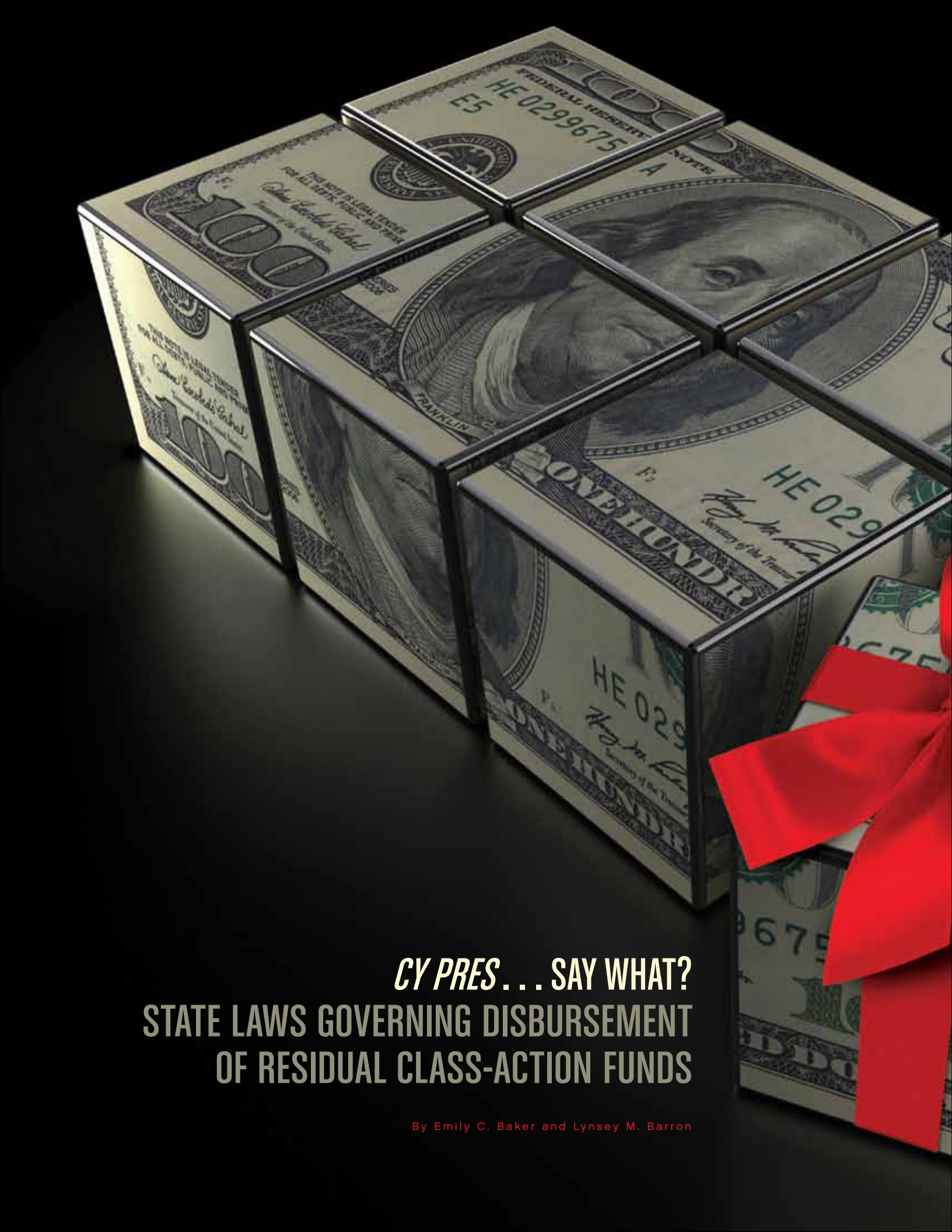
