts, *see id.* at 1047, the Texas Attorney General recently sought to revive this practice, invoking the state's Unclaimed Property Act to lay claim to class settlement residuals in a case where the parties had agreed to a *cy pres* settlement, *see In re Lease Oil Antitrust Litig.*, MDL No. 1206, 2009 U.S. Dist. LEXIS 118833, at *41-44 (S.D. Tex. Dec. 22, 2009). In that case, the state argued that the Unclaimed Property Act applied and therefore mandated that any residual funds escheat to the state. However, the district court rejected the state's argument, holding that "Rule 23 must control," and, thus, the court had discretion to authorize a *cy pres* award.

40 *Miller v. Steinbach*, No. 66 Civ. 356, 1974 WL 350, at *2 (S.D.N.Y. Jan. 3, 1974).

41 *Id.* at *1.

42 *Id.*

43 *Id.* at *2.

44 *Id.*

the retirement plan would benefit the absent class members.[45] Instead, the court simply approved the *cy pres* award because it was viewed as a worthwhile use of unclaimed money.

The problem of distributing class funds to third-party charities that have little or no connection to the interests of injured class members was considered in *Six Mexican Workers v. Arizona Citrus Growers*,[46] an important Ninth Circuit decision from 1990 that set forth limitations on *cy pres* in the context of class actions. In *Six Mexican Workers*, plaintiffs, undocumented Mexican workers, initiated a class action suit against defendant Arizona Citrus Growers and two of its members, alleging that defendants violated the Farm Labor Contractor Registration Act. Plaintiffs contended that defendants committed various transportation, housing and record-keeping violations with respect to Mexican migrant workers.[47] After a bench trial in 1984, the district court found defendants liable for violating the Farm Labor Contractor Registration Act and awarded statutory damages in the amount of $1,846,500 based on the identified class members.[48] The court also ruled that any unclaimed funds be given to the Inter-American Fund for indirect distribution to Mexico through a *cy pres* award.[49]

The defendants appealed the *cy pres* award to the Ninth Circuit, which remanded the case to the district court for further consideration. The Court of Appeals resolved that "[t]he district court's proposal benefits a group far too remote from the plaintiff class."[50] According to the court, *cy pres* must "be rejected when the proposed distribution fails to provide the 'next best' distribution."[51] The court went on to explain that any *cy pres* distribution must "adequately target the plaintiff class."[52] The court concluded that the proposed *cy pres* award did not constitute the "next best" distribution for unclaimed class funds because although "[t]he district court's plan permits distribution to areas where the class members may live, there is no reasonable certainty that any member will be benefited."[53] In setting aside the district court's proposed *cy pres* distribution, the Court of Appeals explained that the fundamental purpose of *cy pres* in class action cases is to

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45 *See* Redish, *supra* note 24, at 635.

46 *Six Mexican Workers v. Ariz. Citrus Growers*, 904 F.2d 1301 (9th Cir. 1990).

47 *Id.* at 1303-04.

48 *Id.* at 1304.

49 *Id.*

50 *Id.* at 1308.

51 *Id.*

52 *Id.* at 1309.

53 *Id.* at 1308.

"effectuate...the interests of silent class members."[54] The court exhorted the district court to consider other alternatives, such as escheating the funds to the state, if the court could not devise a proper *cy pres* distribution.[55] The rationale underlying *Six Mexican Workers* is in line with the approach embraced by the American Law Institute ("A.L.I."): "there should be a presumed obligation to award any remaining funds to an entity that resembles, in either composition or purpose, the class members or their interests."[56]

"There should be a presumed obligation to award any remaining funds to an entity that resembles, in either composition or purpose, the class members or their interests."

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54 *Id.* at 1309.

55 *Id.*

56 *Principles of the Law of Aggregate Litigation* § 3.08 (A.L.I. Council, entitled "Cy Pres Settlements"). According to the *Principles*, *cy pres* should be limited to circumstances in which "direct distributions to class members are not feasible—either because class members cannot be reasonably identified or because distribution would involve such small amounts that, because of the administrative costs involved, such distribution would not be economically viable." *Id.; see also Masters v. Wilhelmina Model Agency*, 473 F.3d 423, 436 (2d Cir. 2007) (relying on rule proposed in the *Principles* and holding that district court did not abuse its discretion in authorizing class action settlement with *cy pres* component).

