

2024

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Scott Dodson

Joseph A. Grundfest

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### Recommended Citation

Scott Dodson & Joseph A. Grundfest, *The Missing Millions: Cy Pres in Federal Securities Class Actions*, 74 Emory L. J. 1 (2024).

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## THE MISSING MILLIONS: CY PRES IN FEDERAL SECURITIES CLASS ACTIONS

Scott Dodson \*

Joseph A. Grundfest \*\*

### ABSTRACT

*Under prevailing cy pres doctrine, class-action-settlement residuals that cannot efficiently or fairly be distributed to the class may be distributed to a third party that represents the “next best” recipient consistent with class interests. Judges embrace cy pres despite theoretical concerns over inattention, conflicts, and abuse. We shed empirical light on the cy pres debate by examining an original, hand-collected dataset of 373 class-action settlements entered between 2010 and 2018. We document that the theoretical concerns have empirical merit. More than 57% of the settlements lack any evidence in the public record of the identity or court approval of cy pres recipients. At an average cy pres award of around \$20,000, we estimate the value of unaccounted-for residuals in all federal securities class-action settlements since 1996 as exceeding \$25 million. Among identified cy pres recipients, most have little or no relationship to interests of the class, and we find some evidence of conflicts of interest. These findings raise concerns about potential breaches of fiduciary duty and noncompliance with Federal Rules of Civil Procedure. We suggest that these deficiencies are caused by a combination of self-interest and inattention on the part of plaintiff’s counsel, lead plaintiffs, and the courts. We also offer solutions to remediate these deficiencies. Prospectively, we propose presumptions for the selection of appropriate recipients of the residual, mandatory disclosure of conflicts, and prior judicial approval of cy pres distributions. Retrospectively, we urge courts to order disclosure of missing information and to consider appropriate disciplinary measures, contingent on the information disclosed.*

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\* James Edgar Hervey Chair in Litigation, Geoffrey C. Hazard Jr. Distinguished Professor of Law, and Director of the Center for Litigation and Courts, University of California Law, San Francisco.

\*\* W.A. Franke Professor of Law and Business, Emeritus, Stanford Law School, and Senior Faculty, Arthur and Toni Rembe Rock Center for Corporate Governance. Our thanks to Nora Engstrom, Rick Marcus, Adam Zimmerman, and others who offered comments during our presentation of this paper at the Ninth Annual Civil Procedure Workshop at UC Law SF. We also are grateful to Gal Dor for her tireless and meticulous assistance.

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## INTRODUCTION

Class actions remain one of the most controversial forms of civil litigation in the federal system.<sup>1</sup> Courts, litigants, and commentators routinely raise concerns about the pressure that class actions impose on defendants,<sup>2</sup> the strictness or laxity of the certification requirements of Rule 23,<sup>3</sup> and the need to protect the due process rights of class members,<sup>4</sup> among other problematic aspects of representative aggregate litigation. Class-action settlements also receive special attention because of the risks of collusion benefitting defendants, named representatives, and their counsel, all at the expense of unnamed class members, who have little meaningful opportunity to participate in the litigation or escape its binding nature.<sup>5</sup>

Class settlements—unlike typical civil litigation—require court approval.<sup>6</sup> The public nature of class certification and class settlement therefore provides data for empirical analysis. For that reason, a robust empirical literature on class

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<sup>1</sup> E.g., Scott Dodson, *A Negative Retrospective of Rule 23*, 92 N.Y.U. L. REV. 917, 917 (2017) (“Controversy over Rule 23 has not waned.”); Bruce Hay & David Rosenberg, “Sweetheart” and “Blackmail” Settlements in Class Actions: Reality and Remedy, 75 NOTRE DAME L. REV. 1377, 1377 (2000) (“[C]lass actions are without doubt the most controversial subject in the civil process today.”).

<sup>2</sup> E.g., Edward H. Cooper, *Federal Class Action Reform in the United States: Past and Future and Where Next?*, 69 DEF. COUNS. J. 432, 433 (2002) (“Detractors . . . talked instead of the compulsion to settle unfounded class claims.”); Deborah R. Hensler & Thomas D. Rowe, Jr., *Beyond “It Just Ain’t Worth It”: Alternative Strategies for Damage Class Action Reform*, 64 L. & CONTEMP. PROBS. 137, 138 (2001) (“To avoid litigation costs and small risks of large judgments, some defendants are willing to settle even very weak claims for their nuisance value.”).

<sup>3</sup> E.g., *Wal-Mart Stores, Inc. v. Dukes*, 564 U.S. 338, 349, 360 (2011) (construing Rule 23(a)(2) and Rule 23(b)(2)); *Ortiz v. Fibreboard Corp.*, 527 U.S. 815, 821 (1999) (construing Rule 23(b)(1)); *Gen. Tel. Co. of the S.W. v. Falcon*, 457 U.S. 147, 157 (1982) (construing Rule 23(a)(3)). Proposals to alter Rule 23’s requirements abound. E.g., Scott Dodson, *An Opt-In Option for Class Actions*, 115 MICH. L. REV. 171 (2016); Richard Marcus, *Once More Unto the Breach? Further Reforms Considered for Rule 23*, JUDICATURE, Summer 2015, at 57.

<sup>4</sup> E.g. MARTIN H. REDISH, *WHOLESALE JUSTICE: CONSTITUTIONAL DEMOCRACY AND THE PROBLEM OF THE CLASS ACTION LAWSUIT* 137, 147–47, 173–75 (2009) (discussing due-process concerns); Geoffrey C. Hazard, Jr., John L. Gedid & Stephen Soble, *An Historical Analysis of the Binding Effect of Class Suits*, 146 U. PA. L. REV. 1849, 1859–60 (1998) (discussing the preclusive effect of class actions). See also *Hansberry v. Lee*, 311 U.S. 32, 37, 43 (1940) (holding that preclusive representative suits implicated due process).

<sup>5</sup> E.g., *Amchem Prods., Inc. v. Windsor*, 521 U.S. 591, 597, 628–29 (1997). Although some classes require notice and opt-out rights, see FED. R. CIV. P. 23(c)(2)(B) (requiring notice and opt-out rights for (b)(3) classes), and class members may object to settlement proposals, see FED. R. CIV. P. 23(e)(5)(A), those opportunities to participate have been criticized as largely cosmetic, e.g., Christopher R. Leslie, *The Significance of Silence: Collective Action Problems and Class Action Settlements*, 59 FLA. L. REV. 71, 92 (2007) (“[E]ven under the best of circumstances many class members might not receive actual notice of the class action litigation.”).

<sup>6</sup> See FED. R. CIV. P. 23(e).

actions has enabled data-driven testing of some class-related theoretical concerns.<sup>7</sup>

Those data, however, are limited to public records in court dockets.<sup>8</sup> While dockets invariably include the court-approved settlement agreement, dockets often do not include easily ascertainable information describing the settlement's subsequent administration.<sup>9</sup> Researchers and scholars have studied fee awards, which are public,<sup>10</sup> as well as claimant data gleaned from approved settlements and other filings,<sup>11</sup> but comprehensive distribution data are sparse.<sup>12</sup> As Professor Linda Mullenix put it in 2014, “[t]here are no empirical studies that have drilled down to ascertain what class claimants actually are paid individually for their claims as a result of the class litigation.”<sup>13</sup> Consequently, the empirical understanding of crucial aspects of settlement administration—data on distribution amounts, claims rates, notice methods, payment methods, and administrative costs—remains woefully incomplete.<sup>14</sup> These aspects relate directly to the efficacy of class actions to provide compensatory relief.

These knowledge gaps are particularly acute for an important aspect of settlement administration: cy pres. Cy pres arises, in part, because of the problem of residuals—money left over in the settlement fund that cannot be distributed

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<sup>7</sup> See, e.g., Theodore Eisenberg & Geoffrey Miller, *The Role of Opt-Outs and Objectors in Class Action Litigation: Theoretical and Empirical Issues*, 57 VAND. L. REV. 1529, 1532 (2004) (examining thousands of class action decisions).

<sup>8</sup> See DEBORAH R. HENSLER, NICHOLAS M. PACE, BONITA DOMBEY-MOORE, BETH GIDDENS & JENNIFER GROSS, CLASS ACTION DILEMMAS: PURSUING PUBLIC GOALS FOR PRIVATE GAIN 5 (2000) (discussing the lack of a national registry for class actions).

<sup>9</sup> One local exception is the Northern District of California, which promulgated, in November 2018, a set of guidelines urging disclosure of post-distribution data. U.S. DIST. CT., N. DIST. OF CAL., PROCEDURAL GUIDANCE FOR CLASS ACTION SETTLEMENTS (2018), <https://www.cand.uscourts.gov/forms/procedural-guidance-for-class-action-settlements/>. See *infra* notes 206–09 and accompanying text.

<sup>10</sup> E.g., Brian T. Fitzpatrick, *An Empirical Study of Class Action Settlements and Their Fee Awards*, 7 J. EMPIRICAL LEGAL STUD. 811, 811 (2010).

<sup>11</sup> E.g., FED. TRADE COMM’N, CONSUMERS AND CLASS ACTIONS: A RETROSPECTIVE AND ANALYSIS OF SETTLEMENT CAMPAIGNS 11 (2019); HENSLER ET AL., *supra* note 8, at 5; NICHOLAS M. PACE, STEPHEN J. CARROLL, INGO VOGELSAND & LAURA ZAKARAS, INSURANCE CLASS ACTIONS IN THE UNITED STATES xvii–xviii (2007); Nicholas M. Pace & William Rubenstein, *How Transparent are Class Action Outcomes?: Empirical Research on the Availability of Class Action Claims Data* 3 (RAND Inst. for Civ. Just., Working Paper No. WR-599-ICJ, 2008).

<sup>12</sup> See Amanda M. Rose, Essay, *Classaction.gov*, 88 U. CHI. L. REV. 487 (2021) (calling for systematic data collection). *But see* Brandon A. Prince, Vaughn R. Walker & Scott Dodson, *Preliminary Report on Class-Action Settlement Distributions in the Northern District of California*, CTR. FOR LITIG. & CTS. (May 30, 2023) (reporting distribution data in the Northern District of California).

<sup>13</sup> Linda S. Mullenix, *Ending Class Actions as We Know Them: Rethinking the American Class Action*, 64 EMORY L.J. 399, 419 (2014).

<sup>14</sup> See *infra* note 130.

efficiently or fairly to the class members.<sup>15</sup> One solution is to award the residual to a cy pres recipient—a third party that will use the money to advance the deterrent, regulatory, or compensatory interests of the class.<sup>16</sup> Importantly, cy pres distributions of class property to an entity that is not a class member requires justification, and the justification has traditionally been that the cy pres recipient must be the “next best” alternative to class distribution, in that the recipient will use the funds to advance the class’s interests.<sup>17</sup> Courts, commentators, and practitioners have gravitated toward cy pres as an appropriate, pragmatic solution for wrapping up the action.<sup>18</sup> Cy pres has become a widespread feature of class-settlement distribution.<sup>19</sup>

Cy pres, however, presents risks. Recipients might not use the distribution to advance the interests of the class.<sup>20</sup> Or recipients might present conflicts of interest because they are affiliated with, and can confer benefits upon, the litigants or the judge.<sup>21</sup> Commentators and courts note these risks, but the concerns have remained largely anecdotal because of the lack of systemic empirical study.<sup>22</sup> As recently as 2020, Professor Bob Bone bemoaned the lack “of any reliable empirical study” of the problems of cy pres conflicts of interest.<sup>23</sup>

This article addresses that gap by shedding empirical light on cy pres practice and exploring the implications of our empirical findings for class administration. Using a hand-collected database of 373 federal securities class settlements, we validate several theoretical concerns about cy pres practice. In particular, we demonstrate that cy pres recipients often do not advance the interests of the class and sometimes create conflicts of interest.<sup>24</sup> We also find that courts often ignore cy pres selection through practices that enable these concerns.<sup>25</sup> Relying on these

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<sup>15</sup> See *infra* text accompanying notes 67–71. In rare cases, the corpus is too small or logistically costly to distribute any of the proceeds to the class, resulting in a cy-pres-only settlement. See *infra* note 87 and accompanying text.

