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ARTICLES

A Practical Guide to the Undistributed Settlement Funds Problem and the Cy Pres Solution

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When you finally reach an agreement to settle a hotly contested class action, you want more than anything for the court to approve your settlement agreement and for the case to be over. But, to get to the end of the case, both class counsel and defense counsel need to anticipate problems in the settlement process and build effective solutions into the settlement agreement and fairness hearing. One obvious and important problem is what to do about any undistributed residue after distribution of the settlement funds to class members. This article is your guide to dealing with the residue problem and the cy pres solution in a way that will satisfy the most meticulous judge and will avoid or defeat objections to the settlement.

Plan Ahead for Undistributed Settlement Funds

Let's begin by recognizing the problem. A class action settlement fund is intended to make distributions to class members, after paying class counsel fees and the expenses of settlement administration. But, despite the best efforts of the settlement administrator to make payments to class members, there will typically be funds left over. This occurs for many reasons: Few class members actually submit claims for small recoveries in large consumer class actions; class member address lists are outdated; class members don't open or don't trust mail about the settlement; and settlement checks go uncashed. Indeed, "a claim rate as low as 3 percent is hardly unusual in consumer class actions[.]" *Keil v. Lopez*, 862 F.3d 685, 697 (8th Cir. 2017). Kroll Settlement Administration estimates that about 45 percent of checks for less than $20.00 and about 70 percent of checks for more than $200.00 are ultimately cashed (although electronic payment options can achieve better results).

While the problem should be obvious in advance, it may be many months before the amount of undistributed settlement funds becomes apparent. Because of that time lag, you will want to avoid later work and complications by preemptively addressing the problem in your settlement agreement and related court filings.

So what should you suggest for the disposition of any residual funds? Three possible answers are (1) a reversion to the settling defendant, (2) escheat to the state or federal government, or (3) cy pres awards. Of the three choices, only one will be expected and well received by your judge.

Reversion is not the correct answer. If you represent a defendant that is unfamiliar with the nuances of class action litigation, you may need to explain to your client that judges firmly reject returning undistributed settlement funds to settling defendants—because returning the money undermines the deterrent effect of class action litigation (*see In re Baby Prods. Antitrust Litig.*, 708 F.3d 163, 172 (3d Cir. 2013); *Diamond Chem. Co. v. Akzo Nobel Chemicals B.V.*, 517 F. Supp. 2d 212, 218–19 (D.D.C. 2007)), and because the defendant has agreed to pay a set amount in exchange for releases from class members (*see In re Motorsports Merch. Antitrust Litig.*, 160 F. Supp. 2d 1392, 1395 (N.D. Ga. 2001)). The opposite side of this coin is that courts have

refused to allow further distributions to class members whose claims had been paid in full. *See In re Lupron Mktg. & Sales Practices Litig.*, 677 F.3d 21, 34–35 (1st Cir. 2012) (collecting cases and authorities that have rejected paying undeserved windfalls to class members).

Escheat to the state as unclaimed property is also a bad fit for leftover class action settlement funds and is rarely even considered in fairness hearings. As a practical matter, state escheat statutes typically provide for long holding periods that would drag out the administration of a settled class action. Moreover, escheat to the state does nothing to benefit the plaintiff class. *See In re Baby Prods. Antitrust Litig.*, 708 F.3d at 172 ("Escheat to the state preserves the deterrent effect of class actions, but it benefits the community at large rather than those harmed by the defendant's conduct."). Even state courts recognize that state escheat statutes simply don't apply to leftover settlement funds. *See Highland Homes Ltd. v. State*, 448 S.W.3d 403, 412 (Tex. 2014) (concluding that a class action settlement residue is not unclaimed or abandoned property under the Texas Unclaimed Property Act). In federal cases, the limited federal escheat statute applies only to unclaimed funds held by the clerk of the court for more than five years, 28 U.S.C. §§ 2041–2042, while class action settlement funds are usually deposited directly into bank trust accounts controlled by the settlement administrator, not by the court clerk.

