Legal Sidebar

UPDATE: Is *Cy Pres* A-OK? Supreme Court to Consider When Class Action Settlements Can Pay a Charity Instead of Class Members

Updated March 20, 2019

UPDATE: The Supreme Court issued its opinion in Frank v. Gaos on March 20, 2019. Significantly, the Court's majority opinion did not address any of the substantive issues discussed in this Sidebar. Instead, the Court remanded the case and directed the lower courts to decide an unrelated issue: namely, whether the federal courts may validly exercise jurisdiction over the case. Thus, guidance from the Supreme Court regarding whether (and under what circumstances) cy pres settlements are legally permissible in class action cases will have to await a future case. The original post from May 10, 2018, is below.

The Supreme Court will soon consider a question that has captured the attention of some Members of Congress as well as other commentators: when, if ever, do the Federal Rules of Civil Procedure permit a defendant to settle a class action lawsuit by paying money to a charity, rather than to the injured class members? The Court's answer to that question could potentially affect whether significant sums of money that are often at issue in class actions can be distributed to third-party charitable organizations, especially when the class members are not directly compensated.

This Sidebar begins by discussing class action litigation generally, with a particular focus on the limitations that federal law imposes upon the parties' ability to settle a class action lawsuit. The Sidebar then discusses *cy pres* settlements—i.e., settlements pursuant to which the defendant agrees to pay some or all of the settlement funds to a third-party organization. The Sidebar then discusses *Frank v. Gaos*—a case that the Supreme Court recently agreed to hear that presents an opportunity to clarify whether, and under what circumstances, *cy pres* settlements are legally permissible. The Sidebar concludes with takeaways for Congress.

Class Actions and the Settlement Thereof

As discussed in greater detail in other CRS publications, a class action is a type of lawsuit that allows a group (i.e., a "class") of persons harmed by a defendant's allegedly unlawful action to challenge that action in a single lawsuit. The class action device thereby provides an alternative to adjudicating numerous separate suits prosecuted by each individual plaintiff. In a class action, the plaintiff (known as

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the "class representative" or the "named plaintiff") sues the defendant not only on his own behalf, but also on behalf of other similarly situated persons (the "class members"). Class members are usually not formal parties to the lawsuit and therefore typically do not actively participate in the case.

As is true of civil litigation generally, very few class actions ultimately proceed to trial; most instead culminate in a settlement. However, because class members typically have few opportunities to participate in the daily activities of the case or to monitor the activities of class counsel and the class representatives, the class members must rely upon class counsel to negotiate a settlement that will serve their best interests. To ensure that the named parties negotiate a settlement that is fair to the absent class members, Federal Rule of Civil Procedure 23(e) limits the parties' ability to settle a class action in federal court. The parties may settle a case on the class members' behalf only if the court determines that the proposed settlement "is fair, reasonable, and adequate" to the class members.

Cy Pres Settlements

Litigants occasionally negotiate class action settlements that propose to distribute some or all of the settlement proceeds to third-party organizations that engage in charitable activities related to the class members' injuries, rather than to the class members themselves. For example, if a group of consumers initiates and ultimately settles a class action alleging that a pharmaceutical company unlawfully published artificially inflated drug prices for a cancer medication, then one possible settlement option could be to distribute some or all of the settlement funds to charitable organizations that fund cancer research or patient care, rather than directly to the injured consumers. This practice of paying settlement proceeds to charities or other third-party organizations is known as "*cy pres*," "which takes its name from the Norman French expression *cy pres comme possible* (or 'as near as possible')."

"Courts have approved *cy pres* funds in settlements" pursuant to Federal Rule of Civil Procedure 23(e) "in at least two circumstances." First, if some class members never claim their share of the settlement proceeds, with the result that a portion of the settlement fund remains unclaimed, it may be appropriate to pay the remaining funds to charity. Secondly—and of particular relevance here—it may be appropriate to distribute some (or even all) of the settlement proceeds to charities when it would be economically infeasible to disburse settlement funds directly to class members. To illustrate, suppose that a defendant harms 10 million individuals. Suppose also that the parties agree to settle the case for $1 million, such that each class member would thus be entitled to recover 10 cents. It might not be economically rational to expend the resources that would be necessary to pay all 10 million class members 10 cents each, as "the cost of verifying and 'sending out very small payments to millions of class members [c]ould exceed the total monetary benefit obtained by the class.'" Courts have therefore generally held that, if it would be "economically infeasible to distribute money to class members" directly, then the court may instead "distribute unclaimed or non-distributable portions of a class action settlement fund to the 'next best' class of beneficiaries for the indirect benefit of the class."

Supporters argue that *cy pres* settlements serve several socially desirable purposes. Some maintain that it is more sensible and efficient to devote "settlement funds . . . for projects that advance the interests of the class as a whole" than to "distribute negligible amounts to class members" directly. Supporters claim that, in the absence of *cy pres*, the "notice and distribution costs" associated with directly paying large numbers of class members "would inevitably swallow up the settlement fund, leaving little to nothing for class members." Proponents also argue that distributing unpaid funds to a charity deters unlawful behavior more effectively than returning some or all of the unused settlement funds to the culpable defendant.

