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Questioning Cy Pres Awards After Class Action Settlements

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Consider the following scenario — your business is one of many sued in a class action lawsuit for allegedly conspiring to overcharge consumers of baby products. After five years of costly litigation, all of the defendants decide to settle. They collectively agree to pay \$35.5 million into a settlement fund.

Of that amount, only \$3 million actually goes to allegedly injured consumers. Fully six times that amount, \$18.5 million, is to be paid to disinterested charities who were uninvolved in the lawsuit. The remaining money, a stunning \$14 million, will be paid to the attorneys who brought the suit, a figure justified by the false assumption that counsel provided a significant benefit to the class, even though the class — on whose behalf the case was filed — is set to receive less than 10 percent of the settlement fund.

A made-up scenario? Hardly. In fact, these are the actual facts presented to the U.S. Court of Appeals for the Third Circuit in *In re Baby Products Antitrust Litigation*, No. 12-1165 (E.D. Pa. 2013). Until recently, a court would likely have found this to be permissible and approved the class settlement. However, in its recent decision, the Third Circuit recognized that class



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counsel are not entitled to a windfall, particularly where so much of the settlement fund is paid to disinterested charities and so little to the plaintiff class. The upshot of the court's decision is to make it more difficult for plaintiffs' class action lawyers to receive such huge fees, paid by legitimate businesses and their insurers. As a result, class actions are now arguably less attractive to bring since attorney fees must now be reduced to discount payments made to disinterested parties and to more accurately reflect the actual benefit provided to the class.

The problem is an old one. Many businesses have been vexed by class action litigation, frequently brought by consumers who have suffered de minimis "injury" (if any), but who seek millions of dollars from defendants on behalf of similarly situated class members. These cases almost always settle. As part of the settlement, defendants frequently agree to pay significant sums to the class, often millions of dollars. For their efforts, class counsel usually reap

outsized fees, paid by the defendants based on a percentage of the recovery they achieved "for the class."

However, significant portions of the settlement proceeds — sometimes in excess of 50 percent — are never paid to the class. There are a variety of reasons for this. Some class members are difficult to identify. Some cannot be located. Others may choose not to participate in what can be a cumbersome claims process. Still others may not feel aggrieved and, therefore, decline to accept the "benefit" conferred upon them.

When this happens, courts need to decide what to do with the unclaimed settlement funds. Over time, courts have developed a variety of approaches to address the issue. One of the most controversial is to pay the unclaimed proceeds to a charity. This approach is based on an extension of an old trust doctrine, known as *cy pres*. Invoking this doctrine, courts allow unclaimed settlement money to be paid to a charity whose mission is said to be "as near as possible" to the concerns of the injured class.

Although popular, courts and commentators have raised numerous questions respecting the use of *cy pres* awards in the class action context. One persistent criticism is that the fees that plaintiffs lawyers receive are unduly excessive, particularly when courts view the *cy pres* distribution as a "benefit to

the class” to be considered when calculating the fee earned by class counsel. This very concern was addressed by the Third Circuit, which provided class action targets with long overdue relief.

Although Baby Products held that cy pres awards are constitutionally permissible, the court did not mask its discomfort with payments to nonparties, deeming them “troubling” and repeatedly referring to this method of distributing settlement proceeds as being plainly “inferior to a direct distribution to the class.” The court noted that such payments “only imperfectly serve the purpose of the underlying causes of action — to compensate the class members.” The court also endorsed the view that cy pres payments frequently provide the class with an “indirect benefit that is at best attenuated and at worst illusory.”

This case represents a potentially significant victory for businesses plagued by consumer class action lawsuits. Recognizing that “class counsel, and not their client, may be the foremost beneficiaries of the settlement” in consumer class actions, the Third Circuit concluded that fees paid to class counsel must be based on the actual benefit conferred upon the class and that any cy pres distribution should be “discounted.” The court’s reasoning is instructive. It was concerned that “inclusion of a cy pres distribution may increase a settlement fund, and with it attorney fees, without increasing the direct benefit to the class,” thereby creating “a potential conflict of interest between absent class members and their counsel.” Quoting U.S. Supreme Court Justice Sandra Day O’Connor in *International Precious Metals*

v. Waters, 530 U.S. 1223, 1224 (2000), the court further expressed the concern that cy pres awards can “decouple class counsel’s financial incentives from those of the class,” thereby undermining the class device “by providing defendants with a powerful means to entic[e] class counsel to settle lawsuits in a manner detrimental to the class.”

The Baby Products court then reversed the \$14 million award of counsel fees and instructed the lower court to determine with “reasonable accuracy the distribution of funds that will result from the claims process.” The lower court was also directed to determine whether the amount actually paid to class members reflects a failure of class counsel to represent adequately the interests of the entire class. The court instructed that “barring sufficient justification, cy pres awards should generally represent a small percentage of total settlement funds.” Perhaps most critically, since cy pres awards are “inferior” to the direct award of benefits actually conferred upon absent class members, the Third Circuit directed courts to discount the amount of the cy pres award when considering class counsel’s fee request.

What does this mean for businesses and class action targets? Potentially, a lot. Skeptics of the class device have long pointed out that such cases frequently result in little monetary benefit to the class even though counsel who file them enjoy substantial fees. By expressly preferring direct payments to injured class members and urging lower courts to “discount” cy pres awards in determining counsel’s fee, the Third Circuit made it

clear that the true purpose of the class device is to benefit allegedly injured class members.

As a result of Baby Products, lawyers who represent class plaintiffs will have to undertake the difficult task of actually locating class members and negotiating a settlement that truly benefits them, rather than some unknown, disinterested charity. This imposes significant additional burdens on class counsel. Those who fail to carry them, or who seek significant cy pres awards from defendants, will find their own fees reduced. As such, the expected downward pressure on fees awarded to plaintiffs counsel in consumer class action cases with significant cy pres awards may provide a disincentive to filing such suits, since the rewards associated with doing so are likely to be reduced. •

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