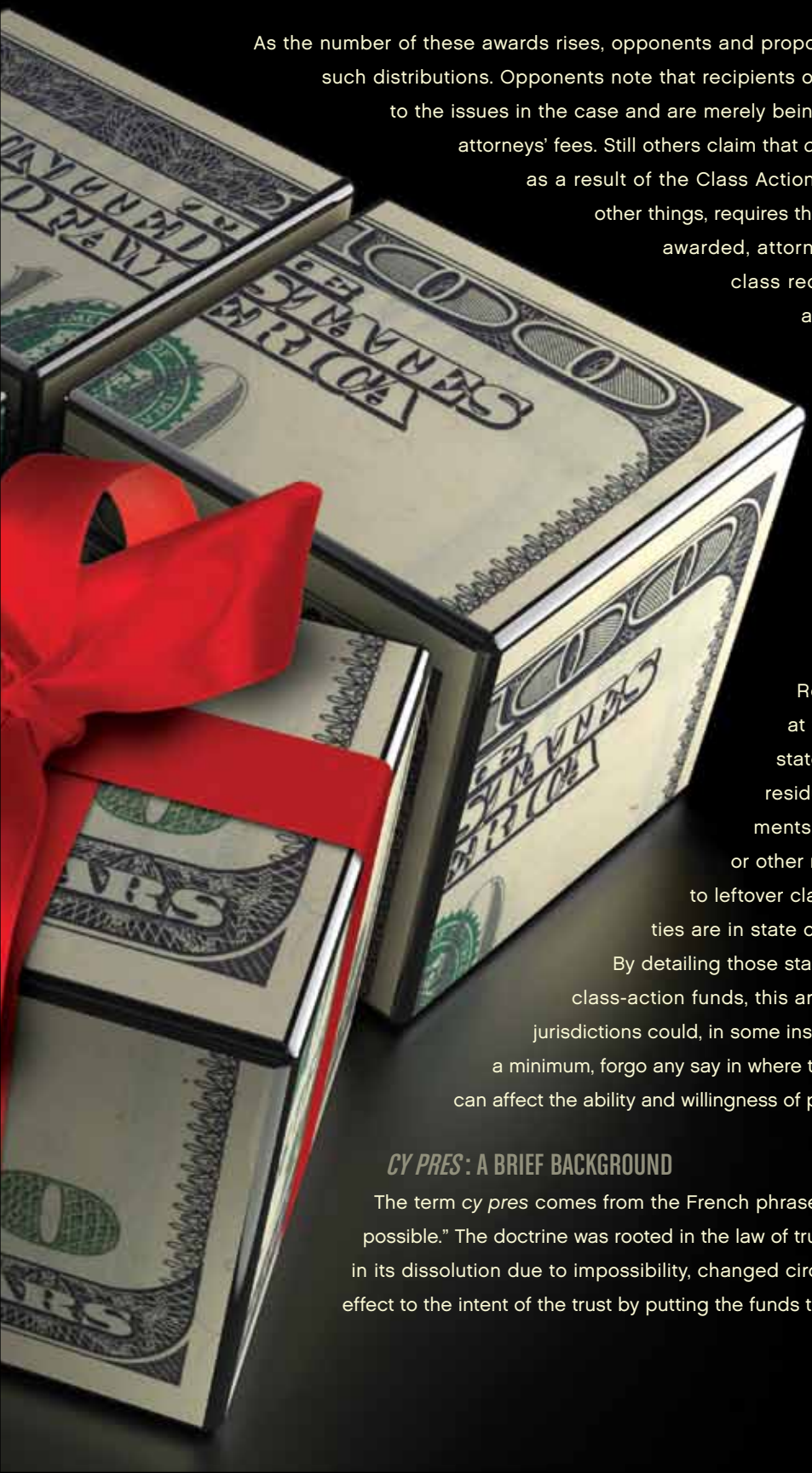