III Unfettered Usage of Cy Pres in Class Action Settlement Cases Poses Numerous Ethical Problems

The use of *cy pres* in class action settlements has benefited numerous organizations, ranging from art schools to law schools and from the American Red Cross to legal aid societies.[57] While these are—without doubt—worthy institutions, critics have recognized that the liberalized use of the *cy pres* doctrine poses serious ethical risks to the American legal system. Below we discuss some of the concerns raised by critics of *cy pres*, in particular: (1) the failure of *cy pres* awards to redress alleged injuries, (2) the potential that parties will use *cy pres* awards to finance activities that advance their own financial or political interests, (3) conflicts of interest between named plaintiffs and absent class members, and (4) the potential for judicial bias (or the appearance thereof) when a judge has a relationship with the recipient charity.

First, critics of *cy pres* awards have expressed concern that they do not provide compensation to injured class members—and thus depart from the objectives of the judicial system. After all, "[t]here is no indirect benefit to the class from the defendant's giving the money to someone else."[58] Thus, it is questionable whether most *cy pres* distributions "effectuate...the interests of [the] silent class members."[59]

A recent class action settlement involving AOL (currently being challenged by objectors on appeal) provides an illustrative example. The

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57 *See, e.g., In re Compact Disc Minimum Advertised Price Antitrust Litig.*, No. MDL 1361, 2005 WL 1923446 (D. Me. Aug. 9, 2005) (authorizing transfer of $271,000 left in antitrust settlement fund to the National Guild of the Community School of the arts and finding that such award "c[a]me closest" to fitting the purposes of the antitrust class action settlement); *In re Infant Formula Multidistrict Litig.*, No. 4:91-CV-00878-MP, 2005 WL 2211312, at *1 (N.D. Fla. Sept. 8, 2005) (awarding unclaimed funds to American Red Cross Disaster Relief Fund in class action involving infant formula); *In re Wells Fargo Secs. Litig.*, 991 F. Supp. 1193, 1198 (N.D. Cal. 1998) (approving *cy pres* award to the Stanford Law School Securities Class Action Clearinghouse); *Jones v. Nat'l Distillers*, 56 F. Supp. 2d 355, 359 (S.D.N.Y. 1999) (authorizing *cy pres* award from securities class action to a legal aid society because the recipient bore a closer relationship to the subject of the class action than would "a dance performance or a zoo").

58 *Mirfasihi*, 356 F.3d at 784.

59 *Six Mexican Workers*, 904 F.2d at 1308-09.

AOL case arose out of the defendant's alleged practice of inserting third-party advertising in emails sent through its free email service. Plaintiffs commenced a putative class action and asserted claims for, *inter alia*, violation of the Electronic Communications Privacy Act, unjust enrichment and violation of various consumer protection statutes under California law.[60] Under the terms of the settlement, the class was to receive no money, while the class attorneys would be paid $320,000.[61] In addition to awarding zero compensation to the class members, the settlement included a payment of $25,000 to each of: (1) the Legal Aid Foundation of Los Angeles; (2) the Federal Judicial Center Foundation; and (3) the Boys and Girls Club of Los Angeles and Santa Monica.[62] In his appellate brief, objector Darren McKinney argued that the *cy pres* distribution "is even more 'remote from the plaintiff' class than the proposed Mexican distribution" in *Six Mexican Workers*.[63] As McKinney noted, none of the recipient charities in the AOL case bears any logical relationship to the plaintiff class or the asserted claims.[64] Moreover, in contrast to *Six Mexican Workers*, where the proposed *cy pres* distribution was geographically targeted to "areas where the class members may live," McKinney explained that the proposed distribution in the AOL case is geographically targeted only to areas where the named plaintiffs live.[65]

The AOL case illustrates how far removed a *cy pres* settlement can be from the injured class members. As Professor Martin Redish of Northwestern University School of Law aptly put it: *cy pres* awards merely "creat[e] the illusion of compensation."[66] That illusion is contrary to the goals of civil justice. The bedrock of our system of civil justice is that a plaintiff who is injured can seek compensation for his or her injuries; using civil litigation to redistribute wealth to charities turns that fundamental goal on its head.

Second, a potentially troubling ethical consequence of *cy pres* awards in class action settlements is the potential for parties to steer money to a favored charity to satisfy their own financial interests. In the AOL case, for example, one of the named plaintiffs was employed by one of the recipient charities.[67] This relationship led

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60 *Fairchild v. AOL, LLC*, No. CV09-03568 CAS (PLAx) (C.D. Cal. 2009) (class action settlement agreement).

61 *Id.* at 9.

