

Residual Funds in Class Action Settlements: Using “*Cy Pres*” Awards to Promote Access to Justice

When class actions are settled, the federal courts play an important role in ensuring that the distribution of settlement funds is both fair and reasonable.¹ In a typical case, class members file claim forms to participate in the settlement; those claims are reviewed to determine that they are proper; and the fund is disbursed accordingly. But what happens if funds are left over? For example, what if there are not enough claims to exhaust the fund? Or what if some claimants fail to cash their checks? Or what if some claimants cannot be located? What if, despite the best efforts to distribute the funds as determined by the settlement, there is still money remaining but not enough to allow a second distribution to all the claimants?

The “*Cy Pres*” Solution

In an increasing number of class action settlements, the parties ask the court to allow a “*cy pres*” award from “residual funds”—that is, the amounts that remain after claims have been paid and a class action settlement is otherwise fully administered—designating those dollars for an approved public interest use.² Often, those requests involve projects that facilitate access to justice for people who are otherwise underserved in the legal system.

Borrowed from the Norman French expression “*cy pres comme possible*” (literally translated, “as close as possible”), the term “*cy pres*” has a long history in the law of testamentary trusts, and it is invoked when the testator’s original intent cannot be carried out exactly.³ In class actions, “*cy pres*” means “the next best use” and is the equitable principle that allows a court to make an award to a nonparty entity for the benefit of the class members, in a manner that is otherwise consistent with the objectives of the class action settlement.⁴

Increasingly, litigants raise the issue of residual funds early in the case—before a settlement has been approved—by drafting the settlement agreement to provide standards and procedures for handling funds that remain after the class members’ claims have been paid from the settlement fund.⁵ When the settlement agreement includes a *cy pres* provision for handling residual funds, the court may decide to address the *cy pres* provision as part of the analysis of whether the entire settlement is fair and reasonable.⁶ If the court has concerns about the proposed *cy pres* provision, the court can direct the parties to rework that provision before the settlement is approved.⁷ Sometimes,

however, the court defers the question about residual funds until after the claims period has expired so that the court can consider a *cy pres* award once it knows the precise dollar amount that could not be distributed to claimants.⁸

Cy Pres Success Stories

There have been many successful uses of *cy pres* provisions in class action litigation, with residual funds supporting important improvements to the justice system. Three instances are informative:

- In a case in the Southern District of New York, residual funds amounting to approximately \$44,000 remained following a \$51 million settlement in a class action suit claiming breach of fiduciary duty. Those funds could not be distributed. In February 2009, the district court approved a *cy pres* award to the City Bar Justice Center of New York, which provides representation for clients in financial need. According to Barbara Berger Opatowsky, vice president of the City Bar Justice Center and the executive director of the City Bar Association, that award helped “to operate a civil legal hotline and to staff the City Bar Justice Center’s pro bono representation projects, which together help 20,000 low income households a year.”
- In the Northern District of Illinois, more than \$150,000 remained as residual funds from settlements in two class action suits. Those funds became a *cy pres* award that funded the initial setup costs for a pro se Help Desk in the courthouse in Chicago, providing unrepresented litigants with assistance in the filing of briefs and in referrals, allowing those cases to begin more smoothly. Additional *cy pres* funds, awarded thereafter, have allowed the Help Desk to continue to provide this service. Bob Glaves, executive director of the Chicago Bar Foundation, which has helped coordinate the project, says that the *cy pres* award was especially appropriate: “Organizations with a mission of improving access to justice are a great match for class action *cy pres* awards, as one underlying premise for all class actions is to make access to justice a reality for people who as a practical matter otherwise would not be able to obtain the protections of our court system.”
- In a 2008 multidistrict litigation class action in the Eastern District of Pennsylvania, the court approved a *cy pres* award to the Philadelphia Bar

Foundation. The funds, totaling \$126,000, went to projects that provide indigent litigants with access to justice. Those residual funds were left unclaimed after a \$200 million settlement in an antitrust case had been fully administered.