<sup>16</sup> See *infra* text accompanying notes 82–84.

<sup>17</sup> See *infra* text accompanying note 85.

<sup>18</sup> See *infra* text accompanying notes 86–87.

<sup>19</sup> See *id.*

<sup>20</sup> See *infra* text accompanying notes 88–92.

<sup>21</sup> See *infra* text accompanying notes 94–96.

<sup>22</sup> E.g., Robert G. Bone, *In Defense of the Cy-Pres-Only Class Action*, 24 LEWIS & CLARK L. REV. 571, 579 (2020).

<sup>23</sup> *Id.*

<sup>24</sup> See *infra* Part II.

<sup>25</sup> See *infra* Part III.

empirical findings, we then offer both theoretical and normative contributions to improve cy pres practice.<sup>26</sup>

This article proceeds in five major parts. Part I describes the background and foundation of class-action administration, explores the benefits and risks of cy pres distributions, and documents the increasing acceptance of cy pres in class-settlement administration.

Part II describes our original database of 373 federal securities class settlements and offers three important empirical findings. First, cy pres practice remains under the radar. The dockets of 213 cases (57%) lack any evidence of the identity or court approval of a specific cy pres recipient. Extrapolating from our sample average of around \$20,000 in cy pres distributions per case to the full population of federal class-action securities-fraud settlements entered from January 1, 1996, to December 31, 2023, we calculate approximately \$25 million in undisclosed cy pres residual distributions.<sup>27</sup>

Second, where cy pres recipients are identified, we find significant percentages that appear to have little or no relationship to the interests of the class. Among the identified cy pres recipients, 65% had missions either unrelated or only distantly related to the aims of the class. Extrapolating from our sample to the full population, the total dollar figure of class funds distributed to unrelated or distantly related cy pres recipients likely exceeds \$31 million.<sup>28</sup>

Third, the risk of distributions that present actual or apparent conflicts of interest is real. As just one example, the Institute for Law and Economic Policy (ILEP), a nonprofit foundation whose principal activity is to organize an annual symposium,<sup>29</sup> was a cy pres recipient in eight cases involving class counsel from Pomerantz LLP.<sup>30</sup> ILEP's president was Marc Gross, a longtime Pomerantz partner and former Pomerantz managing partner.<sup>31</sup> Because our investigation was not exhaustive, we do not claim to have uncovered all connections between every cy pres recipient and class counsel. But because even our cursory investigation reveals concerning instances of potential conflict, our findings likely significantly underestimate the frequency of actual instances of conflicted distributions.

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<sup>26</sup> See *infra* Part IV.

<sup>27</sup> See *infra* text accompanying notes 136–137.

<sup>28</sup> See *infra* text accompanying note 142.

<sup>29</sup> See *infra* note 142.

<sup>30</sup> See *infra* note 144.

<sup>31</sup> See *infra* text accompanying notes 141–43.

Part III addresses explanations for these empirical findings. We surmise that most problematic distributions are caused by benign neglect. In individual cases, the residual amount for cy pres distribution usually represents a very small percentage of the overall settlement corpus. The distribution also often occurs at the very end of a long and logistically complicated process. At that point, both judges and attorneys have long since turned their attention to other matters more important than the distribution of a residual that averages approximately \$20,000 per settlement in our sample. Under these circumstances, apathy might be rational—but not necessarily legal. Further, our findings of potential conflicts suggest that more nefarious motivations might also be at play, and we cannot exclude the possibility of self-dealing. Additional research is required to test that hypothesis.

Whether benign or not, these problems warrant a solution, and Part IV proposes a set of normative recommendations. A court can avoid the problem of cy pres selection entirely by distributing the residual to the class through a lottery mechanism in which each claimant’s probability of prevailing is proportional to the claimant’s share of the total settlement fund. This approach may be most appropriate when the goal of the class is compensation to the class.

But for other goals, such as deterrence or compensation to fraud victims generally, a cy pres distribution may be more appropriate. Courts choosing to proceed with cy pres can, to increase transparency and oversight, require that post-distribution accountings be filed with the court, perhaps as a precondition to final payment of class-counsel fees. These accountings can help ensure that cy pres recipients are properly identified and approved as appropriate, unconflicted recipients. Courts should also authorize cy pres distributions only after issuing a written order explaining why the recipient is appropriate. In addition, we suggest a robust set of presumptions to help guide cy pres selection to the most appropriate recipient that meets the “next best” standard.

To induce attention to these solutions in existing cases, we submit that courts can and should issue orders to show cause to class counsel and administrators to identify *all* proposed recipients of residuals and to justify the appropriateness of each recipient under the cy pres doctrine. We remind courts that noncompliance with those orders can be dissuaded with appropriate sanctions.

In Part V, we show the feasibility and utility of our normative proposals by illustrating, using case studies from our dataset, both how cy pres problems can arise without these controls and how those cy pres problems can be eliminated or reduced with these controls. We end with a brief conclusion.

## I. CLASS ACTIONS, SETTLEMENTS, RESIDUALS, AND CY PRES

This Part sets out foundational information on federal class actions and settlements as relevant to the analysis of cy pres awards and details the law and norms of cy pres distributions.

### A. *Class Actions Under Rule 23*

Class actions are an exception to the usual rule in federal civil litigation that each individual party manages and directs its own case.<sup>32</sup> In a class action, one or more named representatives litigate the class claims on behalf of all members of the class.<sup>33</sup> A decision in the class action affects both the substantive and procedural rights of the unnamed class members.<sup>34</sup> On the substance, if the class prevails, the class members prevail; if the class fails, the class members' claims are extinguished; and if the class settles, the class members share in that settlement on terms negotiated by the representatives.<sup>35</sup> As for procedure, class members generally have no right to participate in the litigation unless they formally intervene, serve as a named representative, or exercise certain limited procedural rights including opting out or objecting.<sup>36</sup>

Because individual class members' substantive rights are at stake, and because those class members have limited procedural ability to control or manage those substantive rights, the system demands close protection of class members' rights.<sup>37</sup> Protection takes the form of obligations imposed on the court, named representatives, and class counsel to ensure that the class action resolves the class members' claims efficiently, effectively, and fairly.<sup>38</sup>

A class action must meet four prerequisites.<sup>39</sup> The first two focus on the importance of efficiency.<sup>40</sup> First, class members must be so numerous that ordinary individual joinder is impracticable.<sup>41</sup> This requirement addresses the

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<sup>32</sup> See *Wal-Mart Stores, Inc. v. Dukes*, 564 U.S. 338, 348 (2011) (citing *Califano v. Yamasaki*, 442 U.S. 682, 700–01 (1979)).

<sup>33</sup> See *Califano v. Yamasaki*, 442 U.S. 682, 700–01 (1979).

<sup>34</sup> *Id.* at 701.

<sup>35</sup> See *Hansberry v. Lee*, 311 U.S. 32, 41 (1940).

<sup>36</sup> See FED. R. CIV. P. 23 (setting out limited procedural rights for unnamed class members).

<sup>37</sup> See *Gen. Tel. Co. of the S.W. v. Falcon*, 457 U.S. 147, 161 (1982) (stating that a class action should not be certified unless “the trial court is satisfied, after a rigorous analysis, that the prerequisites of Rule 23(a) have been satisfied”).

<sup>38</sup> See generally FED. R. CIV. P. 23.

<sup>39</sup> FED. R. CIV. P. 23(a).

<sup>40</sup> See FED. R. CIV. P. 23(a)(1), (a)(2).

<sup>41</sup> FED. R. CIV. P. 23(a)(1).

practical need for representative litigation, as opposed to an ordinary-joinder action in which each claimant has uncompromised agency in pursuing individual claims.<sup>42</sup> Second, a common question of law or fact must unite the class.<sup>43</sup> This requirement ensures the efficiency and fairness of being able to resolve a single question for the entire class in one, uniform swoop.<sup>44</sup>

The third and fourth prerequisites focus on the representational quality of the class action.<sup>45</sup> The third demands that the class representatives' claims and defenses be typical of the class's.<sup>46</sup> The fourth insists that the representative be adequate to represent the interests of the class.<sup>47</sup> These requirements help ensure faithful agency in the litigation; if the representative's claims are typical of the class's and the representative is adequate to represent the class, then the representative is likely to vigorously and fully represent the class's interests in all decisions and efforts to pursue the claims.<sup>48</sup>

If these four prerequisites are met, then a claim can be maintained as a class action if it falls into one of three approved categories of class action.<sup>49</sup> We focus on the third category in this paper: the 23(b)(3) class, which permits class certification only if the common questions predominate over individual questions and the class mechanism is the superior mechanism for resolving the individual claims.<sup>50</sup> In addition, class members have a right to be notified of the class action and a right to opt out of the class action to preserve their individual right to sue.<sup>51</sup>

Settlement of class actions differs from other forms of civil settlements.<sup>52</sup> Usually, a civil settlement can be at any time, on any terms agreed to by the parties, and settlement terms need not be approved by the court.<sup>53</sup> But because class actions resolve all claims of class members who otherwise do not

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<sup>42</sup> Compare FED. R. CIV. P. 23(a)(1) (requiring a large class), with FED. R. CIV. P. 20 (setting rules for party joinder).

<sup>43</sup> FED. R. CIV. P. 23(a)(2).

<sup>44</sup> Wal-Mart Stores, Inc. v. Dukes, 564 U.S. 338, 350 (2011).

<sup>45</sup> See FED. R. CIV. P. 23(a)(3), (a)(4).

<sup>46</sup> FED. R. CIV. P. 23(a)(3).

<sup>47</sup> FED. R. CIV. P. 23(a)(4).

<sup>48</sup> See, e.g., E. Tex. Freight Motor Sys., Inc. v. Rodriguez, 431 U.S. 395, 405–06 (1977) (emphasizing the importance of these factors).

<sup>49</sup> FED. R. CIV. P. 23(b).

<sup>50</sup> FED. R. CIV. P. 23(b)(3).

<sup>51</sup> FED. R. CIV. P. 23(c)(2)(B).

<sup>52</sup> See Howard M. Erichson & Ethan J. Leib, *Class Action Settlements as Contracts?*, 102 N.C. L. REV. 73, 75 (2023).