62 *Id.*

63 Brief for Objector-Appellant at 19, *Nachsin v. AOL, LLC*, No. 10-55129 (9th Cir. July 20, 2010).

64 *Id.*

65 *Id.*

66 Redish, *supra* note 24, at 649.

67 Brief for Objector-Appellant at 7-8, *Nachsin v. AOL, LLC*, No. 10-55129 (9th Cir. July 20, 2010).

the Wall Street Journal to cite the AOL *cy pres* settlement as a leading example of *cy pres* abuse.[68]

Third, *cy pres* awards also create the potential for conflicts of interest between class counsel and the absent class members, particularly where class counsel has a relationship with the recipient charity. One class action settlement in an antitrust case, for example, included an award of $5.1 million of unclaimed antitrust settlement funds to the George Washington University School of Law ("GWU Law") to create a "Center for Competition Law."[69] Not coincidentally, the lead plaintiffs' lawyer was a GWU Law alumnus.[70] The National Law Journal called this result one of the most criticized *cy pres* awards in recent years.[71] The diversion of funds to an organization in which class counsel has such a personal interest arguably runs counter to class counsel's duty to "fairly and adequately protect the interests of the class."[72]

Cy pres awards also create the potential for conflicts of interest by ensuring that class attorneys are able to reap exorbitant fees regardless of whether the absent class members are adequately compensated. After all, the size of class counsel's fees is almost always tied to the size of the entire class award, which includes any *cy pres* distribution.[73] Thus, *cy pres* provides class counsel with an easy mechanism to generate high legal fees without having to devise settlements that confer actual benefits on the absent class members. It also diminishes any incentive to identify class members since the lawyer will receive the same amount of fees even if participation is negligible. For this reason too, the *cy pres* practice creates a potential for conflicts of interest between the financial interests of class counsel and the rights and interests of the absent class members.

Fourth, critics of *cy pres* awards have also argued that they pose potential conflicts of interest between the presiding judge and the absent class members. As part of their effort to secure judicial approval of proposed settlements, the parties often include a *cy pres* award that benefits a charity with which the judge or his or her family is affiliated. For example, Judge Snyder in the AOL case refused to recuse herself even though her husband was on the board of the Legal Aid

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68 *See* Nathan Koppel, *Proposed Facebook Settlement Comes Under Fire*, Wall St. J., Mar. 2, 2010.

69 *See* Ashley Roberts, *Law School Gets $5.1 Million to Fund New Center*, GW Hatchet (Dec. 3, 2007).

70 *Id.* One commentator appropriately concluded that "the *cy pres* distribution would not have gone to GW Law had it not been for the relationship that the class lawyer had with the school." Yospe, *supra* note 40, at 1029.

71 *See* Amanda Bronstad, *Cy Pres Awards Under Scrutiny*, Nat'l L. J., Aug. 11, 2008.

72 Fed. R. Civ. P. 23(a)(4); *see also Amchem Prods., Inc. v. Windsor*, 521 U.S. 591, 625 (1997) ("Rule 23(a)(4) serves to uncover conflicts of interest between named parties and the class they seek to represent."); *Sipper v. Capitol One Bank*, No. CV 01-9547, 2002 WL 398769, at *4 (C.D. Cal. Feb. 28, 2002) ("A central concern of the Rules of Civil Procedure governing class actions is ensuring that the class action format is not hijacked by parties...to their own ends at the expense of the other class members.").

73 4 Alba Conte & Herbert B. Newberg, Newberg on Class Actions §§ 14:5-6 (4th ed. 2002).

Foundation of Los Angeles, one of the recipient charities included in the proposed settlement.[74] Several critics have noted that any relationship between a judge presiding over a *cy pres* award and a recipient charity can, at the very least, give rise to the "appearance of [judicial] impropriety."[75] In addition, judicial involvement in *cy pres* awards can also invite unseemly interactions between charitable organizations and judges.[76] Indeed, a recent *New York Times* article emphasized the growing problem of charities soliciting judges for residual settlement money.[77] As *cy pres* awards become more prevalent, charities are even more likely to attempt to lobby judges, threatening the neutral and independent position of district court judges and distorting their traditional judicial function. Put simply: "allowing judges to choose how to spend other people's money 'is not a true judicial function and can lead to abuses.'"[78]

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74 *See Ninth Circuit Appeal Over Cy Pres: Nachsin v. AOL*, Center for Class Action Fairness Blog, July 21, 2010, *available at* http://centerforclassactionfairness.blogspot.com/2010/07/ninth-circuit-appeal-over-cy-pres.html.

