CORPORATE LITIGATION:

THE FUTURE OF CY PRES CLASS SETTLEMENTS

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When a class action settles, a potential "cy pres" distribution may come into play where direct distribution of all or part of the settlement consideration to class members is infeasible. For decades, district courts have exercised discretion to determine that direct distribution is infeasible either because class members cannot be identified, or because the settlement fund would yield a negligible payment to individual class members (or be consumed by the administrative costs of distribution). Cy pres settlements have grown into a limited but important feature of the class action settlement landscape without Supreme Court guidance. The high court recently granted certiorari, however, to decide the propriety and potential limits of cy pres settlements. *Frank v. Gaos*, 2018 WL 324121 (U.S. April 30, 2018).

Background

The cy pres ("as near as") doctrine is an equitable rule of construction with roots in the Middle Ages. Historically, the doctrine applied where a settlor's original purpose for a trust cannot be implemented because, for instance, the intended recipient no longer exists or the purpose of the trust has been accomplished. A balance of a settlement fund often remains unclaimed after distributions to identifiable class members are complete and it is not feasible or cost-effective to make further distributions to the class. Since the 1970s, courts have used a variant of the cy pres doctrine to distribute a portion of class action settlement funds to third party charitable organizations, often selected by or in consultation with the parties' counsel. More rarely (and recently), courts have approved "cy-pres only" settlements in which no class members receive any compensation: The sole recipients of net settlement funds, after deduction of attorney fees, are third-party nonprofits that seek to promote the same interests as those underlying those of the proposed settlement class. The federal circuits currently require that district court approval of a cy pres distribution include a specific finding that a close nexus exists between the work of any cy pres recipient and the interests pursued by the class in the relevant action. *See Dennis v. Kellogg Co.*, 697 F.3d 858, 865 (9th Cir. 2012); *In re Airline Ticket Com'n Antitrust Litig.*, 307 F.3d 679, 683 (8th Cir. 2002).

Google Privacy Litigation

On April 30, 2018, the Supreme Court granted a petition for certiorari to address whether "cy pres-only settlements" comply with the requirement in Rule 23(e) of the Federal Rules that any settlement that binds class members must be "fair, reasonable, and adequate." *In re Google Referrer Header Privacy Litigation*

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involves an $8.5 million settlement of privacy litigation against Google for disclosing search queries made by users of its search engine to third-party websites via the use of "referrer headers" embedded in URLs. The parties estimated that the class contains 129 million members. After deduction of attorney fees and expenses, the $5.3 million net settlement fund is to be distributed to six nonprofit recipients, including the AARP, academic institutions and research groups, to fund education and/or research relating to Internet privacy. A U.S. Court of Appeals for the Ninth Circuit panel affirmed the district court's approval of the settlement as fair and adequate. One judge concurred and dissented in part, arguing the court should have vacated and remanded for development of a fuller record on the relationships between class counsel and the cy pres recipients, half of which are the alma maters of class counsel. *See In re Google Referrer Header Privacy Litig.*, 869 F.3d 737 (9th Cir. 2017).

The majority and dissent agreed, however, that a cy pres-only settlement was appropriate because settlement funds were effectively "non-distributable" where the recovery for each class member would be four cents. The Ninth Circuit rejected the arguments by objectors that the settlement could be structured to compensate at least some class members through lottery or by awarding a few dollars to each of the fraction of class members who could be expected to submit a valid proof of claim. The court also "easily rejected" the argument that a class action was not the superior method of adjudication, as required by Rule 23(b)(3), where the result is a non-distributable settlement. The court also concluded that objectors failed to "'raise substantial questions about whether the selection of the recipient[s] was made on the merits'" of the recipients.

Sixteen state attorneys general filed an amicus brief urging the Supreme Court to grant objectors' certiorari petition, arguing that the Google case presents the "ideal vehicle" to address the fairness of cy pres settlements. In 2013, Chief Justice John Roberts all but invited a cy pres test case, noting "fundamental concerns surrounding the use of such remedies in class action litigation, including when, if ever, such relief should be considered" and "how to assess its fairness as a general matter." *Marek v. Lane*, 571 U.S. 1003 (2013). *Marek* too involved a cy pres-only settlement of a large Internet privacy class action in the Ninth Circuit. Facebook agreed to fund a new entity led by a board that would contain one of its own employees. In denying the objectors' petition for certiorari, the Justice Roberts noted that the court would not review, as requested, the "particular features" on the settlement, including its amount and the alleged conflicts of interest presented by Facebook's involvement in the cy pres remedy.