<sup>53</sup> See, e.g., Sullivan v. DB Invs., Inc., 667 F.3d 273, 317 (3d Cir. 2011) (stating that parties may settle a case without court approval).

participate in the litigation, special protections are required to ensure that class members are fairly treated and adequately represented in settlement.<sup>54</sup> Accordingly, courts usually direct notice of any settlement and its terms to the class members, who may opt out or object to the settlement.<sup>55</sup> The settlement must be approved by the court, only upon a finding, after a public hearing, that the settlement is fair, adequate, and reasonable.<sup>56</sup>

Throughout the lifespan of a certified class action, the *class* is the party to the action.<sup>57</sup> The named class representatives act as fiduciary representatives of the class.<sup>58</sup> Class counsel represents the *class*, not individual class members or the named representatives.<sup>59</sup> In addition, the court has independent obligations to ensure adequate and fair representation of the absent class members,<sup>60</sup> especially when approving a settlement.<sup>61</sup> One leading class-action treatise characterizes the court's obligation as acting like a fiduciary to the class.<sup>62</sup> Federal courts use similar terms.<sup>63</sup>

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<sup>54</sup> See Erichson & Leib, *supra* note 52, at 75–76.

<sup>55</sup> FED. R. CIV. P. 23(e)(1)(B) (requiring the court to “direct notice in a reasonable manner to all class members who would be bound by the proposal if giving notice is justified”); FED. R. CIV. P. 23(e)(4) (“If the class action was previously certified under Rule 23(b)(3), the court may refuse to approve a settlement unless it affords a new opportunity to request exclusion to individual class members who had an earlier opportunity to request exclusion but did not do so.”); FED. R. CIV. P. 23(e)(5)(A) (“Any class member may object to the proposal if it requires court approval . . .”).

<sup>56</sup> FED. R. CIV. P. 23(e)(2) (“If the proposal would bind class members, the court may approve it only after a hearing and only on finding that it is fair, reasonable, and adequate . . .”).

<sup>57</sup> See generally FED. R. CIV. P. 23 (referring to a certified class as a party to the action).

<sup>58</sup> Eubank v. Pella Corp., 753 F.3d 718, 723–24 (7th Cir. 2014).

<sup>59</sup> FED. R. CIV. P. 23(g)(4) (“Class counsel must fairly and adequately represent the interests of the class.”).

<sup>60</sup> See FED. R. CIV. P. 23(g)(1) (setting out criteria for courts in appointing class counsel, including “any other matter pertinent to counsel’s ability to fairly and adequately represent the interests of the class”).

<sup>61</sup> See *Amchem Prods., Inc. v. Windsor*, 521 U.S. 591, 620 (1997) (stating that class-action settlements “demand undiluted, even heightened, attention” to the strictures of Rule 23 to ensure that the settlement is fair and reasonable for the class as a whole).

<sup>62</sup> WILLIAM RUBENSTEIN, NEWBERG & RUBENSTEIN ON CLASS ACTIONS § 13:40 (6th ed. 2024).

<sup>63</sup> *E.g.*, *Kim v. Allison*, 8 F.4th 1170, 1178 (9th Cir. 2021) (“The district court must act as a fiduciary, protecting the interests of absent class members by scrutinizing the settlement’s fairness in light of the well-established factors.”); *In re Lumber Liquidators Chinese-Manufactured Flooring Prod. Mktg., Sales Pracs. & Prod. Liab. Litig.*, 952 F.3d 471, 483 (4th Cir. 2020) (“When the court reviews a proposed class-action settlement, it acts as a fiduciary for the class.” (internal citation omitted)).

### B. *Settlement and the Prevalence of Residuals*

After a settlement is approved by the court, the practicalities of settlement administration take over. In large class actions, class counsel often will contract with a private company specializing in settlement administration.<sup>64</sup> The settlement administrator oversees the logistics and operations of settlement administration, with the goal of distributing as much of the settlement fund to as many eligible claimants as quickly and as inexpensively as possible.<sup>65</sup> That goal can be daunting. Settlement administration includes the following tasks: requesting, validating, and processing individual class-member claims; distributing fees and costs to class counsel and vendors; distributing any residual amount in the settlement fund; and keeping records in case of a court request for an accounting.<sup>66</sup>

We focus here on residuals. Class distributions commonly leave residual amounts undistributed to class members—and in excess of any fees, costs, and expenses—for many reasons. First, the actual amount distributed to class members may fall below expectations because some class members are not provided with effective notice,<sup>67</sup> too few notified claimants file valid claim forms, or claimants who file valid claim forms never cash their payments.<sup>68</sup> Second, distribution costs could exceed the anticipated distributed amount, particularly for low-value claims.<sup>69</sup> In these cases, the costs of attempting distribution would completely exhaust the fund.<sup>70</sup> In *Nachshin v. AOL, LLC*, for example, the estimated pro-rata recovery per claimant was \$0.03, far below the cost of making the distributions.<sup>71</sup> In these instances, some amount of the settlement fund will remain undistributed to class members and unallocated for payment of fees or expenses.

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<sup>64</sup> E.g., *Class Action Administration*, ANGEION GRP., <https://www.angeiongroup.com/class-action/> (last visited July 30, 2024).

<sup>65</sup> *See id.*

<sup>66</sup> E.g., U.S. DIST. CT., N. DIST. OF CAL., *supra* note 9.

<sup>67</sup> Examples of class members who are not widely known or cannot be provided with reliable notice include consumer classes like product purchasers or taxicab customers. *See* *Freedman v. Arista Records, Inc.*, 137 F.R.D. 225 (E.D. Pa. 1991) (product purchasers); *Daar v. Yellow Cab Co.*, 433 P.2d 732 (Cal. 1967) (taxicab customers).

<sup>68</sup> Rhonda Wasserman, *Cy Pres in Class Action Settlements*, 88 S. CAL. L. REV. 97, 102–05 (2014) (listing and analyzing these possibilities).

<sup>69</sup> *Id.* at 104.

<sup>70</sup> *Id.*

<sup>71</sup> *Id.* (quoting *Nachshin v. AOL, LLC*, 663 F.3d 1034, 1037 (9th Cir. 2011)).

### C. *Cy Pres Distributions*

As discussed in the previous section, residuals present the problem of how to dispose of the excess funds. Reversion to the defendant, while lawful,<sup>72</sup> is normatively undesirable because it amounts to a windfall to the wrongdoer,<sup>73</sup> undermines the deterrence value of class actions,<sup>74</sup> and creates perverse incentives for the defendant to try to minimize class claims and recovery amounts.<sup>75</sup> Residuals could escheat to the state like other unclaimed property<sup>76</sup> or revert to the federal treasury like other unclaimed federal-judgment monies, but it is unclear how often such funds get directed to the proper claimants.<sup>77</sup> Residuals could be distributed to already-compensated class members, either through a cost-effective pro-rata scheme or by lottery,<sup>78</sup> but fully compensated class members have no special claim to excess payments that amount to a windfall.<sup>79</sup> And the potential for that windfall can create perverse incentives for existing claimants (including the representatives) to dissuade other claimants from coming forward.<sup>80</sup>

Because of the downsides of these options, courts today often favor *cy pres*.<sup>81</sup> The Norman French phrase *cy pres comme possible* means “as near as possible”<sup>82</sup> and arose as a doctrine of estate law to permit court diversion of funds from an unpayable beneficiary to a payable alternative that approximated

<sup>72</sup> See *Boeing Co. v. Van Gemert*, 444 U.S. 472, 482 (1980).

<sup>73</sup> See Stewart R. Shepherd, Comment, *Damage Distribution in Class Actions: The Cy Pres Remedy*, 39 U. CHI. L. REV. 448, 456 (1972) (calling reversion “unjust enrichment”).

<sup>74</sup> Gerson H. Smoger, *The Importance of Cy Pres in Modern Class Action Jurisprudence and Myths Concerning Its Use*, 24 LEWIS & CLARK L. REV. 595, 605 (2020) (“Reversion completely undermines the deterrent function of class action settlements.”).

<sup>75</sup> See Wasserman, *supra* note 68, at 107 (pointing out these problems).

<sup>76</sup> See *Texas v. New Jersey*, 379 U.S. 674, 675 (1965) (recognizing escheatment as an option).

<sup>77</sup> See 28 U.S.C. § 2042 (providing for treasury reversion).

<sup>78</sup> See Shay Lavie, *Reverse Sampling: Holding Lotteries to Allocate the Proceeds of Small-Claims Class Actions*, 79 GEO. WASH. L. REV. 1065, 1068 (2011) (proposing and defending a lottery option); Jay Tidmarsh, *Cy Pres and the Optimal Class Action*, 82 GEO. WASH. L. REV. 767, 768 (2014) (noting both options); Wasserman, *supra* note 68, at 111 (noting pro-rata distributions as an option espoused by the American Law Institute); PRINCIPLES OF THE LAW OF AGGREGATE LITIGATION § 3.07 (AM. L. INST. 2010) (preferencing pro-rata distribution).

<sup>79</sup> E.g., *In re Lupron Mktg. & Sales Pracs. Litig.*, 677 F.3d 21, 35 (1st Cir. 2012) (stating this argument); see also Smoger, *supra* note 74, at 605 n.36 (“[V]irtually all circuits have concluded that a distribution to class members should not result in a windfall to members who have submitted claims and already been fully compensated.”); Martin H. Redish, Peter Julian & Samantha Zyontz, *Cy Pres Relief and the Pathologies of the Modern Class Action: A Normative and Empirical Analysis*, 62 FLA. L. REV. 617, 620, 639 (2010) (expressing concern for unjustified windfalls).

<sup>80</sup> Wasserman, *supra* note 68, at 113 (recognizing this concern); e.g., *Lupron*, 677 F.3d at 35.

<sup>81</sup> Wasserman, *supra* note 68, at 117.

<sup>82</sup> *Id.* at 114.

the donor's intent.<sup>83</sup> Noble in theory, cy pres in practice has resulted in some estate diversions that are "at best inconsistent with the donor's wishes and at worst flatly contrary to them."<sup>84</sup> Nevertheless, in the 1970s, cy pres was adapted by modern class-action doctrine as a mechanism for disposing of monetary funds in a manner designed to further the class's interests.<sup>85</sup> Today, "litigants and courts have enthusiastically latched onto cy pres," and "courts increasingly prefer cy pres to the alternative means of distributing unclaimed funds."<sup>86</sup> Prominent commentators have even defended the "cy-pres-only class action," in which no class member receives monetary compensation because all proceeds are distributed to a cy pres recipient whose use of the funds will advance class interests in deterrence.<sup>87</sup>

The appeal of cy pres is obvious. Consider a case in which a million class claimants have all been fully paid under the terms of the settlement, but \$100,000 remains in the settlement fund after all compensatory distributions, costs, and fees. An additional pro-rata distribution of \$0.10 to each class member (less corresponding administrative expenses, of course) is practically meaningless and probably economically infeasible. By contrast, a distribution of the full \$100,000 to an entity that can use that sum for regulatory or deterrence efforts can be made cheaply and might advance class goals far more meaningfully than pro-rata redistribution.

Despite this appeal, cy pres distributions in class actions have generated controversy for multiple reasons, many of which stimulate debate.

First, because the court orders monies allocated by law to compensate victims to third parties who have no legal right to the money and have suffered no compensable harm from the defendant's conduct,<sup>88</sup> some commentators, most prominently Professor Marty Redish, argue that cy pres violates the separation of powers because it transforms a substantive compensatory right into

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<sup>83</sup> *Id.* at 114–15 (discussing this history).