# *CY PRES* . . . SAY WHAT?
# STATE LAWS GOVERNING DISBURSEMENT OF RESIDUAL CLASS-ACTION FUNDS

By Emily C. Baker and Lynsey M. Barron

Unclaimed or leftover funds at the resolution of class-action cases are common. In some cases, members of the class cannot be located or identified. In others, class members may be unable or unwilling to claim their shares of a settlement or judgment. And in some instances, courts can order that no distribution be made to class members because their shares are so small that the cost of notice and disbursement exceeds the value of the claims. Whatever the reason, these unclaimed funds, particularly in consumer class actions, have increasingly become the target for *cy pres* awards, or charitable contributions, in federal court.[1]



As the number of these awards rises, opponents and proponents alike have weighed in on the propriety of such distributions. Opponents note that recipients of *cy pres* awards typically have little connection to the issues in the case and are merely being used as a tool by the plaintiffs' bar to drive up attorneys' fees. Still others claim that *cy pres* awards are replacing coupon settlements as a result of the Class Action Fairness Act of 2005, or "CAFA." CAFA, among other things, requires that in class-action settlements where coupons are awarded, attorneys' fees be based only on those coupons the class redeems, rather than the total dollar value of the agreement. Even if a significant portion of the class fails to redeem coupons, *cy pres* distributions can be incorporated into a settlement in order to drive up the value of the agreement upon which fees are based. Proponents, on the other hand, often counter that *cy pres* awards are a practical alternative to allowing the leftover money simply to revert to the defendant(s), which chips away at whatever deterrent effect such lawsuits have.

Regardless, this trend has not gone unnoticed at the state level. In just the last few years, several states have passed laws either requiring or allowing residual funds from class-action settlements or judgments (or both) to go to charities, legal aid providers, or other nonprofit organizations. Ultimately, what happens to leftover class-action funds will depend on whether the parties are in state or federal court—and if in state court, which one. By detailing those state laws that direct *cy pres* distribution of residual class-action funds, this article seeks to show why unwary parties in those jurisdictions could, in some instances, lose the right to reclaim those funds or, at a minimum, forgo any say in where those funds are directed. In either event, such laws can affect the ability and willingness of parties to settle class-action cases.

## *CY PRES*: A BRIEF BACKGROUND

The term *cy pres* comes from the French phrase "*cy-près comme possible*," meaning "as near as possible." The doctrine was rooted in the law of trusts, such that when the terms of the trust resulted in its dissolution due to impossibility, changed circumstances, or the like, courts attempted to give effect to the intent of the trust by putting the funds to the next best use.[2] Therefore, *cy pres* was a way

to deal with bequests that could no longer be made—such as a donation to something that no longer exists.

*Cy pres* was, for the most part, restricted to the trusts context until class-action lawsuits became more prevalent in the latter part of the 20th century and the issue of what would happen to leftover or unclaimed class funds became the subject of debate and commentary.[3] This money was traditionally just returned to the defendant(s).[4] Other alternatives for how to dispose of unclaimed funds included distributing that money to those class members who did make a claim or allowing the money to escheat to the state.[5] Criticism of these various approaches, however, led to the use of *cy pres* in the class-action context. In recent years, the leftover or earmarked class funds have often been directed to charities or nonprofit organizations—unlike early *cy pres* class-action settlements, which typically directed leftover money to a different set of consumers or individuals.

## EXISTING STATE STATUTES AND RULES GOVERNING DISBURSEMENT OF RESIDUAL CLASS-ACTION FUNDS

Not surprisingly, where there are state rules or statutes governing *cy pres* disbursement of residual class-action funds, virtually all contain an express provision that *cy pres* does not apply to a judgment against a public agency or public employee. Moreover, most states with such statutes or rules permit the settling parties to allow for the reversion of unclaimed class-action money to the defendant, and most seem to direct at least a portion of any residue to legal services organizations for the indigent.[6] There is wide variation, however, in terms of whether the *cy pres* statutes are mandatory, the default, or merely suggested.

At the less restrictive end are Massachusetts and Tennessee, whose *cy pres* laws govern both class-action settlements and judgments.[7] In both states, courts "may provide for the disbursement of residual funds," and the laws are clear that judgments and settlements are not required to provide for residual funds. In almost superfluous language, the Tennessee statute states: "A distribution of residual funds to a program or fund which serves the pro bono legal needs of Tennesseans including, but not limited to, the Tennessee Voluntary Fund for Indigent Civil Representation is permissible but not required." And, even after a judgment is entered or a settlement approved, either party may move, or the court may act *sua sponte*, to arrange for residual funds. Although *cy pres* distributions are equally discretionary in Massachusetts, any residuals must be directed either to a charity or foundation "which support[s] projects that will benefit the class or similarly situated persons consistent with the objectives and purposes of the underlying causes of action on which relief was based" or to the state's IOLTA Committee for indigent representation.[8]

Unlike the laws of Massachusetts and Tennessee, Washington's *cy pres* law distinguishes between settlements and judgments.[9] That is, even though *cy pres* is the default, settling parties may contract around *cy pres* distributions. However, if the class wins a judgment, residual funds *must* be distributed according to the statute. In that latter situation, of the remaining funds, at least 25 percent must go to the Legal Foundation of Washington to support access-to-justice programs for indigent clients, and the balance may be distributed "to any other entity for purposes that have a direct or indirect relationship to the objectives of the underlying litigation or otherwise promote the substantive or procedural interests of members of the certified class."

