Generous to a Fault

The Third Circuit's Ascertainable Scrutiny of *Cy Pres* Awards in Class Action Settlements

by Nicole D. Bearce and Joseph A. Fischetti

The Third Circuit Court of Appeals recently set down rigorous criteria for district courts to consider when deciding whether to approve a class action settlement that includes *cy pres* distributions. In so doing, the court has arguably followed a path treaded by many of its sister circuits. The Third Circuit's unique twist on *cy pres* scrutiny, however, is its articulated reasoning, which is notable for being analytically akin to the court's recent jurisprudence in the area of class ascertainability. Indeed, as discussed below, district courts (and class action litigants) within the circuit may now confront ascertainability questions not only in the earlier class certification phase of a matter, but also at the concluding stage where *cy pres* awards used to bolster the aggregate monetary value of a settlement may not be countenanced if a comparable amount of relief is not provided to actual class members.

The Origin of *Cy Pres* Awards

The doctrine of *cy pres* is a well-established principle that originates in the law of charitable trusts. In that context, when property is placed into a trust and designated for a charitable purpose, and it "becomes unlawful, impossible, or impracticable to carry out that purpose,...the charitable trust will not fail but the court will direct application of the property or appropriate portion thereof to a charitable purpose that reasonably approximates the designated purpose."[1] The doctrine's goal is to ensure that when the intention of the trust's settlor cannot be fulfilled precisely as specified, the settlor's goals are nonetheless achieved as best as possible.

Class action attorneys have borrowed from the *cy pres* doctrine to help craft class action settlements in certain consumer litigation. When the class members are too difficult to identify or when the settlement award is so low relative to the size of the class that it would be prohibitively expensive to distribute the funds to class members, *cy pres* awards make payment to designated charitable organizations in lieu of actual class members.[2] In light of the fact that class members (*i.e.*, the individuals who are alleged to have been aggrieved by the defendant's conduct) are not the recipients of *cy pres* funds, the Third Circuit has admonished that when district courts review settlements that include such awards, they should consider factors including: the number of individual awards against the number of individual claims; the size of the individual awards against the estimated class-wide damages; and the claims process used to determine individual awards.

The Third Circuit's *Baby Products* Decision

In *In re Baby Products Antitrust Litigation*,[3] the plaintiffs alleged that a retailer and several manufacturers conspired to set a floor on the price of certain baby products in violation of antitrust laws, thereby causing consumers to pay inflated prices. The parties arrived at a settlement in which the defendants agreed to deposit $35.5 million into a settlement fund, including approximately $21.5 million designated for the benefit of the settlement class, which consisted of all persons and entities who bought certain baby products at Babies "R" Us and Toys "R" Us during time periods dating back to 1999.

Notwithstanding this allocation, distributing the settlement proceeds to class members proved problematic due to, among other things, documentation requirements. For those class members who submitted a timely and valid claim form, the settlement agreement provided that a class member who could not provide proof of purchase was eligible for a disbursement of only five dollars. In the end, the vast majority of class members fell into this category. As a result, only about $3 million—less than 10 percent of the overall settlement fund and less than 15 percent of the portion of the settlement fund designated for the benefit of the settlement class—could actually be distributed to class members.

The parties anticipated this possibility; the settlement agree-

ment accordingly provided that after distribution to class members, remaining settlement funds would be distributed to unspecified charitable organizations the parties would propose and the district court would select. The district court approved the settlement, and certain absent class members appealed.

Reviewing this settlement, the Third Circuit held that a district court does not necessarily abuse its discretion by approving a class action settlement that includes a *cy pres* component. Nonetheless, the court cautioned that a direct distribution to class members is preferable to an "indirect benefit that is at best attenuated and at worst illusory." The court warned that "*cy pres* awards should generally represent a small percentage of total settlement funds." Therefore, district courts must consider a proposed settlement in as practical a manner as possible, even if it means taking unusual measures such as withholding final approval "until the actual distribution of funds can be estimated with reasonable accuracy" or requiring the parties to include in the settlement a mechanism for re-adjusting the settlement to balance direct and *cy pres* distributions.