75 *Bear, Stearns*, 626 F. Supp. 2d at 415 ("while courts and the parties may act with the best intentions, the specter of judges and outside entities dealing in the distribution and solicitation of large sums of money creates an appearance of impropriety"); *Principles of the Law of Aggregate Litigation* § 3.07 (A.L.I. Council, entitled "Cy Pres Settlements") ("A cy pres remedy should not be ordered if the court...has any significant prior affiliation with the intended recipient that would raise substantial questions about whether the selection of the recipient was made on the merits.").

76 *See* Liptak, *supra* note 3. Another palpable example of the potential for this kind of conflict of interest involved a settlement of Fen-Phen cases in Kentucky, in which tens of millions of dollars that should have gone to injured class members were diverted to an organization for which the judge served as a trustee. *See* Theodore H. Frank, "Fen-Phen Zen," American.com (Apr. 4, 2007).

77 *See* Liptak, *supra* note 3 "The practice is getting out of hand...Charities hire lawyers to go lobby the judge for the extra money." (quoting Samuel Issacharoff, a law professor at New York University).

78 *See* Liptak, *supra* note 3 (quoting former federal judge David F. Levi); *see also In re Compact Disc Minimum Advertised Price Antitrust Litig.*, 236 F.R.D. 48, 53 (D. Me. 2006) ("Federal judges are not generally equipped to be charitable foundations: we are not accountable to boards or members for funding decisions we make; we are not accustomed to deciding whether certain nonprofit entities are more 'deserving' of limited funds than others; and we do not have the institutional resources and competencies to monitor that 'grantees' abide by the conditions we or the settlement agreements set.").

IV Extending Cy Pres to Litigated Class Actions Would Contravene Fundamental Legal Principles

Although the use of *cy pres* has generally been restricted to the class action settlement context (in part because few class actions have historically been tried to verdict),[79] the growing acceptability of *cy pres* in this context suggests the potential for applying the doctrine to litigated cases as well (as in *Six Mexican Workers*). In addition to the ethical concerns discussed in Section III, *supra*, such an approach would raise substantial legal problems. First, employing *cy pres* in litigated class actions would likely violate the Rules Enabling Act by allowing a purely procedural rule—Federal Rule of Civil Procedure 23—to alter the manner in which the governing substantive law is enforced. Second, because many courts have approved *cy pres* awards in the absence of any substantive law authorizing such distributions, the use of *cy pres* in litigated class actions would represent an aggrandizement of judicial power and violate *Erie* principles. And third, expanding *cy pres* into the context of litigated class actions would also threaten the due process rights of defendants and absent class members.

First, extending *cy pres* to litigated class actions would violate the Rules Enabling Act[80]—and threaten the integrity of the judicial process—by using Federal Rule of Civil Procedure 23 to dramatically alter the substantive law. Under the Rules Enabling Act, a rule of procedure or evidence may not "abridge, enlarge or modify any substantive right."[81] This is so because using a procedural rule to alter the substantive law would interfere with the powers of Congress

79 *See* Redish, *supra* note 24, at 661 ("[S]ince 2000, the majority of class action *cy pres* awards are associated with cases that were certified solely for the purposes of settlement[.]").

80 28 U.S.C. § 2072(b).

81 *Id.*

and state legislatures to decide governing laws.[82] Notably, courts have rejected other efforts to transform substantive law in the context of aggregate litigation in similar contexts; of most relevance here, courts have rejected "fluid recovery" theories—under which plaintiffs seek to prove "class" damages rather than individual damages of each class member—as violating the Rules Enabling Act.[83]

In *Schwab v. Phillip Morris USA, Inc.*,[84] for example, the U.S. District Court for the Eastern District of New York (Judge Weinstein) granted plaintiffs' motion for class certification with respect to RICO claims arising out of the defendant manufacturers' allegedly deceptive marketing of "light" cigarettes.[85] Although the trial court recognized that RICO claims require proof of reliance, causation and damages, it embraced plaintiffs' theory of fluid recovery, finding that "[e]very violation of a right should have a remedy in court, if that is possible."[86] Based on this principle, the court determined that reliance could be established with respect to the class as a whole, reasoning that "reliance by many, if not all, of the plaintiffs was reasonable in the totality of the circumstances."[87] With respect to damages, the district court similarly concluded that plaintiffs could prove aggregate damages on a class-wide basis, which would result in a class-wide fund from which individual plaintiffs would then claim their shares. Judge Weinstein explained that "any residue remaining after individual claims have been paid [would be] distributed to the class'[s] benefit under *cy pres* or other doctrines."[88] Thus, the court