Those cases follow a tradition of using *cy pres* awards in settling class action suits.⁹ Typically, the parties work to fashion a closely approximated “next best use” of funds that remain after a class action settlement has been fully administered.¹⁰ Some courts have taken a narrow view of the “closely related” portion of the *cy pres* doctrine, rejecting *cy pres* proposals because the mission of the recipient organization is not similar enough to the purpose of the underlying class litigation.¹¹ Those rejections have become less common; the more recent trend is toward a relaxed approach to *cy pres* uses of residual funds, as courts approve *cy pres* awards upon a showing that the residual funds will serve an important public purpose.¹²

State Statutes and Rules Governing Residual Funds

Some states have recognized the important work that residual funds can support and have codified how judges are to deal with residual funds. At least six states—California, Illinois, Massachusetts, North Carolina, South Dakota, and Washington—have amended their Codes of Civil Procedure in recent years to require residual funds to be distributed, at least in part, to legal aid projects.¹³ In the coming years, more states are expected to pass laws and adopt rules to direct residual funds to public interest projects. Collectively, those state statutes and rules will provide evidence of a public policy favoring *cy pres* awards that serve the justice system. Litigants in federal courts may be able to rely on those state statutes and rules for support when recommending a recipient of a *cy pres* award.

The American Law Institute’s Position on Residual Funds

At its 2009 Annual Meeting, the American Law Institute (ALI) adopted a paper, “Principles of the Law of Aggregate Litigation,” which concerns, among other topics, *cy pres* awards in class action settlements.¹⁴ ALI concluded that courts may approve a settlement with a *cy pres* component, even if the court would not have had authority, in the first instance, to issue *cy pres* relief in a contested case.¹⁵ ALI further concluded that a court should approve a *cy pres* award only if the court finds that (1) settlement funds “remain after distributions (because some class members could not be identified or chose not to participate)” and (2) the remaining funds cannot be distributed to class members.¹⁶ In those circumstances, a settlement may award those residual funds to “a recipient involving the same subject matter as the lawsuit that reasonably approximates the interests being pursued by the class.”¹⁷ ALI emphasized that this provision, known

as § 3.07, was not meant to limit the parties’ ability to negotiate a mechanism for disbursing residual funds, subject, of course, to court approval.¹⁸

Section 3.07 has not been adopted widely for federal class actions under Fed. R. Civ. P. 23,¹⁹ perhaps because courts are trending toward a more relaxed view of the “closely related” requirement. Still, most federal court settlements that involve residual funds will have little difficulty satisfying § 3.07’s standards for a *cy pres* award.

Practical Advice

When negotiating a common fund settlement, class action practitioners should discuss a precise mechanism for dealing with any residual funds that may remain at the end of any claims administration period. A *cy pres* award supporting a public interest legal services organization merits consideration during negotiations.

When considering how to handle a fixed sum that remains after a common fund settlement has been fully administered, counsel should consult the settlement agreement, research applicable local law, confer with the other side, and make a formal recommendation to the court. As part of that recommendation, counsel should be prepared to discuss the efforts that have been made to distribute the funds to the claimants under the settlement. Counsel should also be ready to support the proposed award recipient by discussing why the recipient is proper for the particular case and by detailing how the recipient will use the funds to serve an important public interest. If necessary, counsel should make a record to support a *cy pres* recommendation.

A *cy pres* award can be an artful way to conclude the settlement administration portion of a class action suit. In an increasing number of cases, courts have invoked the doctrine of *cy pres* when approving a negotiated proposal for distributing the last portion of settlement monies that cannot be otherwise distributed to class members. Those residual funds can help support worthwhile public interest projects and can also facilitate improvements in the justice system. **TFL**

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Endnotes

¹See, e.g., *In re Global Crossing Sec. & ERISA Litig.*, 225 F.R.D. 436, 462 (S.D.N.Y. 2004).

²In some class actions, the settlement agreement

provides that residual funds will revert to the defendant (see, e.g., *Waters v. Int'l Precious Metals Corp.*, 237 F.3d 1273, 1275 (11th Cir. 2001)), but this article does not analyze the issues involved with reverter provisions.

³*In re Airline Ticket Commission Antitr. Litig.*, 307 F.3d 679, 682 (8th Cir. 2002).