Turning to the facts before it, the Third Circuit vacated the order approving the settlement and remanded the matter, finding the district court did not have sufficient information on the size of the distribution that would be made to class members, and that the absence of such information precluded a fulsome review of whether the settlement provided a sufficiently direct benefit to the class. The court also left open the possibility that *cy pres* distributions might not be eligible for inclusion as part of the assessment of the reasonableness of plaintiffs' counsel's fee request.

Although the Third Circuit never explicitly connected its holding in *Baby Products* with its recent holdings in other areas of class certification, the court's concern about *cy pres* awards shares a common theme with its concerns about classes with potentially unascertainable classes. In both instances, the circuit has indicated its frustration with class actions containing indeterminable class members, thereby creating a risk that a wide swath of class members might not be receiving the benefits to which they are entitled.

The Third Circuit's focus on this concern becomes especially clear when comparing the reasoning in *Baby Products* with the analysis in which other courts have recently expressed skepticism when scrutinizing *cy pres* awards.

Other Courts' Approaches to *Cy Pres* Settlements

The Third Circuit is far from the only court to address *cy pres* awards. In 2013, a *cy pres* award in a class settlement resulted in a split panel of the Ninth Circuit, as well as six subsequent dissenting votes from a decision to deny the petition for rehearing *en banc*.[4] A class member filed a petition for a *writ of certiorari*, which the U.S. Supreme Court denied.[5] But, with the denial, Chief Justice John Roberts included a statement suggesting the Supreme Court shares the circuits' concerns about the propriety of *cy pres* settlements.

That case, *Lane v. Facebook, Inc.*, involved a feature of Facebook's advertisement system in which participating companies provided Facebook with information regarding users' activities at those companies' external websites, such as when users posted a comment or purchased a product. Certain actions would then be published to that user's Facebook page. As the chief justice explained: "So rent a movie from Blockbuster.com, and all your friends would know the title. Or plan a vacation on Hotwire.com, and all your friends would know the destination."

A group of Facebook users brought a putative class action, alleging violation of various privacy laws. The case culminated in a $9.5 million settlement, all of which was paid to attorneys, the named plaintiffs, and a charitable organization that was specifically created for the purpose of being a recipient of the settlement award. To boot, the newly established charitable organization would include a senior Facebook employee as one of three board members.

In his statement respecting the denial of *certiorari*, the chief justice noted he agreed with the denial of the petition for *certiorari* because the challenge to the *cy pres* settlement was focused on that settlement's particular features. Consequently, the case would not have given the Court an opportunity to consider more fundamental concerns with *cy pres* awards, including "when, if ever, such relief should be considered; how to assess its fairness as a general matter; whether new entities may be established as part of such relief; if not, how existing entities should be selected; what the respective roles of the judge and parties are in shaping a *cy pres* remedy; how closely the goals of the enlisted organization must correspond to the interests of the class; and so on." Based upon the chief justice's articulated concerns over the viability and implementation of *cy pres* settlements, some have suggested he has invitingly teed up the issue to be considered by the Court should the right case come before it.[6]

A decade earlier, Judge Richard Posner of the Court of Appeals for the Seventh Circuit critiqued the very existence of *cy pres* settlements, describing them as a means "to prevent the defendant from walking away from the litigation scot-free because of the infeasibility of distributing the proceeds of the settlement...to the class members."[7] He candidly criticized the practice of awarding relief to a stranger to the litigation, reasoning that "[t]here is no indirect benefit to the class from the defendant's giving the money to someone else."

Even aside from general philosophical disputes with the use of *cy pres* settlements in class actions, courts have closely scrutinized and sometimes rejected settlements

if distribution to the *cy pres* designee will not help address the harm at issue in the litigation. For example, in *Dennis v. Kellogg Co.*,[8] Kellogg Co. was sued under a consumer fraud theory for an advertising campaign in which it claimed Frosted Mini-Wheats cereal "was scientifically proven to improve children's cognitive functions for several hours after breakfast." The case settled, and part of the settlement required that Kellogg's donate $5.5 million worth of food products to charities feeding the indigent.