The third and best option is to include a provision in your settlement agreement about cy pres awards—a provision that your judge will expect to see. Section 3.07 of the American Law Institute's *Principles of the Law of Aggregate Litigation* (the *ALI Principles*) provides the following generally accepted criteria for when a court should approve a proposed class action settlement that includes a provision for cy pres awards:

> (a) If individual class members can be identified through reasonable effort, and the distributions are sufficiently large to make individual distributions economically viable, settlement proceeds should be distributed directly to individual class members.
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> (b) If the settlement involves individual distributions to class members and funds remain after distributions (because some class members could not be identified or chose not to participate), the settlement should presumptively provide for further distributions to participating class members unless the amounts involved are too small to make individual distributions economically viable or other specific reasons exist that would make such further distributions impossible or unfair.
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> (c) If the court finds that individual distributions are not viable based upon the criteria set forth in subsections (a) and (b), the settlement may utilize a cy pres approach.

ALI Principles § 3.07 (2010).

Even after your settlement agreement has been approved with a provision for cy pres awards, keep in mind that the *ALI Principles* above—and a host of appellate opinions—put heavy emphasis on making appropriate efforts to pay settlement funds to class members before distributing any cy pres awards. If the settlement administration process in your case concludes with considerable funds left over and identified class members have been paid only part of their

individual claims, the parties may want to propose a second distribution to them. Or a careful judge may want to see another round of distribution efforts where there are considerable funds and alternative ways to reach more class members. Anticipating that, cautious lawyers will want to propose additional distributions to class members—or make a record that there have already been appropriate efforts to reach class members. Getting this right in the district court can defeat objections and appeals demanding additional distribution efforts. For example, the Court of Appeals for the Eighth Circuit recently rejected objector arguments for additional class notices, finding that the district court had not abused its discretion when it conducted a hearing and concluded that further efforts would not be effective to distribute a $14 million residue. *See* *Jones v. Monsanto*, 38 F.4th 693 (8th Cir. 2022).

Propose Cy Pres Awards That Fit Your Case

Section 3.07(c) of the *ALI Principles* also provides a generally accepted and simple enough test for what sort of organizations should receive cy pres awards: "The court, when feasible, should require the parties to identify a recipient whose interests reasonably approximate those being pursued by the class." *ALI Principles* § 3.07(c).

Every court of appeals that has considered this question has taken the same approach, albeit with some differences in wording. *See* Michael J. Slobom, "Recalibrating Cy Pres Settlements to Restore the Equilibrium," 123 *Dick. L. Rev.* 281 (2018) (discussing the different wording used across courts of appeals). Any brief you file in support of your proposals should use both the wording from the *ALI Principles* and the wording favored by your court of appeals—and should say enough to show that your proposed cy pres recipients meet those requirements. For smaller settlements and widely recognized organizations, just the names and a sentence or two may be enough. For larger settlements or less obvious proposals, the court may want to see a fuller explanation supported by information about the organizations.

What about proposing cy pres awards to local organizations in a national class action? National settlement agreements that include local cy pres recipients are generally approved, particularly if they propose both national organizations and local organizations and explain the local connection. Class counsel may have relevant reasons why their national class action was filed in a particular forum. In multidistrict litigation settlements, the original transfer order from the Judicial Panel on Multidistrict Litigation will typically include the panel's reasoning for sending the cases to one particular courthouse.

Proposing legal aid organizations as cy pres award recipients offers at least three advantages for securing court approval. First, legal aid providers often have programs and services in the same field as the subject matter of the settled class action. Second, established legal aid organizations have credibility with judges. Third, "both class actions and [legal aid programs] facilitate the supply of legal services to those who cannot otherwise obtain or afford representation in legal matters." *Lessard v. City of Allen Park*, 470 F. Supp. 2d 781, 783–84 (E.D. Mich. 2007). Earlier cases recognizing this "access to justice" connection between cy pres awards and legal aid programs are collected in *Jones v. National Distillers*, 56 F. Supp. 2d 355, 359 (S.D.N.Y. 1999).