⁴*Id.* at 682–83; *Jones v. Nat'l Distillers*, 56 F. Supp. 2d 355, 359–60 (S.D.N.Y. 1999).

⁵This case is different from a settlement that uses a *cy pres* award to a third party as a substitute for distributing funds to class members. See, e.g., *In re Mexican Money Transfer Litig.*, 267 F.3d 743, 746 (7th Cir. 2001) (in a class action suit involving wire transfer fees, the settlement agreement allocated \$4.6 million of the settlement fund to “organizations that assist the Mexican-American community”). Some federal courts have been reluctant to approve *cy pres* proposals that would replace a claims process—especially if the claims of class members could have been paid—expressing concern that a settlement should directly compensate class members for the injuries that led to the class action lawsuit in the first place. *Molski v. Gleich*, 318 F.3d 937, 954–55 (9th Cir. 2003). *Cf. Mirfasibi v. Fleet Mortgage Corp.*, 356 F.3d 781, 784 (7th Cir. 2004). This article does not consider the issues that arise when a proposed settlement uses a *cy pres* award to a nonparty as a substitute for paying amounts directly to class members.

⁶See, e.g., *In re Heartland Payment Sys. Inc. Data Sec. Breach Litig.*, No. H-09-MD-02046, 2010 U.S. Dist. LEXIS 34619 (S.D. Tex. Apr. 8, 2010); *Hopson v. Hanesbrands Inc.*, No. CV-08-0844, 2009 U.S. Dist. LEXIS 33900 (N.D. Cal. Apr. 3, 2009).

⁷For example, in *Kaufman v. Am. Express Travel Related Svcs. Co. Inc.*, 264 F.R.D. 438 (N.D. Ill. 2009), the district court considered a motion for preliminary approval of a class action settlement. Expressing concern over the *cy pres* procedure for residual funds, the court instructed counsel for the parties to revisit that procedure (and other parts of the proposed settlement) and submit amended papers. *Id.* at 449. See also *Six Mexican Workers v. Arizona Citrus Growers*, 904 F.2d 1301, 1308–09 (9th Cir. 1990).

⁸See, e.g., *Orser v. Select Portfolio Svcs. Inc.*, No. C-05-1507, 2009 U.S. Dist. LEXIS 112317 (W.D. Wash. Dec. 2, 2009); *Damassia v. Duane Reade Inc.*, No. 04-CV-08816, 2009 U.S. Dist. LEXIS 77489 (S.D.N.Y. July 27, 2009); *In re Janney Montgomery Scott LLC Fin'l Consultant Litig.*, No. 06-3202, 2009 U.S. Dist. LEXIS 60790 (E.D. Pa. July 16, 2009); *Reyes v. Buddha-Bar NYC*, No. 08-CIV-02494, 2009 U.S. Dist. LEXIS 45277 (S.D.N.Y. May 28, 2009).

⁹See, e.g., *Jones*, *supra* note 4, 56 F. Supp. 2d at 359; *Powell v. Georgia-Pacific Corp.*, 119 F.3d 703, 707 (8th Cir. 1997); *Superior Beverage Co. Inc. v. Owens-Illinois Inc.*, 827 F. Supp. 477, 478–80 (N.D.

Ill. 1993).

¹⁰See, e.g., *Mobney v. Shelly's Prime Steak, Stone Crab & Oyster Bar*, No. 06-CIV-4270, 2009 U.S. Dist. LEXIS 115637 at *5–6 (S.D.N.Y. Dec. 8, 2009); *In re Publication Paper Antitr. Litig.*, No. 3:04-MD-1631, 2009 U.S. Dist. LEXIS 66654 at *24–25 (D. Conn. July 30, 2009); *Turner v. Murphy Oil USA Inc.*, No. 05-4206, 2009 U.S. Dist. LEXIS 50509 at *59–61 (E.D. La. May 27, 2009); *Plotz v. NYAT Maint. Corp.*, No. 98-CIV-8860, 2006 U.S. Dist. LEXIS 4799 at *4–7 (S.D.N.Y. Feb. 6, 2006).