<sup>84</sup> Maureen E. Brady, Book Review, *The Uses of the Dead: The Early Modern Development of Cy-Pres Doctrine*, 38 *LAW & HIST. REV.* 291, 291 (2020) (reviewing CAROLINE R. SHERMAN, *THE USES OF THE DEAD: THE EARLY MODERN DEVELOPMENT OF CY-PRES DOCTRINE* (2018)).

<sup>85</sup> Redish et al., *supra* note 79, at 634–38. Cy pres appears to have been first proposed for class actions in *Shepherd*, *supra* note 73 at 456.

<sup>86</sup> Wasserman, *supra* note 68, at 117.

<sup>87</sup> One defender is Bone, *supra* note 22, at 578. Such cy-pres-only settlements are very rare. See Brief of Professor William B. Rubenstein as Amicus Curiae in Support of Respondents at 11–12, *Frank v. Gaos*, 139 S. Ct. 1041 (2019) (No. 17-961) (reporting that such actions amount to around one case per year in the federal courts).

<sup>88</sup> Bone, *supra* note 22, at 572.

the equivalent of a civil fine.<sup>89</sup> But this perspective fails to recognize that Congress endorsed cy pres in the Class Action Fairness Act of 2005.<sup>90</sup> Further, as Professor Bone has argued, “the court certifies the class with the understanding that a serious effort will be made to deliver the proceeds of a settlement to the class members,” and cy pres enters the scene only as a last-resort remedial tool when the indirect benefits to the class through cy pres exceed the direct monetary benefit.<sup>91</sup> The conventional wisdom is that, done right, cy pres is an appropriate way to advance the deterrence policies underlying the substantive law.<sup>92</sup>

Second, cy pres presents incentive risks to the disadvantage of the absent class members. Distributions to a cy pres recipient, over distributions to absent class members, could offer some benefits to those promoting the settlement, namely, the defendant and class counsel.<sup>93</sup> On the defendant side, because cy pres recipients are generally charitable organizations, direct payments to cy pres charities could provide defendants with tax breaks and public goodwill.<sup>94</sup> On the class-counsel side, hammering out a detailed and convoluted settlement, and then overseeing those distributions, can take significantly more attorney time than a single distribution to a single cy pres recipient.<sup>95</sup> Thus, if cy pres distributions are less time-consuming to negotiate and effectuate, and defendants reap a goodwill advantage, then class counsel and defendants are incentivized to maximize cy pres at the expense of class members.<sup>96</sup>

These incentive risks are not particularly worrisome. Defendants mostly care about resolving the dispute and global peace; how the settlement funds are distributed rarely motivates them.<sup>97</sup> Meanwhile, class counsel’s fees generally come off the total settlement amount regardless of how the funds are distributed.<sup>98</sup> Finally, the court’s obligation to ensure that the settlement is fair and reasonable arguably protects against unwarranted diversion of funds from

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<sup>89</sup> Redish et al., *supra* note 79, at 642, 644–47. In rejoinder, Professor Bone has argued that cy pres can be thought of as enforcing, rather than transforming, the substantive law by enabling lawsuits that would otherwise not be financially feasible to bring. *See* Bone, *supra* note 22, at 582–83.

<sup>90</sup> 28 U.S.C. § 1712(e) (providing, for coupon settlements, that “[t]he court, in its discretion, may also require that a proposed settlement agreement provide for the distribution of a portion of the value of unclaimed coupons to 1 or more charitable or governmental organizations, as agreed to by the parties”).

<sup>91</sup> Bone, *supra* note 22, at 574.

<sup>92</sup> *See id.* at 581.

<sup>93</sup> Wasserman, *supra* note 68, at 101, 123–24.

<sup>94</sup> *Id.* at 101, 120.

<sup>95</sup> *See* Redish et al., *supra* note 79, at 640, 660.

<sup>96</sup> Wasserman, *supra* note 68, at 123–24.

<sup>97</sup> Exceptions exist. *See, e.g.,* Lane v. Facebook, Inc., 696 F.3d 811, 818, 820–21 (9th Cir. 2012).

<sup>98</sup> Bone, *supra* note 22, at 579.

class members to cy pres recipients.<sup>99</sup> Thus, according to some, the mere possibility of a cy pres distribution for residuals is unlikely to generate troublesome incentives that disadvantage the absent class members.<sup>100</sup> For these and other reasons, every circuit has approved cy pres for residuals.<sup>101</sup>

Nevertheless, qualms persist. In 2013, Chief Justice John Roberts wrote in a statement respecting the denial of certiorari that important questions of class-action cy pres remain unresolved, including “when, if ever, such relief should be considered” and “how to assess its fairness as a general matter.”<sup>102</sup> In 2015, the Civil Rules Advisory Committee briefly considered developing a rule on the topic of cy pres but declined to move forward with it.<sup>103</sup> Since then, the questions revolving around cy pres have percolated among lower courts and a few commentators.<sup>104</sup>

#### *D. Selecting an Appropriate Cy Pres Recipient*

We join that conversation by focusing on an understudied challenge of cy pres distributions: the selection of an appropriate recipient. Appropriate cy pres recipients should have two characteristics. First, cy pres recipients should be committed to using the funds to further the deterrence or compensatory interests of the class.<sup>105</sup> Second, they should be free of conflicts of interest.<sup>106</sup>

##### *1. Furthering the Interests of the Class*

The justification for distributing class-settlement funds to a nonparty cy pres recipient is that the distribution furthers the class’s interests in deterrence and compensation.<sup>107</sup> It is, therefore, essential that the recipient’s use of the funds be related to those class claims. Courts have adopted different tests—including the “reasonable approximation” test and the “next best” test—to determine which cy pres recipient best advances class interests.<sup>108</sup> For example, when the class

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<sup>99</sup> See *id.* at 591.

<sup>100</sup> See Smoger, *supra* note 74, at 601–02.

<sup>101</sup> *Id.* at 597.

<sup>102</sup> *Marek v. Lane*, 134 S. Ct. 8, 9 (2013) (statement of Chief Justice Roberts respecting denial of certiorari).

<sup>103</sup> See Richard Marcus, *Revolution v. Evolution in Class Action Reform*, 96 N.C. L. REV. 903, 923 (2018).

<sup>104</sup> See *supra* notes 86–87.

<sup>105</sup> WILLIAM B. RUBENSTEIN, NEWBERG AND RUBENSTEIN ON CLASS ACTIONS § 12:33 (6th ed. 2022); see *Lane v. Facebook*, 696 F.3d 811, 821 (9th Cir. 2012).

<sup>106</sup> See Smoger, *supra* note 74, at 603–04 (explaining that class members should initially determine the cy pres recipient to eliminate conflicts of interest that may arise when the defendant or judge selects the recipient).

<sup>107</sup> See *id.* at 606 (“[C]y pres should be distributed so that it indirectly benefits the class, consistent with the goals of the underlying case.”).

<sup>108</sup> *Capsolas v. Pasta Res., Inc.*, 505 F. Supp. 3d 255, 259 (S.D.N.Y. 2020).

device is important for enabling a negative-value lawsuit in the first instance, thus increasing access to justice, courts have upheld cy pres awards to access-to-justice organizations.<sup>109</sup> Because of the need for a nexus between the mission of the cy pres recipient and the goals of the class, “some courts have rejected proposed cy pres distributions which have no relationship to the underlying case.”<sup>110</sup> For example, in *Dennis v. Kellogg Co.*,<sup>111</sup> the Ninth Circuit rejected cy pres distributions to organizations that feed the poor because the class claims were about false advertising.<sup>112</sup>

Yet the American Law Institute’s *Principles on Aggregate Litigation* states that when no appropriate cy pres recipient reasonably approximates the interests of the class, cy pres distributions can still be made.<sup>113</sup> And anecdotal reports exist of cy pres distributions to charities with “little relationship to the absent class members or the laws underlying their claims.”<sup>114</sup>

In *In re Motorsports Merchandise Antitrust Litigation*,<sup>115</sup> a price-fixing class action against vendors of stock-car merchandise, the judge approved cy pres distributions of \$250,000 each to Make-a-Wish, American Red Cross, Race Against Drugs, Atlanta Legal Aid, Children’s Healthcare of Atlanta, Georgia Legal Services Program, KIDS’ CHANCE, Duke Children’s Hospital and Health Center, and the Lawyers Foundation, and an additional \$100,000 distribution to the Susan G. Komen Breast Cancer Foundation.<sup>116</sup> The court did not explain how any of these organizations would further class interests, and it is doubtful that this cy pres distribution did in fact further class interests.<sup>117</sup>

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<sup>109</sup> Smoger, *supra* note 74, at 607 (reporting this); Michael Grant, *Cy Pres: Not the First Option, but “As Near as Possible”*, 32 GEO. J. LEGAL ETHICS 637, 656 (2019) (“Legal Service organizations are proper choices in most cases.”); e.g., *Lessard v. City of Allen Park*, 470 F. Supp. 2d 781, 783–84 (E.D. Mich. 2007) (“The Access to Justice fund is the ‘next best’ use of the remaining settlement monies in this case, because both class actions and Access to Justice programs facilitate the supply of legal services to those who cannot otherwise obtain or afford representation in legal matters.”).

<sup>110</sup> Smoger, *supra* note 74, at 606.

<sup>111</sup> *Dennis v. Kellogg Co.*, 697 F.3d 858 (9th Cir. 2012).

<sup>112</sup> *Id.* at 867.

<sup>113</sup> PRINCIPLES, *supra* note 78, at § 3.07(c).

<sup>114</sup> Wasserman, *supra* note 68, at 118; *see also id.* at 101 (“[R]ecipient charities often fail to serve the interests of the class or to address the concerns raised in their lawsuit.”); Adam Liptak, *Doling Out Other People’s Money*, N.Y. TIMES, Nov. 26, 2007, at A14 (reporting that “judges are turning into grant administrators” by “doling out leftover class-action settlement money, sometimes to organizations only tangentially related to the subject of the lawsuit”).

<sup>115</sup> *In re Motorsports Merch. Antitrust Litig.*, 160 F. Supp. 2d 1392 (N.D. Ga. 2001).

<sup>116</sup> *Id.* at 1399.

<sup>117</sup> *See id.* at 1393 (stating that the case concerns a price-fixing conspiracy among NASCAR race-souvenir sellers).

## 2. *Conflict-Free*

Cy pres recipients should also be free of conflicts, or the appearance of conflicts or of self-dealing, through connections or relationships with the judge, attorneys, parties, or settlement vendors. Actual conflicts could induce judges, counsel, or parties to “steer the funds to a favored charity or alma mater,”<sup>118</sup> to the detriment of the class, even if a different cy pres recipient is better positioned to advance the class’s interests. In addition, if a cy pres recipient has ties to the judge hearing the case, those ties could entice the judge to approve the settlement more readily. Conflicted administrators or class attorneys could be induced to increase the size of the residual by shortchanging class members, for example, by depressing the number of claims filed, giving claims stricter scrutiny before approval, or demanding higher evidentiary proof.<sup>119</sup>

Even if an existing relationship with the cy pres recipient does not actually disadvantage the class, the relationship can create an appearance of impropriety that damages public confidence in the civil-justice system’s neutrality and impartiality.<sup>120</sup> The selection of a cy pres recipient can create a problematic appearance of impropriety if, for example, the judge’s spouse sits on the board of the charity<sup>121</sup> or if the cy pres recipient is affiliated with the judge’s alma mater.<sup>122</sup>

The ALI’s *Principles* directs the parties, rather than the court, to identify cy pres recipients<sup>123</sup> and would prohibit the selection of a cy pres recipient with “any significant prior affiliation” with the judge or parties that “would raise

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<sup>118</sup> Wasserman, *supra* note 68, at 101; *see also* Bone, *supra* note 22, at 579 (characterizing as concerning when “cy pres allows attorneys and judges to choose their favorite charities”); Grant, *supra* note 109, at 649 (“The selection of cy pres recipients presents an opportunity for lawyers and judges to further their own personal interests,” and “judges may approve settlements where the charities are causes they support or in which they have a material interest.”).

