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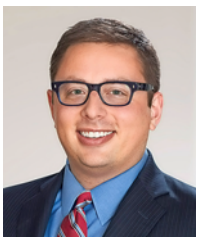
CLASS SETTLEMENTS

Two attorneys with Patterson Belknap discuss the recent grant of certiorari by the U.S. Supreme Court involving the issue of *cy pres* awards of class-action proceeds.

Frank v. Gaos: *Cy Pres* Gets Its Day at the Supreme Court



BY JONAH M. KNOBLER AND SAM A. YOSPE

Increasingly, courts presiding over class actions employ a controversial practice called *cy pres* (''see-pray'') that diverts damages owed to injured class members to non-party charitable institutions. The theory behind *cy pres* is that, when getting damage awards to class members is difficult, giving that money to a relevant charity is the next-best result. The U.S. Supreme Court has never considered whether *cy pres* is legitimate or how it is supposed to work. That may soon change: on April 30, the Court granted certiorari in *Frank v. Gaos* (No. 17-961), which presents these questions. The decision in *Frank* may have enormous implications for class-action practice. At minimum, however, it should provide much-needed clarity on this contentious subject.

Origins of *Cy Pres*

The term *cy pres* derives from the French *cy pres comme possible* (''as near as possible''). In trust law, it is a doctrine providing that, when the proceeds of a charitable trust can no longer be paid to the intended beneficiary (*e.g.*, because it is defunct), a court may designate a new beneficiary ''as near as possible'' to the original one, so that the donor's intent may be substantially vindicated. For example, after the Emancipation Proclamation, ''a 19th-century court applied the [*cy pres*] doctrine to repurpose a trust that had been created to support the abolition movement to instead provide assistance to poor African Americans.'' *Frank v. Gaos*, Cert. Pet. at 5. This trust-law version of *cy pres* has existed in one form or another since ancient Rome.

By contrast, the class-action version of *cy pres* is relatively new. In 1966, Fed. R. Civ. P. 23(b)(3) was enacted, and the money-damages class action was born. A fundamental problem with this new form of litigation soon became evident. Even when it was possible to calculate the aggregate damage caused by a defendant, it was often difficult or impossible to locate the injured class members and notify them of an available damage award (and when class members *were* notified, they often failed to complete the claims process). Courts faced with this scenario were in a bind. They could allow the unclaimed portion of the aggregate damage award to revert to the defendant—but this would permit the defendant to keep the fruits of its wrongful conduct. They could permit the unclaimed funds to escheat to the state—but this would provide no benefit to the class. Or they could pay the unclaimed funds out as a bonus to those class members who had already claimed and received damages—but this would provide a windfall to those class members at the expense of the ''nonclaiming or unidentified class members'' who ''have superior equitable interests in the remaining fund[s].'' *Powell v. Georgia-Pacific Corp.*, 843 F. Supp. 491, 496 (W.D. Ark. 1994), *aff'd* 119 F.3d 703 (8th Cir. 1997).

Class-action *cy pres* developed in the 1970s and 1980s as a purported solution to this problem. *See Miller v. Steinbach*, No. 66-cv-356 (S.D.N.Y. 1974) (first recorded application of class-action *cy pres*). As courts now apply it, the doctrine provides that, when it is impracticable to pay out some or all of the damages fund to injured class members—*e.g.*, because they cannot be located, because they do not submit claims, or because the per-person award is *de minimis*—that money may instead be paid to a charity or nonprofit whose mission relates to the subject matter of the lawsuit. *See* Redish,

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Julian & Zyontz, *Cy Pres Relief and the Pathologies of the Modern Class Action: A Normative and Empirical Analysis*, 62 Fla. L. Rev. 617, 618-20 (2010) (''Redish''). In a consumer-protection case, for example, a *cy pres* award might go to a consumer advocacy group; in a race-discrimination case, a *cy pres* award might go to a civil-rights organization. In this way, the theory goes, class members who do not receive money damages still derive *some* benefit from the lawsuit—however indirect—because they will supposedly feel the positive impact of the *cy pres* recipient's charitable work.