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82 *See Schwab v. Philip Morris USA, Inc.*, No. CV 04-1945 (JBW), 2005 U.S. Dist. LEXIS 27469, at *13 (E.D.N.Y. Nov. 14, 2005) (noting that "courts must stay within the bounds of due process and avoid altering substantive law in violation of the Rules Enabling Act when shaping the remedies in Rule 23(b)(3) actions"); *Eisen v. Carlisle & Jacquelin*, 479 F.2d 1005, 1014 (2d Cir. 1973) ("Amended Rule 23 was not intended to affect the substantive rights of the parties to any litigation"); *see also Amchem*, 521 U.S. at 620 (noting that Rules Enabling Act "limits judicial inventiveness" with respect to Rule 23).

83 *Eisen*, 479 F.2d at 1014 (holding that fluid recovery ran counter to spirit of Rules Enabling Act); *Windham v. Am. Brands, Inc.*, 565 F.2d 59, 66 (4th Cir. 1977) (holding that generalized class-wide proof of damages violated Rules Enabling Act by altering substantive requirements for private antitrust cause of action); *In re Hotel Tel. Charges*, 500 F.2d 86, 90 (9th Cir. 1974) ("allowing gross damages by treating unsubstantiated claims of class members collectively significantly alters substantive rights under the antitrust statutes[,]" which "is clearly prohibited by the Enabling Act"). One federal court has concluded that a c*y pres* remedy in a class action settlement may "circumvent individualized proof requirements and alter the substantive rights at issue," thereby violating the Rules Enabling Act. *See Molski v. Gleich*, 318 F.3d 937 (9th Cir. 2003). In *Molski,* the United States Court of Appeals for the Ninth Circuit reversed a *cy pres* award in a class action settlement arising out of alleged discrimination against disabled customers. *Id.* at 941. The Court of Appeals reversed the consent decree approving the proposed settlement on multiple grounds, including that the *cy pres* award purported to "replace[] the claims for actual and treble damages of potentially thousands of individuals." *Id.* at 954.

84 *Schwab v. Phillip Morris USA, Inc.*, 449 F. Supp. 2d 992 (E.D.N.Y. 2006).

85 *Id.* at 1019.

86 *Id.* at 1020.

87 *Id.* at 1049.

88 *Id.* at 1254.

recognized that much of the fund may never actually reach the allegedly injured consumers.

The U.S. Court of Appeals for the Second Circuit rejected this approach, holding that issues of causation, reliance and damages "are not susceptible to generalized proof but would require a more individualized inquiry."[89] According to the Court of Appeals, "reliance [in this case was] too individualized to admit of common proof."[90] In reversing the lower court's use of fluid recovery to calculate damages, the Court of Appeals explained that aggregating damages was "likely to result in an astronomical damages figure that does not accurately reflect the number of plaintiffs actually injured by defendants and that bears little or no relationship to the amount of economic harm caused by defendants."[91] In short, such a result would impermissibly "alter defendants' substantive right to pay damages reflective of their actual liability."[92] The court reasoned that because "any residue would be distributed to the class's benefit on the basis of *cy pres* principles rather than returned to defendants, defendants would be paying [an] inflated total estimated amount of damages[.]"[93]

The *Schwab* case highlights why *cy pres* violates the Rules Enabling Act—and the slippery slope of adopting *cy pres* in litigated class actions. After all, in non-representative private lawsuits, if one party obtains a judgment, but ultimately does not collect on it, the award is not seized by the court and given to an uninjured third party. Instead, the money reverts to the defendant. *Cy pres* seeks not only to abrogate that fundamental principle in violation of established law—but to go even further. After all, relying on the principle that every wrong deserves a right (even if the "victim" and "beneficiary" are not the same people), the *Schwab* case sought to eliminate nearly all the elements of plaintiffs' claims in order to redress what it saw as a "wrong" by the defendant. As that ruling indicates, *cy pres* is one step along a perilous road of using class actions as a means to achieve one judge's views of "social good," untethered to any legal principles.

Second and relatedly, *cy pres* awards in federal court violate *Erie* principles, which require federal courts to apply the appropriate state's laws where jurisdiction is based on diversity of citizenship.[94] As explained above, state legislatures are only just beginning to consider whether *cy pres* makes sense in the context of class actions. Those federal courts that continue to authorize *cy pres* awards absent law or

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89 *McLaughlin v. Am. Tobacco Co.*, 522 F.3d 215, 234 (2d Cir. 2008).