<sup>119</sup> *See generally* Wasserman, *supra* note 68, at 101 (worrying that “class counsel may not work its hardest to put money into the hands of the absentees”).

<sup>120</sup> JOHN H. BEISNER, JESSICA DAVIDSON MILLER & JORDAN M. SCHWARTZ, CY PRES: A NOT SO CHARITABLE CONTRIBUTION TO CLASS ACTION PRACTICE 13–14 (2010).

<sup>121</sup> *See* Nachshin v. AOL, LLC, 663 F.3d 1034, 1039, 1041 (9th Cir. 2011).

<sup>122</sup> Perkins v. Am. Nat’l Ins. Co., No. 3:05-CV-100 (CDL), 2012 WL 2839788, at \*1 (M.D. Ga. July 10, 2012) (approving a cy pres award to the University of Georgia School of Law); *Land, Clay D.*, FED. JUD. CTR., [www.fjc.gov/history/judges/land-clay-d](http://www.fjc.gov/history/judges/land-clay-d) (listing the University of Georgia School of Law as Judge Land’s alma mater). Not all such affiliations will raise questions about the independence and appropriateness of the recipient. *See, e.g., In re Google Referrer Header Priv. Litig.*, 869 F.3d 737, 740–44 (9th Cir. 2017) (upholding selection of recipients to organizations affiliated with class counsels’ alma maters because that link, by itself, was too tenuous to create an appearance of impropriety and because the recipients pledged, in detailed proposals, to devote the funds to activities related to protecting the legal interests of the class).

<sup>123</sup> PRINCIPLES, *supra* note 78, at § 3.07(c).

substantial questions about whether the selection of the recipient was made on the merits.”<sup>124</sup> Nevertheless, anecdotal reports of such conflicts exist. One report uncovered evidence that a trial judge directed cy pres funds to his alma mater, which then awarded the judge an honorary degree.<sup>125</sup> In a notorious example, *Lane v. Facebook*, a class of Facebook users brought claims that Facebook unlawfully exposed personal information.<sup>126</sup> The court approved (and the Ninth Circuit affirmed) a settlement of \$9.5 million, with \$3 million going to lawyers and the rest to a cy pres recipient created specifically for the purpose of receiving the settlement balance, run by Facebook’s Director of Public Policy and two other directors, and whose legal advisors included Facebook’s attorney and class counsel.<sup>127</sup>

### *E. The Lack of Empirical Data*

Courts and commentators have recognized these theoretical concerns and have noted supporting anecdotal evidence.<sup>128</sup> But, as one prominent commentator observes, “it is not clear how serious” selection problems are because of the lack “of any reliable empirical study showing . . . a widespread problem.”<sup>129</sup> In 2010, Professor Redish and coauthors published a study of ninety-five cy pres awards between 1974 and 2008 but found no conclusive evidence of abusive practices.<sup>130</sup> The academic conclusion is “[e]mpirical evidence about abusive cy pres awards is elusive.”<sup>131</sup>

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<sup>124</sup> *Id.* § 3.07 cmt. b.

<sup>125</sup> R. Robin McDonald, *Retirement Ends JQC Probe*, DAILY REP. (Aug. 24, 2011, 12:00 AM), <https://www.law.com/dailyreportonline/almID/1202551149760/>.

<sup>126</sup> *Lane v. Facebook*, 696 F.3d 811, 816–17 (9th Cir. 2012).

<sup>127</sup> *Id.*

<sup>128</sup> See *supra* notes 121–122 and accompanying text (expressing concern about, and noting anecdotal evidence of, conflicts of interest in cy pres distributions).

<sup>129</sup> Bone, *supra* note 22, at 579.

<sup>130</sup> Redish et al., *supra* note 79, at 634–38, 653 n.164.

<sup>131</sup> Tidmarsh, *supra* note 78, at 783 n.52.

## II. DOCKET STUDY

We address that empirical gap by conducting a docket study of securities class-action settlements filed between 2010 and 2018. Using the Stanford Securities Class Action Clearinghouse (SCAC) database, we built a dataset of all 373 private-party, securities-fraud, federal-court, class-action cases in which settlements were filed between January 1, 2010, and December 31, 2018.<sup>132</sup> With one exception, the status of each case is noted as “closed” on the court docket.

Our dataset includes case and cy pres information captured by SCAC. That information was then reviewed manually for accuracy. Additional docket information was also compiled by hand from both Bloomberg Law Litigation Intelligent Center and PACER.<sup>133</sup> The dataset was created between December 2021 and March 2022, and a second “quality control” review of fields relating to cy pres was conducted from March to May 2022. Among other categories of data, the database contains information pertaining to the dollar amount of the settlement fund; the identities of the judges, attorneys, and administrators involved; the identities of any cy pres recipients; and the amounts distributed to cy pres recipients.<sup>134</sup>

We analyzed the data along three dimensions: the selection of cy pres recipients; the connection of selected cy pres recipients to the legal claims and interests of the class; and the connection of selected cy pres recipients to the judges, parties, and administrators. We relied on publicly available information presented on institutional websites to identify potentially conflicting relationships between cy pres recipients and class counsel and other participants in the litigation process.

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<sup>132</sup> The SCAC also provides information relating to class-action cases filed by the SEC and the DOJ, but these cases are not included in our analysis.

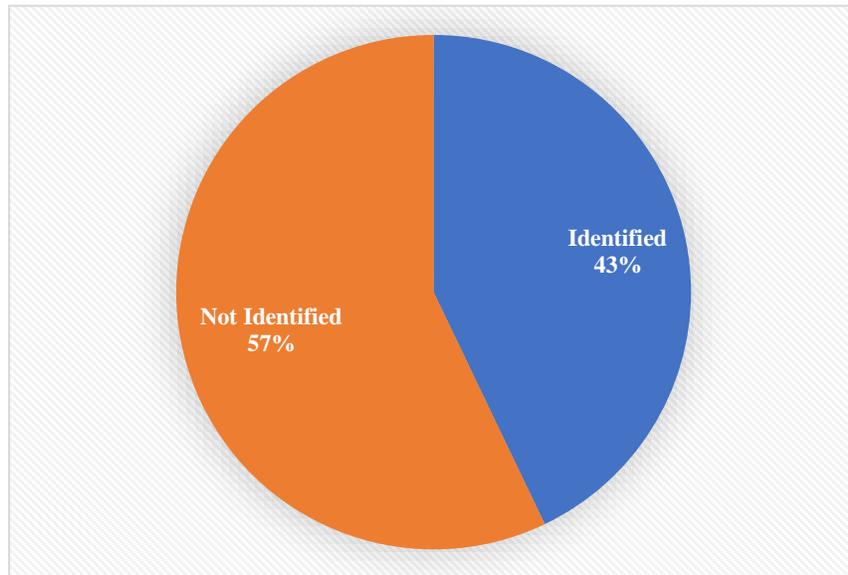
<sup>133</sup> Specifically, we reviewed the Motion for Distribution and the declaration attached thereto, the Order for Distribution, and the Order for Distribution to the cy pres recipient. The full dockets of ten randomized cases in which the cy pres recipient was not specifically named in the Stipulation of Settlement were reviewed to confirm that the cy pres recipient was not named in other documents.

<sup>134</sup> A complete list of fields of data collected is set out in Appendix A.

### A. Identification of Cy Pres Recipients

Our first finding is that 213 of the 373 cases in our sample (57%) lack any evidence in the docket of the identity or court approval of a specific cy pres recipient.<sup>135</sup> Figure 1 depicts this finding.

**Figure 1: Cy Pres Recipients in 373 Closed Cases**



With an average of \$19,982 in residuals per settlement where data are available, we estimate the total amount of residual funds in the 213 dataset cases without an identified cy pres recipient at more than \$4 million.<sup>136</sup>

The SCAC database records 2,199 settlements from 1996 to 2023, with a total settlement value of more than \$100 billion.<sup>137</sup> Linear extrapolation of our findings to the 2,199 SCAC settlements implies total residuals of approximately \$43.9 million. If 57% of that sum also represents distributions as to which no cy

<sup>135</sup> Settlement administrators provided us with sporadic information about cy pres distributions that were not reflected in the public dockets. We have not included that information in the data reported in Figure 1.

<sup>136</sup> The thirty-five cases with confirmed residual amounts average \$19,982. Multiplying that average by 213 results in \$4,256,207. Residuals are pervasive; only rarely is a fund fully distributed without a residual. Of the thirty-five cases with confirmed residual amounts, in only five were the amounts at zero. The five cases with zero residuals are included in the average-residual calculation.

<sup>137</sup> To be precise, SCAC settlements total \$100,362,734,975 (or \$141,243,801,889 in inflation-adjusted dollars). Data are on file with the authors.

pres recipients are identified, then more than \$25 million in residual distributions would be unidentified. These are the “missing millions.”

The immediate question is why so many cases, representing millions of dollars in distributions, lack any identification of a cy pres recipient. At least three explanations are possible. First, although these 213 dataset cases (with one exception) represent cases designated as “closed” on the court dockets, distributions are not yet complete. Our informal conversations with settlement administrators suggest that this is a realistic possibility for some cases because securities-fraud class-action distributions can take many years of administration, and cy pres distributions are among the very last distributions. Second, it is possible that courts have granted approval of the identity and amount of cy pres distributions, but a record of that approval was not filed in the publicly available docket. We think this possibility unlikely, but without confirmation from the court or the parties, we cannot exclude this possibility as a logical matter. The third explanation is that cy pres distributions were made without specific approval from or disclosure to the court. Evidence exists that this third possibility accounts for a nontrivial number of the cases: one settlement administrator supplied data on actual cy pres distributions for three cases that were not reflected in the dockets.<sup>138</sup>

If this third possibility occurs in a case in which the settlement required court preapproval, the distribution could violate a court order. However, we did not find direct evidence of cy pres distributions made in violation of such orders. In our dataset, only 142 settlements expressly required court preapproval of cy pres distributions. In those 142 cases, we found no evidence in the dockets of unapproved cy pres distributions. In ninety-seven cases, we found no evidence of *approved* cy pres distributions, either. The possibility thus remains that cy pres distributions were, in fact, made, but absent verification from settlement administrators, class counsel, or courts, we cannot be certain.<sup>139</sup> Whether cy pres distributions are being made in violation of court orders is worthy of further investigation and study, and Part IV proposes steps to initiate that investigation.

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<sup>138</sup> E-mail from CEO of an administrator to Scott Dodson, author (Nov. 6, 2023, 1:21 PM) (on file with authors).