According to critics, however, *cy pres* settlements often "provide little or no benefit to class members" because they result in little to no money being paid to the class members themselves. Opponents have been particularly troubled by "*cy pres*-only" settlements, in which all of the settlement proceeds go to third parties while the class members receive nothing. Some critics therefore maintain that it "deprives

class members of due process" to "dispose of the legal claims of absent class members" without providing those class members any significant financial benefit. Critics further contend that *cy pres* settlements unfairly allow plaintiffs' attorneys to "reap exorbitant fees" while class members receive little or no money. According to opponents, *cy pres* settlements incentivize class counsel to unfairly collude with defendants to structure settlements that benefit the named parties and their attorneys to the detriment of the absent class members. Additionally, some opponents argue that, "by directing . . . settlement funds away from . . . members of the injured plaintiff class to advocacy groups," *cy pres* settlements "effectively force[] those plaintiffs to provide financial support to organizations with which they may not agree, in violation of the First Amendment's prohibition on compelled speech." Several critics have therefore recommended that Congress either modify the legal standards governing *cy pres* settlements or prohibit *cy pres* settlements entirely.

Frank v. Gaos

The Supreme Court has decided to weigh in on this ongoing debate by granting *certiorari* in *Frank v. Gaos*. The plaintiffs in *Frank* initiated a class action alleging that Google unlawfully "violated [its] users' privacy by disclosing their Internet search terms to owners of third-party websites." The parties ultimately negotiated a settlement whereby Google agreed to pay $5.3 million to six organizations that "promote public awareness and education and/or . . . support research, development, and initiatives[] related to protecting privacy on the Internet." Pursuant to that settlement, class counsel would receive $2.125 million in fees, while the named plaintiffs would each receive $15,000. The absent class members, however, would receive nothing—save for any indirect benefits that might accrue to society at large as a result of the six organizations' efforts to promote privacy.

The district court approved the settlement over the objections of several class members. The U.S. Court of Appeals for the Ninth Circuit affirmed, concluding that the district court did not abuse its discretion by approving a *cy pres* settlement that resulted in no direct monetary benefit to the class members. The Ninth Circuit emphasized that, because the "settlement fund was approximately $5.3 million, but there were an estimated 129 million class members," each class member would be "entitled to a paltry 4 cents in recovery" if the fund were distributed directly to class members. The Ninth Circuit therefore agreed with the district court "that the cost of verifying and 'sending out very small payments to millions of class members would exceed the total monetary benefit obtained by the class,'" thereby justifying the use of *cy pres*.

The objectors maintain that both the Ninth Circuit and the district court reversibly erred by concluding that this *cy pres*-only settlement was "fair, reasonable, and adequate" within the meaning of Rule 23(e). The objectors further argue that the Ninth Circuit's decision conflicts with decisions of other federal courts of appeals regarding the permissibility of *cy pres* settlements, though the class representatives and the defendant dispute the objectors' contention that any such circuit split exists.

The Supreme Court has now granted *certiorari* to decide whether, or in what circumstances, a *cy pres* settlement that provides no direct relief to class members comports with Rule 23(e)'s requirement that a class action settlement be "fair, reasonable, and adequate." The court will not hear the case until the October 2018 term. Significantly, at least one member of the Court has previously suggested limiting the availability of *cy pres*. Specifically, Chief Justice Roberts has previously signaled his discomfort with *cy pres* settlements in an opinion respecting the denial of *certiorari* in the 2013 case of *Marek v. Lane*. In that case, the Chief Justice expressed "fundamental concerns surrounding the use of [*cy pres*] remedies in class action litigation," implying that "limits on the use of such remedies" might be appropriate.

Takeaways for Congress

Some (albeit not all) commentators believe that *cy pres* settlements are becoming increasingly prevalent. The Supreme Court's decision in *Frank* could therefore potentially affect the way that millions—or even billions—of dollars ultimately get distributed in class action cases. Thus, the Court's decision to hear *Frank* could be of significant interest to Congress. No matter how the Court ultimately rules in *Frank*, Congress also possesses some power to limit or expand the use of *cy pres* settlements if it so chooses—subject, of course, to any constitutional limitations on *cy pres* settlements that the Supreme Court may ultimately articulate in its opinion in *Frank*. For instance, Congress could modify Federal Rule of Civil Procedure 23(e)'s standards for determining whether a proposed settlement is "fair, reasonable, and adequate" to the absent class members. To that end, some Members of the 115th Congress have introduced a bill—namely, the Fairness in Class Action Litigation and Furthering Asbestos Claim Transparency Act of 2017 (H.R. 985) (FICALA)—which would affect "the allocation of class action settlement funds, including *cy pres* awards." Among other things, FICALA would prohibit "any attorneys' fee award to class counsel" in a class action case that exceeds "a reasonable percentage of any payments directly distributed to and received by class members." "In no event shall the attorneys' fee award" in such a case "exceed the total amount of money directly distributed to and received by all class members." Thus, by tying class counsel's recovery to a reasonable percentage of the amount of money actually received by the class members themselves, FICALA would thereby discourage attorneys from negotiating *cy pres* settlements that pay zero or minimal damages to class members, like the settlement at issue in *Frank*. As of the date of this publication, FICALA has passed the House and is pending before the Senate Committee on the Judiciary.

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