When settling state court class actions, you may be required to comply with a state statute or a state court rule governing the distribution of residual settlement funds. These statutes and rules typically provide that a specified portion of cy pres awards must go to legal aid providers or other public interest organizations. A current digest of some 25 state statutes and rules has been compiled by the ABA Resource Center for Access to Justice Initiatives: Legislation and Court Rules Providing for Legal Aid to Receive Class Action Residuals.

When you have worked through all of these issues and settled on a proposal involving cy pres awards and recipients, your submission to the court about the cy pres awards should include (1) a provision in the settlement agreement itself, (2) supporting materials and arguments in your motion papers, (3) a paragraph approving cy pres awards in any proposed order you submit, and (4) something short and simple for inclusion in the proposed class notice.

Anticipate Fairness Hearing Complications, Objections, and Appeals

Asking the court for preliminary approval of a proposed settlement agreement with no provision about residual funds can cause avoidable problems. The absence of a residual funds provision will invite a careful judge to demand the submission of a revised settlement agreement. In addition, if a settlement agreement is approved with no residue provision, counsel may later be required to go back to the court with an unexpected report on undistributed funds and a belated proposal for cy pres awards (thus running the risk of receiving nasty questions from the bench about the need for another notice to class members and an additional hearing).

Including a cy pres provision in your settlement agreement can avoid these pitfalls but requires consideration of what and how much to say. Where a successful distribution to class members and a small residue is likely, a common approach is to include a simple provision calling for a later report to the court about the amount left over and recommendations for cy pres recipients. This approach may satisfy the judge at your fairness hearing, but it also obligates counsel to do more work later. The more efficient approach would be to propose a cy pres provision that sets a deadline for distributions and designates one or more cy pres recipients after that deadline. This more detailed approach will require one final (and simple) report to the court upon completion.

While settlement administration is generally the responsibility of class counsel, careful defense counsel can and should weigh in on the selection of proposed cy pres recipients, if only to avoid bad choices that might attract objections. And defense counsel can quietly say no if class counsel want to propose organizations that have a history of antagonism toward the defendant. At the same time, wise defense counsel will want to avoid proposing organizations that have obvious ties to the defendant. Sending funds to favored organizations may seem to be a good idea to some clients, but proposing that can attract objectors arguing that the proposed award benefits the defendant and not the class members.

Before proposing cy pres awards to university or law school programs, think twice about whether you can tell the judge how funding the program would indirectly benefit the class members. Academic programs on antitrust compliance or securities trading may be useful for students and faculty, but an objector can argue that they do not serve the interests of class

members. And before proposing a cy pres award to an institution you attended (or the judge attended), think three times. Objectors can and do argue that counsel are abusing their role by using settlement funds to make their own personal charitable contributions to their alma maters. While those objections can be defeated, it is better to avoid them altogether.

Asking the judge to select cy pres award recipients can be problematic for several reasons. First, the role of a judge at a fairness hearing is to decide whether a private settlement agreement meets the requirements of Federal Rule of Civil Procedure 23 (or a state law equivalent) and protects the rights of absent class members. A judge who picks which third parties will receive part of the settlement funds plays a somewhat different role. Second, a judge's unfortunate selection can raise an uncomfortable issue during an appeal challenging the settlement approval. Third, a cautious judge might decline to select cy pres recipients and assign that task to a special master. While there are rare, large settlements where a special master is a useful precaution, in the ordinary settlement situation, the appointment of a special master will result in more hearings, filings, and other avoidable work and delay.

Finally, what to do if there are objections to your settlement fund distributions and cy pres awards? When faced with objections before a fairness hearing, be pragmatic. If the objector is a class member/lawyer making a legitimate point, consider negotiating a change to the proposed cy pres awards to satisfy the objections and avoid an appeal. If you are faced with a serial objector looking to use your case as the vehicle for an appeal challenging cy pres awards generally, then you should request a hearing, make a record, and ask the judge for an opinion denying the objections. That record will serve as the foundation for the parties' subsequent arguments on appeal that the trial court exercised reasonable discretion in overruling the objections and approving your cy pres provision. Making that record and taking the precautions suggested above will give you a solid basis for defeating the appeal and finally completing your class action settlement.

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