¹¹*In re Airline Ticket*, *supra* note 3, 307 F.3d at 683–84; *In re Am. Tower Corp. Sec. Litig.*, 648 F. Supp. 2d 223, 224–25 (D. Mass. 2009).

¹²A growing majority of federal courts is adopting a more relaxed view of the “closely related” requirement when approving *cy pres* uses of residual funds. See, e.g., *In re Pharm. Indus. Avg. Wholesale Price (In re AWP) Litig.*, 588 F.3d 24, 30, 36 (1st Cir. 2009); *In re San Juan DuPont Plaza Hotel Fire Litig.*, 687 F. Supp. 2d 1, 2–3 (D.P.R. 2010); *Tarlecki v. Bebe Stores Inc.*, No. C-05-1777, 2009 U.S. Dist. LEXIS 102531, at *15 (N.D. Cal. Nov. 3, 2009); *Gravina v. Client Servs. Inc.*, No. 2:08-CIV-03634, 2009 U.S. Dist. LEXIS 78204, at *4 (E.D.N.Y. Aug. 25, 2009); *Rosenau v. Unifund Group Corp.*, 646 F. Supp. 2d 743, 755–56 (E.D. Pa. 2009); *In re Lupron Mktg. & Sales Practices Litig.*, No. 01-CV-10861, 2009 U.S. Dist. LEXIS 65276, at *9 (D. Mass. May 19, 2009); *Hopson*, *supra* note 6, 2009 U.S. Dist. LEXIS 33900 at *25–27; *Herring v. Hewitt Assoc. LLC*, No. 3:06-CV-00267, 2009 U.S. Dist. LEXIS 67283, at *15 (D.N.J. Mar. 20, 2009); *In re Linerboard Antitr. Litig.*, No. 98-5055, 2008 U.S. Dist. LEXIS 77739, at *13–14 (E.D. Pa. Oct. 3, 2008); *Fears v. Wilhelmina Model Agency Inc.*, No. 02-CIV-4911, 2007 U.S. Dist. LEXIS 48151, at *4–5 (S.D.N.Y. July 5, 2007), *rev'd on other grounds*, 315 Fed. Appx. 333, 335–36 (2d Cir. 2009); *Schwartz v. Dallas Cowboys Football Club Ltd.*, 362 F. Supp. 2d 574, 577 (E.D. Pa. 2005); *In re Motorsports Merch. Antitr. Litig.*, 160 F. Supp. 2d 1392, 1394–99 (N.D. Ga. 2001).

¹³Cal. Code Civ. Proc. § 384; 735 ILCS § 5/2-807; Mass. R. Civ. P. 23(e); N.C. Gen. Stat. § 1-267.10; S.D. Codified Laws § 16-2-57; and Wash. CR 23(f).

¹⁴American Law Institute on Aggregate Litig., § 3.07 at 220–25.

¹⁵*Id.* § 3.07(a).

¹⁶*Id.* § 3.07(b).

¹⁷*Id.* § 3.07(c). The ALI’s analysis “begins from the premise that funds generated through the aggregate prosecution of divisible claims are presumptively the property of the class members (and that the settlement has not been structured so that any funds remaining revert to the defendant). Starting from this vantage point, this Section generally favors *cy pres* awards only when direct distributions to class members are not feasible. ... In such circumstances,

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,” American Law Institute, Comments, ALI on Aggregate Litig, § 3.07 at 221.

¹⁸“The approach of this section to *cy pres* remedies should not be construed to limit the scope of remedies that parties may agree to.” *Id.* at 223.

¹⁹One court of appeals has rejected § 3.07, see *Pharm. Indus.*, *supra* note 12, 588 F.3d at 35–36.

Another court of appeals cited that section in dicta when offering guidance to trial court judges, see *Masters v. Wilhelmina Model Agency Inc.*, 473 F.3d 423, 436 (2d Cir. 2007)). A few district courts have cited § 3.07, see *Lupron Mktg.*, *supra* note 12, 2009 U.S. Dist LEXIS 65276, at *6–7; *SEC v. Bear, Stearns & Co. Inc.*, 626 F. Supp. 2d 402, 416–17 (S.D.N.Y. 2009); *In re Tyco Int’l Ltd. Multidistrict Litig.*, 535 F. Supp. 2d 249, 262 (D.N.H. 2007).