<sup>139</sup> Our inquiries to relevant administrators and class counsel regarding this question have gone unanswered.

### B. *Relatedness of Cy Pres Recipients*

For the twenty-six cases in which a specified, nonzero amount was distributed to an identified cy pres recipient, we analyzed the connection of that recipient's mission to the class claims in the case. We categorized as "close" three recipients whose missions were proximately related to the classes' interests: Investor Protection Trust, Council of Institutional Investors Research and Education Fund, and University of San Francisco Law Investor Justice Clinic.<sup>140</sup> "Close" recipients were recipients in nine (35%) of the twenty-six cases. We categorized as "distant" those recipients whose missions include, but are not focused on, investor justice; distant recipients include legal-aid organizations, the Institute for Law and Economic Policy, and Public Justice.<sup>141</sup> "Distant" recipients represent twelve (46%) of the cases. We categorized the remaining five recipients as "unrelated"—the American Red Cross and food banks—which represent 19% of the cases. Table 1 summarizes these percentages and amounts.

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<sup>140</sup> See *About*, INV. PROT. TR., <https://investorprotection.org/about/> ("The Investor Protection Trust is a nonprofit organization devoted to independent and unbiased investor education, research, and support of investor protection efforts.") (last visited May 13, 2024); *About CII-REF*, CII RSCH. EDUC. FUND, <https://www.ciiref.org/> ("CII-REF focuses on educating the public, investors, corporations, other financial market participants and policymakers about topical issues, including corporate governance, shareholder rights, investment, capital markets, accounting standards and securities litigation.") (last visited Aug. 8, 2024); *LAW 965 - Investor Justice Clinic*, UNIV. S.F., [https://catalog.usfca.edu/preview\\_course\\_nopop.php?catoid=38&coid=556537](https://catalog.usfca.edu/preview_course_nopop.php?catoid=38&coid=556537) ("In the Investor Justice Clinic, students represent investors in actions involving allegations of wrongdoing by securities firms and/or their employees.") (last visited Aug. 8, 2024).

<sup>141</sup> See INST. FOR L. & ECON. POL'Y, <https://www.ilep.org/> ("The Institute for Law and Economic Policy ('ILEP') is a public policy research and educational foundation whose mission is to preserve, study, and enhance investor and consumer access to the civil justice system.") (last visited Aug. 8, 2024); *Our History*, PUB. JUST., <https://www.publicjustice.net/who-we-are/mission/our-history/> ("Public Justice (originally Trial Lawyers for Public Justice) is a nonprofit legal advocacy organization that takes on purveyors of corporate corruption, sexual abusers and harassers, and polluters who ravage the environment.") (last visited Aug. 8, 2024).

**Table 1: Cy Pres Relatedness Data – Known Distributions**

<b>Relatedness</b>	<b>Number Of Cases</b>	<b>Case Percent</b>	<b>Total Amount</b>	<b>Percent Amount</b>
Closely Related	9	35%	\$142,572	32%
Distantly Related	12	46%	\$188,370	42%
Unrelated	5	19%	\$117,701	26%
<b>Totals</b>	<b>26</b>	<b>100%</b>	<b>\$448,643</b>	<b>100%</b>

To extrapolate these findings beyond the twenty-six cases with known distributions, we analyzed the 123 cases in which cy pres recipients were specifically identified but no distributed amounts appear in the docket filings. Table 2 applies the same relatedness categories of close, distant, and unrelated to this expanded sample, along with estimated distribution amounts (case number multiplied by \$19,982, the average cy pres amount derived from known distributions).

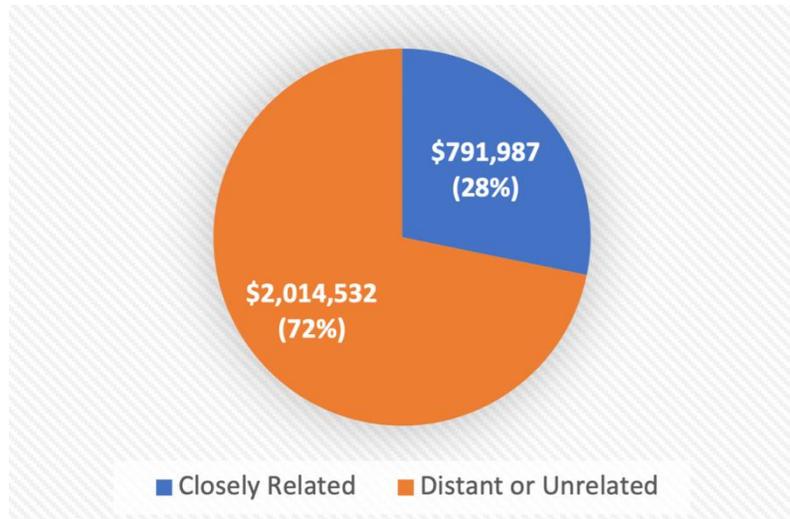
**Table 2: Cy Pres Relatedness Data – Estimated Distributions**

<b>Relatedness</b>	<b>Number Of Cases</b>	<b>Case Percent</b>	<b>Total Amount</b>	<b>Percent Amount</b>
Closely Related	32.5	26%	\$649,415	26%
Distantly Related	74.67	61%	\$1,492,056	61%
Unrelated	10.83	9%	\$216,405	9%
Unknown	5	4%	\$99,910	4%
<b>Totals</b>	<b>123</b>	<b>100%</b>	<b>\$3,107,201</b>	<b>100%</b>

Note: partial case numbers allocated based on percentages when multiple cy pres recipients were designated in a single case.

Combining Table 1 and Table 2, we estimate that, among the 149 cases in our database in which a specific cy pres recipient is identified, less than \$1 million in cy pres distributions went to recipients likely to advance class interests, while more than \$2 million was distributed to recipients significantly less likely, or even unlikely, to use the money to advance the interests of the class. Figure 2 below depicts these ratios.

**Figure 2: Amounts Distributed to Known Cy Pres Recipients**



Applying the same ratios to all federal-securities class-action settlements from 1996 to 2023 results in an estimate of more than \$31 million in residuals distributed to recipients distantly related or unrelated to class aims.<sup>142</sup>

These data validate the concern that the cy pres mechanism, as applied in the context of securities-fraud class-action residuals, does not distribute class property to entities that will advance class interests. This problem is compounded by evidence that cy pres distributions can also be conflicted in a nontrivial number of cases.

<sup>142</sup> We compute \$43.9 million in residuals, *see supra* text accompanying note 137, multiplied by 72%. The exact estimate is \$31,637,101.

### C. Distributions to Conflicted Cy Pres Recipients

For cases in which a specific cy pres recipient was approved, we researched publicly available evidence of connections between that recipient and parties, vendors, and judicial personnel involved in the case.

We identified several potential conflicts. The Institute for Law and Economic Policy (ILEP) is a particularly problematic cy pres recipient. ILEP President Marc Gross is a longtime partner of Pomerantz LLP and was managing partner of the firm for most of the years covered by our dataset.<sup>143</sup> Pomerantz was class counsel in seventeen dataset cases. In eight—nearly half—of those cases, ILEP was selected as a cy pres recipient,<sup>144</sup> more than for any other class counsel.

ILEP's principal activity is to organize an annual symposium, to which ILEP often invites judges, class-action attorneys, and class-settlement administrators as participants.<sup>145</sup> This close connection between ILEP and repeat class-action players creates the risk of a perception that the diversion of class funds to ILEP may induce ILEP to reward those who approve of the diversion with symposium opportunities (and vice versa). More generally, most ILEP vice presidents are plaintiff-side class counsel with an interest in supporting efforts to market themselves and their business model.<sup>146</sup> In our dataset, among cy pres recipients with known distributions, ILEP was the second-most selected recipient. The actual dollar amount of known ILEP distributions in our dataset is small—just over \$11,000 in total—but that amount represents a fraction of what ILEP could have received in other cases. In any event, the distribution of even a small amount creates an appearance of a conflict of interest.

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<sup>143</sup> See *About Us*, INST. FOR L. & ECON. POL'Y, <https://www.ilep.org/about-us/> (last visited Aug. 8, 2024).

<sup>144</sup> See Order on Distribution of Class Settlement Funds at 3, *Thomas v. Magnachip Semiconductor Corp.*, No. 3:14-CV-01160 (N.D. Cal. Nov. 15, 2018), ECF No. 351 (two separate settlements); Order Authorizing Distribution of Net Settlement Fund to Authorized Claimants ¶ 6, *In re Lipocine Inc. Securities Litigation*, No. 2:17-CV-00182 (D. Utah Nov. 5, 2018), ECF No. 87; Order Re: Final Distribution of Settlement Fund at 3, *In re Delcath Sys., Inc.*, No. 1:13-CV-03116 (S.D.N.Y. Apr. 6, 2016), ECF No. 147; Order on Final Distribution of Class Settlement Funds at 2, *In re KaloBios Pharma., Inc. Sec. Litig.*, No. 5:15-CV-05841 (N.D. Cal. Jan. 24, 2019), ECF No. 155 (two separate settlements); Order on Distribution of Class Settlement Funds at 2, *Monachelli v. Hortonworks, Inc.*, No. 3:16-CV-00980 (N.D. Cal. Jan. 9, 2018), ECF No. 86; Order Granting Plaintiff's Motion for Distribution of Settlement Funds at 2, *Todd v. STAAR Surgical Co.*, No. 2:14-CV-05263 (C.D. Cal. May 11, 2018), ECF No. 189.

<sup>145</sup> See INST. FOR L. & ECON. POL'Y, *supra* note 141 (“ILEP organizes symposia, co-sponsored by law schools and attended by academics, jurists, and practitioners.”); *Symposia Participants*, INST. FOR L. & ECON. POL'Y, <https://www.ilep.org/symposia-participants/> (providing a list of recent symposium participants).

<sup>146</sup> See *ILEP Officers*, INST. FOR L. & ECON. POL'Y, <https://www.ilep.org/about-us>.

The dataset also reveals additional instances of potential conflict. Cohen Milstein was class counsel in *In re Braskem Securities Litigation*,<sup>147</sup> which named the Public Justice Foundation as a cy pres recipient.<sup>148</sup> Victoria Nugent, a Cohen Milstein partner, also is a member of Public Justice's Executive Committee, and Theodore J. Leopold, another partner, previously served as president of Public Justice.<sup>149</sup> We found no indication in the record that these potential conflicts were disclosed to the class or to the court.

The data also reveal an instance of a close connection between a defendant and a cy pres recipient. In *Kaplan v. S.A.C. Capital Advisors, L.P.*,<sup>150</sup> the approved settlement designated a cy pres recipient selected by the defendant's founder, Steve Cohen.<sup>151</sup> The court subsequently approved a motion for cy pres distributions to The Robin Hood Foundation and Team Rubicon,<sup>152</sup> and a cy pres distribution was ultimately made to each.<sup>153</sup> At the time, Cohen was an emeritus board member at Robin Hood,<sup>154</sup> and Team Rubicon was a recipient of funds from the Steve and Alexandra Cohen Foundation.<sup>155</sup> Again, we found no indication in the record that these potential conflicts were disclosed to the class or to the court.