The analogy to trust-law *cy pres* is somewhat strained. *See Mirfasihi v. Fleet Mortg. Corp.*, 356 F.3d 781, 784 (7th Cir. 2004) (Posner, J.) (describing class-action *cy pres* as ''something parading under [the] name'' of trust-law *cy pres* that is ''applied . . . for a reason unrelated to the reason for the trust doctrine''). In both of its forms, *cy pres* involves courts picking a ''next best'' recipient for money originally intended for someone else. But that is where the similarity ends. In the trust context, the donor who created a charitable trust obviously *intended* to give his money away to charity; thus, it can be safely assumed that he would have wanted the trust to benefit a related charitable cause rather than having the trust fail and the corpus revert to his heirs. In the class-action context, by contrast, *cy pres* does not even arguably effectuate the intent of the injured class members whose money is being given away. If given a choice, they would prefer to be made whole for their injuries, rather than make a charitable donation that will benefit them indirectly at best. Thus, rather than substantially vindicating the intent of the ''donor,'' class-action *cy pres* usually subverts it. Nevertheless, the analogy has taken root, and *cy pres* is now widely employed in class-action practice, especially when classes are certified for settlement. *See Frank v. Gaos*, Cert. Pet. at 32 (noting that ''*cy pres* settlements [are now] at their highest levels ever'').

Criticisms of *Cy Pres*

Unlike trust-law *cy pres*, class-action *cy pres* is controversial. For starters, the legal basis for it is unclear. Rule 23, which governs class actions in federal court, says nothing about *cy pres*. No statute affirmatively authorizes it. The Supreme Court has never said a word about it. Rather, it appears that the notion of class-action *cy pres* ''can be traced largely to a pioneering student comment, published in the University of Chicago Law Review in 1972.'' Redish, *supra*, at 631. Two years later, the first court to employ the doctrine, *Miller v. Steinbach*, No. 66-cv-356 (S.D.N.Y. 1974), acknowledged that ''neither counsel nor the Court ha[d] discovered [any] precedent for [it]'' (aside from the questionable analogy to trust law). That is a shaky foundation for a practice that redistributes many millions of dollars each year.

Some argue that *cy pres* is affirmatively *prohibited* by the Rules Enabling Act, the statute under which the Federal Rules of Civil Procedure were promulgated. The Act states that those Rules—including Rule 23—''shall not abridge, enlarge or modify any substantive right.'' 28 U.S.C. § 2072(b). Thus, the use of Rule 23 to aggregate individual claims does not permit courts to alter the substantive law governing those claims. That includes the *remedies* that are authorized, and not authorized, by the underlying substantive law. For example, if a given statute permits only injunctive relief in an individual action, then Rule 23 does not permit a court to award money damages in a class suit; that would be a prohibited ''modif[ication] of . . . substantive right[s].'' The same arguably goes for *cy pres*: if a statute does not authorize a court to deny compensation to an *individual* plaintiff and order the defendant to make a charitable donation instead, then the Rules Enabling Act prohibits courts from doing so in the class-action context.

Indeed, some go even further and argue that class-action *cy pres* is *unconstitutional*. *See, e.g.*, Redish, *supra*, at 641. For example, Article III's ''case or controversy'' requirement may prohibit federal courts from ordering monetary awards to non-parties that are strangers to an adversarial proceeding and lack an injury-in-fact traceable to the defendant. The Due Process Clause may prohibit courts from appropriating funds rightfully belonging to absent class members and transferring them to someone else. And when *cy pres* awards are made to groups that engage in expressive or political activity, as is often the case, this may infringe on class members' First Amendment right not to subsidize ''speech'' with which they disagree. *Cf. Janus v. Am. Fed. of State, Cnty., and Mun. Empls., Council 31*, No. 16-1466 (argued Feb. 26, 2018) (case challenging mandatory union ''agency fees'' under First Amendment on grounds that such fees fund advocacy with which some employees disagree).