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in encouraging his judicial colleagues to attend CLE programs and other bench and bar events.

It is no accident that the increased interaction between the court and the bar has paralleled the growth of the FBA’s Delaware Chapter, which is currently the largest FBA chapter in the Third Circuit and one of the association’s fastest growing chapters nationwide. Anne Shea Gaza, president of the Delaware Chapter, credits Judge Farnan as being instrumental in helping to grow the chapter. Gaza explains that “Judge Farnan was the catalyst for increasing the dialogue between the federal bench and bar. He inspired the Delaware Chapter to begin hosting quarterly CLE programs and membership luncheons. The court’s enthusiastic involvement in these and other chapter programs generated renewed interest in the FBA, which led our membership to skyrocket. We have been fortunate to work with Judge Farnan and are grateful for the mentorship and assistance he has provided to the Delaware Chapter and to the FBA as a whole.”

According to Judge Farnan, that relationship has been mutually beneficial. “Since the court and the bar have been involved in growing their relationship,” he says, “the growth of the FBA in Delaware has been nothing short of spectacular. The work of the FBA, in the truest sense, contributes in a major way to the fair administration of justice in the civil and criminal systems. I intend to be actively and energetically involved in the continued growth and relevance of the FBA as an entity following my retirement from judicial service.”

One of the ways in which Judge Farnan intends to continue working with the FBA is through his latest brainchild: the Delaware Chapter’s new Federal Trial Practice Seminar. Judge Farnan and his judicial colleagues elicited the FBA’s assistance to create a unique, multiweek trial practice seminar designed for lawyers who have less than 10 years of experience and desire to practice in federal court. The seminar participants, who were chosen through an application process, benefit from a series of lectures and workshops culminating in a formal mock trial exercise. As with other CLE programs sponsored by the FBA, Judge Farnan recruited his judicial colleagues—in addition to experienced mentors chosen by the court—to participate in each session. Christopher J. Burke, chair of the Federal

Trial Practice Seminar, explained that Judge Farnan’s leadership in creating the seminar is an extension of his “lifelong commitment to both education and the law.” According to Burke, “Judge Farnan created the Federal Trial Practice Seminar out of a desire to teach younger lawyers how to be effective courtroom advocates. The seminar is a unique opportunity for federal practitioners in our district to learn trial practice skills from the judges of our district court and from experienced litigators. Thanks to Judge Farnan, we expect that the seminar will be a yearly event that will further the FBA’s mission—to be a bridge between our Delaware federal courts and the lawyers who practice before those courts.”

Judge Farnan’s legacy of public service has had a profound impact on so many people: the students he taught at Wilmington College, where he remains a member of the university’s board of directors; the individuals he represented as a public defender; the prosecutors he supervised and taught to dispense justice with dignity and fairness; his judicial colleagues, to whom he has been a trusted mentor and friend; and the Delaware bar, which has benefited from his intellect and excellence as a trial judge. “Judge Farnan is a larger-than-life individual, who has touched this court and this community with a broad stroke,” reflected Judge Robinson. Chief Judge Sleet, echoing the sentiments of the entire court, as well as the Delaware legal community, remarked, “Judge Farnan not only has a great intellect but also an enormous amount of grace. We realize that we are losing part of our institutional memory as a court, but we will always have his friendship. And we know that he is only a phone call away.”

Even in retirement, Judge Farnan will continue to serve the public good. And for that, all of us who practice in the District of Delaware remain grateful. **TFL**

Robert F. Kravetz is an assistant U.S. attorney for the District of Delaware. This judicial profile is written solely in the author’s personal capacity and does not reflect the official views of the U.S. Department of Justice or the U.S. Attorney’s Office for the District of Delaware. The author wishes to thank Christopher J. Burke, Anne Shea Gaza, Debbie Krett, and David C. Weiss for their valuable assistance in the preparation of this profile.