South Dakota is the only state where *cy pres* distribution applies solely to class-action settlements.[10] There, residual funds must be distributed to the "Commission on Equal Access to Our Courts," and the courts, upon finding "good cause" to do so, may designate up to 50 percent of any residual amount to a charity. It should be noted, however, that the settling parties, pending court approval, can agree that any unclaimed funds revert to the defendant.

At the more aggressive end of the spectrum are North Carolina, California, and Illinois. The *cy pres* statutes of North Carolina and California are almost identical and apply to both class-action settlements and judgments.[11] Both contain a statement of legislative intent, which seeks to ensure that unpaid class funds are used "to further the purposes of the underlying causes of action, or to promote justice for all [citizens of the state]."[12] Courts in both states must determine the amount payable to all class members if all are actually paid what they are entitled to under the settlement or judgment, and they must set a date by which the parties are to report how much was actually paid. In North Carolina, the court must direct the defendant(s) to divide any residual balance between the "Indigent Person's Attorney Fund" and the North Carolina Bar "for the provision of civil legal services

for indigents." In California, interest on the fund begins to accrue from the date of judgment and must be directed toward: (i) a charity that supports projects that benefit either the class or "similarly situated persons"; (ii) an organization that "promote[s] the law consistent with the objectives and purposes of the underlying cause of action"; (iii) a child-advocacy program; or (iv) a legal services organization for the indigent. If the class action is a multistate or national case brought under California law, the residual must be distributed to "provide substantial or commensurate benefit to California consumers." Notably absent from the statutes of both North Carolina and California is any language suggesting that parties may recommend, or that the court may approve, a settlement or judgment that would include a reversion to the defendant(s) of any unpaid funds.

At least one California court has noted that if such an option is expressly provided for in a settlement agreement and subsequently approved by a court, it must not conflict with the statute.[13] In *In re Microsoft*, the settlement agreement specified that one-third of any unclaimed remainder was to be retained by the defendant, with the remaining two-thirds to be issued as vouchers enabling low-income schools to obtain Microsoft products. Although the *cy pres* distribution to the schools did not fall within the strict confines of Cal. Code Civ. Proc. § 384(b), the California Court of Appeals found that the provision was legal because the *cy pres* statute's purpose is "to prevent a subsequent reversion of residue to a defendant when that reversion was not a part of the settlement terms that were previously scrutinized during the approval process."[14]

Similar to those of North Carolina and California, Illinois's *cy pres* statute is mandatory.[15] The primary difference is the end to which the residual funds must be directed. Under the Illinois law, if money remains in a common fund after judgment for the class, the money must be distributed to a nonprofit that "has a principal purpose of promoting or providing services that would be eligible for funding under the Illinois Equal Justice Act."[16] If money remains in a settlement fund, the court has discretion to distribute for "good cause" up to half the money to another charity that serves the public good.

## CONCLUSION

The irony of *cy pres* distributions in the settlement context cannot be overstated. As one scholar recently noted, the primary goal of *cy pres* distributions is to guarantee that even if few injured parties claim a share of the settlement, the defendant will be adequately punished.[17] But in the case of a class-action settlement, the settling defendant has not been found liable, has not admitted liability, and may in fact be settling for reasons wholly unrelated to its liability. Plaintiffs' attorneys, on the other hand, have strong motivation to seek or provide for *cy pres* distribution because it is often difficult or costly to identify class members, prove their claims, and distribute the settlement.[18] In these instances, and absent *cy pres*, the size of the fund (and, more important, the resulting attorneys' fees) can be significantly smaller. As a result, there may be a push, heavily supported by the plaintiffs' bar, to expand *cy pres* laws into other states.