The *Google* case will necessitate the Supreme Court tackling head-on the evolving jurisprudence on cy pres settlements. The U.S. Court of Appeals for the Seventh Circuit has memorably asserted that the "cy pres" settlement is "badly misnamed." *Mirfasihi v. Fleet Mortg. Corp.*, 356 F.3d 784 (7th Cir. 2004). While the historical use of cy pres provided an indirect benefit to a trust settlor by putting trust funds to uses very similar to those intended, "[t]here is no indirect benefit to the class from the defendant's giving the money to someone else." *Id.* at 784. Thus characterized, cy pres-only settlements may punish the defendant and deter further misconduct, but arguably do not compensate class members.

In opposing certitorari, Google argued that cy pres-only settlements are increasingly rare, particularly in light of the Justice Robert's comments in *Marek*. But *Google* nonetheless presents the court's first opportunity to address the baseline assumption of all cy pre settlements: that some or all of the settlement fund may properly be diverted away from class members to court-approved third parties where it is not feasible to compensate the class directly. In the Ninth Circuit's view, a class action settlement is "non-distributable" when "the proof of individual claims would be burdensome or distribution of damages costly." *Nachshin v. AOL*, 663 F.3d 1034, 1038 (9th Cir. 2011).

In practice, some portion of a settlement of any very large class action – including those common in Internet privacy cases—will be "non-distributable." In *Google*, the Ninth Circuit quickly dispensed with the objectors' argument that if the settlement fund could not be distributed, then the settlement class failed to meet the superiority requirement of Rule 23. The objectors argued in their certiorari petition that cy pres-only settlements are categorically inadequate because they entail release of class members' claims in exchange for no direct benefit to class members while class counsel secure an attorney fee award. The court also will likely need to assess the extent to which lower courts and counsel can navigate class counsel's potential conflict of interest in recommending a settlement that awards attorney fees but provides no direct consideration to class members. The proponents of cy pres settlements will likely argue that such settlements are fair and adequate when a court determines that the charitable distribution in fact benefits class members by promoting the interests underlying the suit. Moreover, cy pres facilitates settlement of low value claims for which defendants might otherwise have avoided any payment at all because of the infeasibility of direct payment to class members.

Conclusion

The Supreme Court may more closely scrutinize certification of a class of over a hundred million people where none will be compensated. Two decades ago, in *Amchem Products v. Windsor*, the court rejected the certification of a class for settlement purposes of "hundreds of thousands, perhaps millions" of asbestos tort claimants, cautioning against "class certifications dependent upon the court's gestalt judgment or overarching impression of the settlement's fairness." 521 U.S. 591, 621 (1997). In other words, a class may be certified, for settlement purposes or otherwise, only if each requirement of Rule 23 is met.

The conclusion that a settlement fund is "non-distributable" ordinarily has much to do with the relationship between the strength of the claim and the negotiated settlement amount. Class counsel has every incentive to bargain for the largest settlement obtainable, but if the claim is vulnerable a modest settlement fund is better than none. If the paramount settlement objective of compensating class members directly is unattainable given the dynamics, a cy pres-only recovery should be within the permissible range of a fair and adequate settlement. In addition, a number of intermediate alternatives short of rejecting cy pres settlements may be available under the applicable abuse of discretion standard, focusing on the meaning of "infeasible to distribute." For example, several courts have approved cy pres distributions but barred its use where it is possible to compensate at least some class members. *See, e.g., In re BankAmerica Corp. Sec. Litig.*, 775 F.3d 1060, 1064 (8th Cir. 2015) ("Because the settlement funds are the property of the class, a cy pres distribution to a third party of unclaimed settlement funds is permissible 'only when it is not feasible to make further distributions to class members' ...except where an additional distribution would provide a windfall to class members with liquidated-damages claims that were 100 percent satisfied by the initial distribution.") (citations omitted). This approach would leave the door open to approval of the flexible use of cy pres doctrine where good faith mechanisms are in place to distribute settlement consideration to the extent practicable.