Even if it is not unlawful, however, *cy pres* can be deeply problematic. For starters, the notion at the heart of *cy pres* that charitable awards provide a meaningful benefit to unidentified or non-claiming class members is often a fiction. *See Pearson v. NBTY Inc.*, 772 F.3d 778, 784 (7th Cir. 2014) (Posner, J.) (''The $1.13 million *cy pres* award to [an] orthopedic foundation [in a consumer class action involving joint-health supplements] did not benefit the class, except insofar as armed with this additional money the foundation may contribute to the discovery of new treatments for joint problems—a hopelessly speculative proposition.''). In addition, *cy pres* can create an appearance of impropriety—if not outright corruption—by permitting judges and lawyers to direct millions of dollars to institutions they are personally connected to, such as their own *alma maters*. *Frank v. Gaos*, Cert. Pet. at 26. *Cy pres* can also permit defendants to reduce or even eliminate their effective liability by selecting a recipient charity that they were already planning to sponsor independently of the litigation. *Id.* at 28. Moreover, *cy pres* creates an inherent conflict of interest between class counsel and the class members they ostensibly represent. *Id.* at 25-26. Specifically, class counsel's fee award is usually based on the size of the total recovery obtained, and *cy pres* ''recovery'' is usually considered part of that total—no different from money paid to class members. Class counsel, therefore, have no incentive to fight for a settlement that maximizes their clients' recovery. To the contrary, since locating class members and providing notice is expensive and time-consuming, and writing a check to a charity is quick and easy, class counsel are incentivized to prefer a *cy pres* award that minimizes, or even eliminates, their own clients' recovery—in Judge Posner's words, to ''s[ell] [their clients] down the river.'' *Mirfasihi*, 356 F.3d at 785. Finally, because *cy pres* allows attorneys to reap large fee awards in cases that might not otherwise be certified for class treatment, its

existence may motivate lawyers to file many suits that they would not otherwise file—and, some would argue, ought not be filed. *See* Redish, *supra*, at 653-56 (discussing *cy pres*' enablement of '' 'faux' class actions'').

Frank v. Gaos

In *Frank v. Gaos*, many of these concerns are prominently on display. The case began as a consolidated class action brought against Google. In the underlying case, web users allege that Google violated the Stored Communications Act and committed various privacy torts by disclosing their search queries to the websites that they access through Google searches. *See In re Google Referrer Header Privacy Litig.*, No. 5:10-cv-04809 (N.D. Cal.).

Google reached an early settlement with class counsel. It agreed to pay $8.5 million in exchange for a release of all the privacy claims of the approximately 129 million Americans who used its search engine between 2006 and 2014. However, none of that $8.5 million would go to the allegedly wronged web searchers giving up their claims. Instead, $3.2 million of the fund would go toward the fees and costs of plaintiffs' counsel, and the remainder would be paid as a *cy pres* award to institutions that research or advocate for Internet privacy. Together, class counsel and Google selected six awardees, which included the *alma maters* of the parties' lawyers; institutions with which Google had a preexisting donor relationship; and a nonprofit (AARP) that lobbies on controversial legislative and policy issues.

Ted Frank, a class member (who is also the Director of the Center for Class Action Fairness), objected to the proposed settlement. He argued that a *cy pres*-only settlement, under which every class member's right to sue is extinguished without any corresponding compensation, is by definition not ''fair, reasonable, and adequate'' as Rule 23(e)(2) requires of any class settlement. The district court approved the settlement over Frank's objection, *In re Google Referrer Header Privacy Litig.*, 87 F. Supp. 3d 1122 (N.D. Ca. 2015), and Frank appealed.