Nevertheless, whether state *cy pres* rules and statutes will significantly affect the class-action resolution process remains to be seen. CAFA ostensibly expanded federal jurisdiction over class actions,[19] and federal courts authorize *cy pres* distributions with some frequency where there are residual or undistributed class-action funds.[20] Because of this increased access to federal courthouses, some commentators have speculated that state *cy pres* rules or statutes governing the distribution of unclaimed class-action funds will have minimal impact on settlements and judgments in state court.[21] And, to date, there have been few cases in these states interpreting these laws (although most of those statutes are fairly recent enactments). In any event, parties facing putative class actions in any of the seven states that currently have *cy pres* class-action statutes or rules on the books must understand and be prepared to address what will happen with residual or unclaimed class-action funds. ■

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[1] Martin H. Redish *et al.*, "Cy Pres Relief and the Pathologies of the Modern Class Action: A Normative and Empirical Analysis," 62 *Fla. L. Rev.* 617, 620 (2010).

[2] *See id.* at 625.

[3] *See id.* at 624.

[4] *See id.* at 631.

[5] *See id.*

[6] The practice of handing residual money over to legal services organizations for the indigent is so prevalent that these organizations have come to rely on *cy pres* distributions to finance their work. Adam Liptak, Sidebar, "Doling Out Other People's Money," *N.Y. Times*, Nov. 26, 2007. Note that this approach stands in contrast to the view that, to the extent possible, residual funds should be used only to "effectuate . . . the interests of silent class members." *Six Mexican Workers v. Ariz. Citrus Growers*, 904 F.2d 1301, 1309 (9th Cir. 1990); *see also* 5 Jerold S. Solovy *et al*., *Moore's Federal Practice* – Civil ¶ 23.171 (2011). In considering nonstatutory *cy pres* in a federal class action, the Ninth Circuit concluded that *cy pres* is designed to provide the "next best" alternative to compensating injured class members and thus is not appropriate when the proposed distribution is unrelated to the interests of silent class members. *Six Mexican Workers*, 904 F.2d at 1308–09. The court proposed escheat (to the state) as an alternative, if no appropriate charity could be identified. *Id.* at 1309.

[7] Tenn. Code Ann. § 23.08; Mass. Civ. Proc. 23(e).

[8] This provision was added in 2008 at the recommendation of the Massachusetts IOLTA Committee. *Id.* Reporter's Notes (2008).

[9] Wash. Civ. R. 23(f).

[10] S.D. Codified Laws § 16-2-57 (2008).

[11] Cal. Code Civ. Proc. § 384; N.C. Gen. Stat. § 1-267.10 (2009).

[12] Both also contain language indicating that the use of residual funds in this manner "is in the public interest, is a proper use of the funds, and is consistent with essential public and governmental purposes." *Id.*

[13] *See In re Microsoft I-V Cases*, 135 Cal. App. 4th 706 (2006).

[14] *Id*. at 721.

[15] 735 Ill. Comp. Stat. 5/2-807 (2009).

[16] The Illinois Equal Justice Act, 30 Ill. Comp. Stat. 765/1 *et seq*., established a system for distributing money to organizations that provide for civil defense for the indigent.

[17] *See* Redish *et al*., *supra* note 1, at 638.

[18] *Id.* at 640–41.

[19] Pub. L. No. 109-2. CAFA extends federal jurisdiction to cases where the aggregate claims of the class exceed $5 million and in which "(A) any member of a class of plaintiffs is a citizen of a State different from any defendant; (B) any member of a class of plaintiffs is a foreign state or a citizen or subject of a foreign state and any defendant is a citizen of a State; or (C) any member of a class of plaintiffs is a citizen of a State and any defendant is a foreign state or a citizen or subject of a foreign state." 28 U.S.C. § 1332(d)(2).

[20] *See* Redish *et al*., *supra* note 1, at 620 (noting that, among the range of alternatives for dispensing of unclaimed funds in federal court, *cy pres* relief is the one most often granted).

[21] *See* Sam Yospe, "Cy Pres Distributions in Class Action Settlements," 2009 *Colum. Bus. L. Rev*. 1014, 1059 n.154 (2009).