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<sup>147</sup> Opinion & Order at 2, *In re Braskem S.A. Secs. Litig.*, No. 1:15-CV-05132 (S.D.N.Y. Sept. 8, 2015), ECF No. 24.

<sup>148</sup> Order Directing Cy Pres Distribution of Residual Settlement Funds at 1, *In re Braskem S.A. Secs. Litig.*, No. 1:15-CV-50132 (S.D.N.Y. Dec. 6, 2019), ECF No. 146.

<sup>149</sup> See *Public Justice Board*, PUB. JUST., <https://www.publicjustice.net/who-we-are/team/public-justice-board/> (last visited July 21, 2024). Public Justice was named as a cy pres recipient in eight cases in our dataset. In six of those cases, Federman Sherwood was class counsel. (Federman Sherwood was class counsel in seven total cases in our dataset.) Although we did not find an obvious connection between Federman Sherwood and Public Justice, such repetitive conduct deserves further scrutiny.

<sup>150</sup> *Kaplan v. S.A.C. Cap. Advisors L.P.*, No. 12-CV-09350, 2015 WL 5730101 (S.D.N.Y. Sept. 10, 2015).

<sup>151</sup> Stipulation and Agreement of Settlement at 27, *Kaplan v. S.A.C. Cap. Advisors, L.P.*, No. 1:12-CV-09350 (S.D.N.Y. Nov. 30, 2016), ECF No. 350-1; Marcia Vickers, *The Most Powerful Trader on Wall Street You've Never Heard Of*, BLOOMBERG (July 20, 2003, 11:00 PM), <https://www.bloomberg.com/news/articles/2003-07-20/the-most-powerful-trader-on-wall-street-youve-never-heard-of> (identifying Steven A. Cohen as the founder of S.A.C. Capital Advisors).

<sup>152</sup> Class Distribution Order at 3, *Kaplan v. S.A.C. Cap. Advisors, L.P.*, No. 1:12-CV-09350 (S.D.N.Y. Sept. 20, 2018), ECF No. 425 (approving the distributions); Plaintiffs' Memorandum of Law in Support of Motion for Class Distribution Order at 6, *Kaplan v. S.A.C. Cap. Advisors, L.P.*, No. 1:12-CV-09350 (S.D.N.Y. Mar. 21, 2018), ECF No. 411 (identifying the recipients and noting the recipients were "designated by the SAC Capital defendants").

<sup>153</sup> Letter addressed to Judge Naomi Reice Buchwald from Ethan Wohl at 1, *Kaplan v. S.A.C. Cap. Advisors, L.P.*, No. 1:12-CV-09350 (S.D.N.Y. Sept. 20, 2019), ECF No. 430.

<sup>154</sup> See *Board of Directors*, ROBIN HOOD, <https://www.robinhood.org/about-us/governance/> (last visited July 21, 2024); *Steven A. Cohen*, MILKEN INST., <https://milkeninstitute.org/events/gc19/speakers/37485> (last visited July 21, 2024).

<sup>155</sup> See 2022 Annual Report, TEAM RUBICON 49 <https://teamrubiconusa.org/app/uploads/2023/09/2022AnnualReport.pdf> (last visited July 21, 2024).

We report these potential conflicts anecdotally rather than systematically because we cannot claim to have made a thorough investigation of all potential conflicts. This anecdotal approach is conservative in that it likely underreports the incidences of conflicted cy pres recipients in our dataset.

### III. IMPLICATIONS AND EXPLANATIONS

Our data validate multiple concerns previously expressed in the literature over cy pres awards as undersupervised and inappropriately allocated. This Part addresses these concerns first by considering their doctrinal implications and then by discussing the causes of this challenging situation.

#### A. Doctrinal Implications

Cy pres originally developed as a “next best” alternative to satisfying claimant interests.<sup>156</sup> Yet our data show millions of dollars being diverted from the class to organizations unlikely to use the funds to advance claimants’ litigation interests, and to organizations likely to advance class counsel’s or other nonclass participants’ interests.

Practice breeds precedent. As lower courts approve distributions to unrelated charities, or to conflicted charities, those approvals are cited to support future distributions to similarly unrelated charities, thereby drifting cy pres even further from its traditional moorings. We see evidence of this phenomenon in the dockets. In *Nathanson v. Polycom, Inc.*,<sup>157</sup> class counsel—Pomerantz—sought approval to distribute residuals to ILEP and asserted, as support, that “[n]umerous courts have awarded *cy pres* funds to ILEP.”<sup>158</sup> As an example of “numerous courts,” Pomerantz cited to *In re Delcath Systems, Inc. Securities Litigation*,<sup>159</sup> in which Pomerantz also was class counsel.<sup>160</sup>

Distributions to recipients with self-dealing conflicts risk causing harm to class members by diverting class property to recipients who will not use it to advance the class’s interests. This practice can harm the courts by eroding public perceptions of judicial neutrality. We do not contend that all conflicted distributions generate these harms. We can foresee circumstances in which a conflicted recipient remains the next best alternative to class distribution.

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<sup>156</sup> See *supra* text accompanying notes 82–87.

<sup>157</sup> *Nathanson v. Polycom, Inc.*, No. 4:13-CV-03476, 2015 WL 12964727 (N.D. Cal. Apr. 16, 2015).

<sup>158</sup> See Lead Plaintiffs’ Motion for an Order Designating Cy Pres Recipients at 1, *Nathanson v. Polycom, Inc.*, No. 4:13-CV-03476 (N.D. Cal. Mar. 19, 2018), ECF No. 131.

<sup>159</sup> *Id.*; *In re Delcath Sys., Inc. Secs. Litig.*, 36 F. Supp. 3d 320 (S.D.N.Y. 2014).

<sup>160</sup> *In re Delcath Sys., Inc. Secs. Litig.*, 36 F. Supp. 3d at 324.

Whether these harms actually occur requires further study. But our data identify multiple appearances of conflicts that should be scrutinized closely by judges and regulated by the law.

One source for regulation is in Rule 23 itself, which imposes duties on class counsel to “fairly and adequately represent the interests of the class.”<sup>161</sup> The court also has duties under Rule 23 to ensure fair treatment of the absent class members.<sup>162</sup> Each of these duties extends to cy pres practice, which is a part of the court-approved settlement. In theory, Rule 23 should provide a check on inappropriate cy pres distributions. Professor Bone has dismissed theoretical cy pres problems on this ground: “if there is a problem, the solution is obvious: bar judges from choosing beneficiaries with which they or any of the lawyers have had a relationship.”<sup>163</sup>

We agree that Rule 23 authorizes—even instructs—courts to regulate cy pres practice and enforce compliance with cy pres norms. But our data suggest that courts largely do not. To repeat, only 142 of the 373 settlements require, in the settlement-approval order, court preapproval of a cy pres recipient.<sup>164</sup> And only 43%—fewer than half—show any public record of the identity of a cy pres recipient.<sup>165</sup> Even when cy pres recipients are selected and approved by the court, many appear to have little relationship to the interests of the class.<sup>166</sup> Why?

### B. *Theoretical Explanations*

We theorize that the predominant explanation is benign neglect, or, more academically, rational apathy. By the time a distribution to a cy pres recipient is ready, the case has long since settled, the parties are in a nonadversarial posture, the settlement administrator has been running the day-to-day administration of the claims process, the class members and representatives have been fully compensated within logistical limits, and the judge generally has moved on to

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<sup>161</sup> FED. R. CIV. P. 23(g)(4).

<sup>162</sup> *E.g.*, FED. R. CIV. P. 23(e)(2) (stating that a court may approve a settlement “only on finding that it is fair, reasonable, and adequate” to the class).

<sup>163</sup> Bone, *supra* note 22, at 579. *See also* Smoger, *supra* note 74, at 602 (urging “the consistency and vigilance of judicial oversight in scrutinizing and, as required, preventing abuses”); *id.* at 604 (“Indeed, even after selection, the court has a continuing obligation to monitor the distribution of the class’s funds. . . . Once proffered by class counsel and class representatives, it becomes the court’s obligation to scrutinize that selection. Ultimately, then, it is the court that has the duty to ensure that class counsel and the class representatives have diligently and fairly assessed the need for *cy pres* and then properly chosen the *cy pres* recipients.”).

<sup>164</sup> *See supra* Part II.A.

<sup>165</sup> *See id.*

<sup>166</sup> *See supra* Part II.B.

more pressing matters. In most cases, the cy pres distribution represents a small fraction of the overall settlement fund.<sup>167</sup> In these circumstances, parties are likely to propose organizations with which they are familiar, or even have a close relationship, as a low-cost heuristic for identifying a potential recipient.<sup>168</sup> Meanwhile, the judge may exhibit an indifference toward this last step before complete resolution of the settlement estate.<sup>169</sup> Under these circumstances, and applying a charitable interpretation of class-counsel motives, class counsel is likely to select a known recipient without much additional investigation of the recipient's appropriateness and without much concern for what counsel may see as superficial conflicts of interest, knowing that the judge will likely give only cursory scrutiny to counsel's proposal.<sup>170</sup> This theory is consistent with much of our data.

Our hypothesis is generalized, and we remain open to the possibility, even likelihood, that less benign motivations drive the selection of recipients in specific cases. We think this area ripe for further empirical investigation of motivational influences, and, in the next Part, we urge interventions to shed more light on the relevant circumstances.

#### IV. SOLUTIONS

Benign neglect or not, remedies exist. We consider multiple solutions that would promote greater scrutiny and disclosure and better selection of recipients for class-settlement residuals. Our general principles urge attention to the goals of the class, front-end controls, back-end transparency, and concrete guidelines for rulemaking consideration or for the development of best practices.

##### A. *Avoiding Cy Pres Via a Lottery*

If the class goals are primarily compensatory for the class members themselves, then a lottery distribution to one or more existing class members should be considered over any cy pres distribution.<sup>171</sup> A lottery system “treats

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<sup>167</sup> In our dataset, the vast majority of cy pres amounts represented a very small percentage of the full settlement—on average, roughly four hundredths of one percent of the total settlement pool. See *supra* notes 136–38 and accompanying text.

<sup>168</sup> Cf. DANIEL KAHNEMAN, THINKING, FAST AND SLOW 7 (2015) (discussing the availability heuristic).

<sup>169</sup> See Wasserman, *supra* note 68, at 157.

<sup>170</sup> See *id.* (noting widespread judicial indifference to cy pres proposals).

<sup>171</sup> See generally Lavie, *supra* note 78, at 1068 (describing a lottery distribution as a method of addressing class-action residual funds).

class members equitably relative to each other”<sup>172</sup> because each class member has a pro-rata chance, proportionate to the size of the class member’s claim, at receiving the residual amount.<sup>173</sup> This approach is also easy and efficient to implement because it results in the payment of the residual through a single transfer, or a small number of transfers, to existing class members who already have submitted valid claims.<sup>174</sup> This approach also eliminates all concerns over conflicts of interest with potential third-party recipients and obviates the need to consider the appropriateness of the recipient under cy pres doctrine.<sup>175</sup> Further, by creating a “lottery ticket” potential for every claimant, this mechanism could induce a greater claims rate, particularly among smaller claimants.<sup>176</sup> In that case, the lottery-allocation approach would likely also reduce the size of the residual because it would increase the amount actively distributed to claimants.