The Ninth Circuit affirmed. *In re Google Referrer Header Privacy Litig.*, 869 F.3d 737, 742 (9th Cir. 2017). It relied on circuit precedent holding that *cy pres*-only settlements ''are appropriate where the settlement fund is 'non-distributable' '' because ''proof of individual claims would be burdensome or distribution of damages costly.'' *Id.* at 741. Here, the court observed, the funds remaining after accounting for attorney's fees amounted to just ''a paltry four cents'' per class member—''a *de minimis* amount if ever there was one.'' *Id.* at 742. The cost of sending out 129 million four-cent checks would exceed the value of the settlement. In the Ninth Circuit's view, therefore, *cy pres* was the only option. It dismissed out of hand Frank's argument that this quandary indicated that the case should never have been certified for class treatment in the first place. As for the particular *cy pres* awardees, the court concluded that they were sufficiently related to ''the objectives of the Stored Communications Act'' and found no problem with their connections with Google or counsel. *Id* at 743-46.

Frank petitioned for certiorari, supported by a coalition of *amici*—most notably, a bipartisan group of 16 state attorneys general. Google and the class plaintiffs opposed. On April 30, 2018, the Supreme Court agreed to hear the case in its upcoming Term. This was no great surprise: In 2013, when the Court denied certiorari in a class action against Facebook, Chief Justice John Roberts observed that *cy pres* awards are a ''growing feature of class action settlements'' and that there are ''fundamental concerns surrounding the use of such remedies in class action litigation'' that merited examination in an appropriate case. *Marek v. Lane*, 571 U.S. 1003, 1006 (2013) (Roberts, C.J., concurring in denial of certiorari). These concerns included:

> when, if ever, such relief should be considered; how to assess its fairness as a general matter; . . . how [recipients] should be selected; what the respective roles of the judge and parties are in shaping a *cy pres* remedy; [and] how closely the goals of any enlisted organization must correspond to the interests of the class.

Id.

What To Expect

The Supreme Court may use *Frank* as a vehicle to resolve some or all of the concerns that Chief Justice Roberts posed in *Marek*. Notably, the very first question in that list—''when, *if ever*, such relief may be considered'' (emphasis added)—suggests that the Court could potentially deem class-action *cy pres* illegitimate across the board, perhaps citing the statutory and constitutional concerns described above. If the Court issues such a ruling, class-action practice could be completely transformed: again, if *cy pres* were categorically unavailable, many class actions that now make sense for plaintiffs' lawyers to pursue would no longer be economically viable and might not be filed at all. *See Frank v. Gaos*, Reply in Support of Cert. at 13 (''After all, without a *cy pres* award to inflate the settlement fund, it would have been impossible to justify paying class counsel over $2 million in fees, and so the case may never have been filed.''). Class-action filings could drop sharply in situations where class members are difficult to locate or notify or where each class member's damage award would be *de minimis*.

On the other hand, the Court may eschew any sweeping pronouncements and confine its ruling to *cy pres*-only settlements, like the one in *Frank* itself. Class-action *cy pres* was originally conceived, and is most often used, as a fallback method to dispose of funds remaining after reasonable efforts to make all of the injured class members whole. The situation in *Frank* is quite different: there, the district court certified the class and approved the proposed settlement with the express understanding that *no attempt would even be made* to pay any portion of the settlement fund to the class. If the Court finds this unorthodox use of *cy pres* improper, it may leave for another day whether and how *cy pres* may be used to distribute residual settlement funds after an initial attempt has been made to compensate class members. Because *cy pres*-only settlements like the one in *Frank* represent a modest percentage of all *cy pres* awards—perhaps as low as 3 percent (*see* Google Br. in Opp. to Cert at 21)—a ruling cabined to such settlements would be important, though perhaps not earth-shaking.

It is difficult to guess at what the Court will do. The odds may be that the Court will rule for Frank and reverse the Ninth Circuit—if only because the Supreme

Court most often grants certiorari in cases that it believes were wrongly decided. What is certain, however, is that the class-action bar (and the charities who rely on *cy pres* awards for funding) will be watching closely.

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