The Ninth Circuit found that, given the nature of the litigation, feeding the indigent had nothing to do with the class claims, which related to false advertising. Thus, the court reasoned, "[o]n the face of the settlement's language, 'charities that provide food for the indigent' may not serve a single person within the plaintiff class of purchasers of Frosted Mini-Wheats," and a preferable organization would be one "dedicated to protecting consumers from, or redressing injuries caused by, false advertising." The court also criticized the vagueness of the settlement's requirement that the company donate "$5.5 million worth" of food without any specification of how that price would be ascertained (*i.e.*, wholesale or retail), whether the company would benefit from tax deductions, and whether this was a charitable distribution that would have occurred even absent the settlement. Accordingly, the Ninth Circuit vacated the settlement and remanded for further proceedings.

Where the Third Circuit Stands Out

The Third Circuit's analysis of *cy pres* awards reflects related, but distinct, concerns from those the chief justice and other circuit courts have raised. Specifically, the Third Circuit's *Baby Products* holding was driven by a clear concern that the disproportionate *cy pres* award meant class members were not receiving the benefit of their settlement. Where other circuits have more often emphasized the quasi-punitive nature of *cy pres* awards and closely examined the identity of the intended recipient of the award, the centerpiece of the Third Circuit's concern is that *cy pres* relief can be used to mask instances where settlements offer very little in the way of relief to the class members whose injury brought about the litigation in the first place.

Indeed, though analytically discrete, the Third Circuit's concerns with *cy pres* awards are strikingly similar to its concerns over the ascertainability of class members. On the latter subject, the Third Circuit has observed that "[i]f class members are impossible to identify without extensive and individualized fact-finding or 'mini-trials,' then a class action is inappropriate," and that strict requirements for the ascertainability of class members ensure the protection of "absent class members by facilitating the best notice practicable" while avoiding "serious administrative burdens that are incongruous with the efficiencies expected in a class action by insisting on the easy identification of class members."[9]

In effect, within the Third Circuit the ascertainability question is no longer pertinent only during the course of litigated class certification questions. Rather, district courts in the Third Circuit must now confront ascertainability at both the front end—where the circuit demands courts apply meticulous and discerning standards to determine whether the class is sufficiently ascertainable to be certified—and at the back end of settlements—where *cy pres* awards may not be used to augment the cumulative monetary value (and, often, plaintiff's counsel's fees) of a settlement if it does not provide a comparable amount of relief to actual class members.

Conclusion

Although *cy pres* components to class action settlements have been around for many years, they have recently become a much hotter topic in the courts, with circuits seeking to reign in their use by requiring that district courts approve *cy pres* awards only after subjecting them to close scrutiny. As more circuits weigh in on this subject, this trend in favor of greater scrutiny for *cy pres* awards will likely either continue or compel the Supreme Court to hear the type of suitable test case the chief justice suggested might be used to establish a uniform analytical framework for the approval of *cy pres* settlements. ⚖

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ENDNOTES

1. *Restatement (Third) of Trusts* § 67 (2003).
2. *See* Martin H. Redish, Peter Julian, and Samantha Zyontz, *Cy Pres* Relief and the Pathologies of the Modern Class Action, 62 *Fla. L. Rev.* 617, 631 (2010).
3. 708 F.3d 163 (3d Cir. 2013).
4. *Lane v. Facebook, Inc.*, 696 F.3d 811 (9th Cir. 2012), *reh'g en banc denied*, 709 F.3d 791 (9th Cir. 2013).
5. *Marek v. Lane*, 134 S. Ct. 8 (2013).
6. *See, e.g.*, Wilber H. Boies and Latonia Haney Keith, Class Action Settlement Residue and *Cy Pres* Awards: Emerging Problems and Practical Solutions, 21 *Va. J. Soc. Pol'y & Law* 267, 280 n.55 (2014); Allison Grande, Chief Justice Roberts Turns Up the Heat on *Cy Pres* Pacts, *Law360*, Nov. 4, 2013; Linda Greenhouse, Bring Me a Case, *N.Y. Times*, Nov. 13, 2013.
7. *Mirfasihi v. Fleet Mortg. Corp.*, 356 F.3d 781, 784 (7th Cir. 2004).
8. 697 F.3d 858 (9th Cir. 2012).
9. *Carrera v. Bayer Corp.*, 727 F.3d 300, 305–06 (3d Cir. 2013) (*quoting Marcus v. BMW of N. Am.*, 687 F.3d 583, 593 (3d Cir. 2012)), *reh'g en banc denied*, No. 12-2621, 2014 WL 3887938 (3d Cir. May 2, 2014).

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