90 *Id.* at 225.

91 *Id.* at 231.

92 *Id.*

93 *Id.* at 232.

94 *See Erie R.R. v. Tompkins*, 304 U.S. 64, 78 (1938).

regulation are usurping power that belongs to the state judiciary or political branches. Until the states have acted to authorize the use of *cy pres* in the class action context, federal courts should refrain from distributing unclaimed class-wide funds in this manner. As the U.S. Supreme Court has noted, "[i]n our federalist system, Congress has not mandated that federal courts dictate to state legislatures the form that their substantive law must take."[95]

Third, *cy pres* represents a significant threat to the due process rights of both defendants and absent class members. In the case of litigated class actions, use of *cy pres* would likely infringe on the due process rights of defendants by seizing their property and directing it to a third party to whom the defendants owe no legal obligation. As explained by one federal district court, "[b]ecause class actions adjudicate the rights of absent class members, due process requires the proposed class representatives to establish that...[class] counsel will adequately and fairly represent the interests of those absent individuals."[96] However, *cy pres* encourages exorbitant fees for class counsel at the expense of the absent class members, who are left with zero compensation. *Cy pres* therefore creates an insidious incentive for class counsel to shirk their responsibility to "vigorously advocate on [absent class members'] behalf," thereby undermining the due process rights of the injured class members.[97]

"However, cy pres encourages exorbitant fees for class counsel at the expense of the absent class members, who are left with zero compensation."

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95 *Shady Grove Orthopedic Assocs., P.A. v. Allstate Ins. Co.*, 130 S. Ct. 1431, 1450 (2010) (Stevens, J., concurring).

96 *Brasfield v. Owens*, No. A-05-CA-1009-SS, 2007 U.S. Dist. LEXIS 99017, at *15 (W.D. Tex. Aug. 28, 2007).

97 Redish, *supra* note 24, at 650 (citing *Hansberry v. Lee*, 311 U.S. 32 (1940)); *see also* Fed. R. Civ. P. 23(a)(3) (articulating adequacy-of-representation requirement for class certification, which provides that "the representative parties will fairly and adequately protect the interests of the class").

V Conclusion

The archaic doctrine of *cy pres* "is a misnomer in the class action context" because it does not vindicate the interests of injured class members.[98] To the contrary, application of the *cy pres* doctrine in the context of class actions is fraught with serious legal and ethical concerns that threaten to undermine the interests of class members. Most notably, the expansion of *cy pres* into the class action context has generated significant conflict of interest concerns with respect to plaintiffs' attorneys, judges and defendants. As a result, courts should eschew *cy pres* as a means of disposing of unclaimed class funds both in litigated class actions and in class action settlements.

If *cy pres* is to have any application in class action cases, it should only be available in the settlement context—and not in cases litigated to trial. This is critical for all the reasons discussed *supra:* applying the doctrine in litigated cases would violate the Rules Enabling Act, run afoul of important separation of powers and *Erie* principles, and undermine the due process rights of defendants and absent class members.

Moreover, in order to mitigate the legal and ethical concerns associated with *cy pres* awards, any application of the *cy pres* doctrine—even in the context of settlements—should be subject to two critical limitations. First, whenever a settlement agreement includes a *cy pres* component, the fees awarded to class counsel should be tied to the value of money and benefits actually redeemed by the injured class members—not the theoretical value of the *cy pres* remedy. Such a restriction would be consistent with the intent of the Class Action Fairness Act ("CAFA"), which mandates that any portion of plaintiffs' counsel's fees that is based on the value of coupons awarded to class members "shall be based on the value to class members of the coupons that are redeemed," rather than the theoretical value of the coupons available to class

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98 Theodore H. Frank, *Cy Pres Settlements*, Class Action Watch (Mar. 2008) (characterizing Judge Richard Posner in *Mirfasihi*, 356 F.3d at 784).

99 28 U.S.C. § 1712(a).

members.[99] Extending the CAFA coupon requirement to class action settlement cases involving *cy pres* would help ensure that plaintiffs' attorneys vigorously represent and defend the interests of absent class members by maximizing the benefits actually redeemed by the class members.[100]

Second, the parties (rather than the court) should determine whether residual settlement funds should be disposed of through *cy pres*—and if so, to what charities. Such an approach will minimize the risk that judges will use their influence to steer *cy pres* funds to their preferred charities.

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100 This approach has been endorsed by Theodore Frank of the American Enterprise Institute's Legal Center for the Public Interest. *See* Frank, *supra* note 98.

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