We do not rush to call the lottery option a panacea. Various circumstances may render a lottery inappropriate or infeasible in a particular case, or a court may determine that additional class distribution does not enhance the goals of the class.<sup>177</sup> We also recognize the ex post optics of one or more individual class members receiving a fortuitous windfall, even though the lottery chance is fairly allocated ex ante. However, we see some promise in the use of a lottery-based approach as a pragmatic, least-bad solution to the residual problem, especially in compensation-driven cases. For now, we mean only to introduce the lottery option into the mix as a potential superior solution to the problem of residual distribution.

#### *B. Party Identification and Court Approval of Cy Pres Recipients*

If a settlement follows the traditional model in which a cy pres recipient is proposed and approved, we suggest multiple enhancements to the process. Although not explicitly required by Rule 23, no cy pres distribution should be made without prior party proposal and court approval of the identity of the recipient and amount to be distributed. It is insufficient to propose and get approval of, as many settlement documents do, only a generic cy pres recipient, such as a “non-sectarian, not-for-profit organization,” without further approval

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<sup>172</sup> FED. R. CIV. P. 23(e)(2)(D) (stating that a settlement can be approved only if it “treats class members equitably relative to each other”).

<sup>173</sup> See Lavie, *supra* note 78, at 1079.

<sup>174</sup> See *id.* at 1074.

<sup>175</sup> See *id.* at 1075.

<sup>176</sup> See *id.* at 1073.

<sup>177</sup> See *id.* at 1083.

from the court.<sup>178</sup> That generic identification gives no information about the appropriateness of the recipient in terms of relatedness or conflicts. Nor does it disclose the amount distributed. That language also abdicates the court's responsibility to ensure the appropriateness of the cy pres recipient for the benefit of the class.<sup>179</sup> Instead, when a cy pres distribution is ready, class counsel or the settlement administrator should file with the court a proposal for distribution that identifies the specific recipient and amount to be distributed.

Some commentators argue that the parties should be required to provide a specific identification of the cy pres recipient in the settlement proposal so that the class members, who are provided notice of the settlement, can object to the recipient.<sup>180</sup> We see the value in giving class members notice and a voice in the cy pres selection process. After all, class members are in a good position to evaluate whether the proposed recipient is likely to advance their legal interests, and it is, at the end of the day, their money that is being distributed.<sup>181</sup>

However, we recognize the concern that defendants can exert undue influence over the cy pres selection at the time of settlement, as in *Lane v. Facebook*<sup>182</sup> and, in our dataset, as in *S.A.C. Capital*.<sup>183</sup> Concern also exists over the logistics of requiring cy pres identification at the time of settlement because cy pres distributions often occur at the end of a protracted administration.<sup>184</sup> The particular recipient identified at the outset may have shifted its priorities—and may not even exist anymore—by the time a distribution is ready.<sup>185</sup> New conflicts between the recipient and existing parties may arise that render distribution problematic. In short, the long lag time of many settlement administrations presents the risk that the initial cy pres recipient will no longer be appropriate by the time of distribution.

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<sup>178</sup> *E.g.*, Order for Distribution of Class Settlement Funds at 2, *Sood v. Pharma. Partners, Inc.*, No. 1:13-CV-23878 (S.D. Fla. Aug. 20, 2015), ECF No. 155.

<sup>179</sup> *Id.* (failing to require any subsequent filing with the court concerning distribution).

<sup>180</sup> *See Wasserman, supra* note 68, at 151–52.

<sup>181</sup> *See id.*

<sup>182</sup> For a discussion of *Lane*, see *supra* text accompanying note 127.

<sup>183</sup> For a discussion of *S.A.C. Capital*, see *supra* text accompanying notes 150–155.

<sup>184</sup> *See supra* text accompanying notes 64–87 (documenting the process of settlement administration and, ultimately, the use of cy pres to dispose of residuals).

<sup>185</sup> *E.g.*, Letter addressed to Judge Edward J. Davila from Matthew L. Tuccillo at 1, *In re KaloBios Pharma., Inc. Secs. Litig.*, No. 5:15-CV-05841 (N.D. Cal. Sept. 4, 2019), ECF No. 158 (advising the court that the original recipient identified in the settlement agreement was no longer operational by the time a cy pres distribution was ready).

Further, we believe class counsel, the settlement administrator, and the court are adequately positioned to assess the class's legal interests without assistance from particular class objectors. There is legitimate concern that objector litigation over a cy pres recipient will give rent-seeking objectors excess leverage at the settlement-approval stage. We acknowledge unusual cases, such as cy-pres-only settlements, in which cy pres recipients should be identified at the settlement stage and be subject to challenge.<sup>186</sup> But in the normal course, the most appropriate time for proposal and approval of the cy pres recipient and distribution amount is likely immediately prior to distribution.

Regardless of timing, our primary argument is that a docket-filed disclosure of the proposed recipient and prior court approval are essential. We believe sunlight is the best disinfectant here: forced transparency will serve both as a reminder of the importance of cy pres norms and obligations to the class and as a deterrent to lax attitudes that may develop as the case nears its conclusion.<sup>187</sup>

### C. *Proof of Appropriateness*

Parties proposing a cy pres distribution should provide sufficient information to the court to demonstrate that the cy pres recipient is appropriate under the "next best" standard and should identify any and all conflicts.<sup>188</sup>

In particular, parties should document for the court how the cy pres recipient meets the "next best" standard in light of other plausible alternatives.<sup>189</sup> The parties should specifically identify the legal interests of the class advanced in the case, such as compensation and future deterrence, and show how the cy pres recipient's receipt of settlement funds furthers those interests.<sup>190</sup> An affidavit from a proposed cy pres recipient committing to specific uses of the funds could be helpful for the court, but the burden remains on class counsel, which has the legal obligation to act in the class's interests.<sup>191</sup>

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<sup>186</sup> See generally Bone, *supra* note 22 (discussing cy-pres-only settlements).

<sup>187</sup> Cf. Alexandra Lahav, *Fundamental Principles for Class Action Governance*, 37 IND. L. REV. 65, 121 (2003) ("Class counsel may behave differently when the prospect of transparency looms over them, and thus results may be improved *ex ante*.").

<sup>188</sup> See *supra* note 108 and accompanying text (describing the "next best" standard).

<sup>189</sup> See *id.*

<sup>190</sup> See Wasserman, *supra* note 68, at 151 (proposing that "class counsel should identify the charity or charities to which it proposes to donate the unclaimed or non-distributable funds; report on the charity's record of service; [and] explain how the charity's interests align with those of the class").

<sup>191</sup> FED. R. CIV. P. 23(g)(4) ("Class counsel must fairly and adequately represent the interests of the class.").

For certain types of legal claims, the imposition of a set of default presumptions regarding the “next best” standard could help guide the parties and focus judicial discretion. Presumptions should depend upon what the class goals—customarily compensation and deterrence—primarily are.<sup>192</sup>

We illustrate the general principle of presumptive cy pres selectees by proposing presumptive selectees for securities-fraud class settlements. If a securities class’s goals are primarily compensatory for fraud victims generally, then distribution to the Securities and Exchange Commission’s Fair Fund should be presumptively selected.<sup>193</sup> The Fair Fund is statutorily authorized to accept residuals from private class-action securities-fraud cases, which the Fund then can distribute to investors who have been harmed by similar securities frauds.<sup>194</sup> Court orders for cy pres distributions to the Fund can come with instructions that the Commission exercise its best efforts to distribute to investors reasonably similar to members of the class in the settlement giving rise to the residual.<sup>195</sup>

If a class’s goals are primarily deterrence-related, public regulatory entities like Financial Industry Regulatory Authority (FINRA) or private nonprofits with dedicated regulatory-compliance missions should be presumptively selected.<sup>196</sup>

If a class’s goals are a combination of compensation and deterrence, then, especially for low-value harms that are at risk of going unremedied, a law-school clinic or a private nonprofit offering representation to similar kinds of investors for similar claims in the same geographic area should be presumptively selected.<sup>197</sup> There should be a strong presumption against otherwise worthy charities like food banks and other groups that have little connection to securities-class interests.

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<sup>192</sup> E.g., David Rosenberg, *Decoupling Deterrence and Compensation Functions in Mass Tort Class Actions for Future Loss*, 88 VA. L. REV. 1871, 1874 (2002) (discussing these goals in the mass-torts context).

<sup>193</sup> Fair Funds for Investors, 15 U.S.C. § 7246(b) (2018) (“The Commission is authorized to accept, hold, administer, and utilize gifts, bequests and devises of property, both real and personal, to the United States for a disgorgement fund or other fund described in subsection (a). Such gifts, bequests, and devises of money and proceeds from sales of other property received as gifts, bequests, or devises shall be deposited in such fund and shall be available for allocation in accordance with subsection (a).”).

<sup>194</sup> *Id.*

<sup>195</sup> See *supra* note 108 and accompanying text (describing the “next best” standard).

<sup>196</sup> See generally *About FINRA*, FINRA, <https://www.finra.org/about> (last visited July 7, 2024) (“FINRA is dedicated to protecting investors and safeguarding market integrity in a manner that facilitates vibrant capital markets.”).

<sup>197</sup> We make our own conflict disclosures here: each of us is employed at a law school that houses clinics that could fit the definition we propose above. Neither of us has any direct stake in or role with those clinics, but we recognize and disclose that cy pres donations to those clinics could indirectly benefit us by benefiting our institutions. For the same reason, we disclose that one of us (Scott Dodson) is an active arbitrator for FINRA.

Class members may have varied interests in compensation or deterrence, and class actions may seek to advance multiple interests.<sup>198</sup> We submit that it is the burden of class counsel, in light of counsel's fiduciary obligations to the class, to articulate the class's interests to the court. If the class has multiple interests, class counsel can suggest allocating portions of the residual to different recipients. For example, class counsel can propose allocating the residual in proportion to the weighted interests of the class, e.g., 50% distributed by lottery, 25% to the Fair Fund, and 25% to a law-school clinic. We do not believe such allocations need be perfectly representative of the actual class interests, if such a calculation can even realistically be made. But forcing class counsel to articulate the interests of the class and to propose recipients that further those interests can help better guide the selection of appropriate recipients.

Parties must also document for the court all connections the proposed recipient has to the named parties, lawyers, settlement administrators, and the judge. Any whiff of self-dealing should be met with some skepticism and addressed in the court order. We decline to advocate for a hard prohibition on distributions to conflicted recipients. The class-counsel community is small and tends toward common ancillary activities. A conflicted recipient could well be the "next best" alternative for the class. We do stress that conflicts necessarily should raise concerns that must be alleviated before approval, and that the burden to show that those conflicts are alleviated rests with class counsel.

As an alternative reform measure, Professor Rhonda Wasserman has proposed that the court appoint an objector or devil's advocate to oppose the cy pres.<sup>199</sup> We appreciate concerns that the lack of adversarialism may lead to insufficient scrutiny of the appropriateness of the cy pres recipient.<sup>200</sup> But we do not support Professor Wasserman's proposal. The logistics of appointing an objector are too cumbersome and expensive in light of the amounts at stake, which, in our sample, average under \$20,000.<sup>201</sup> We worry about how the objector will be recruited and compensated, how the objector will get information useful to the objector's role (e.g., discovery?), and additional costs generated by this process.<sup>202</sup> We do, however, agree with Professor Wasserman

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<sup>198</sup> See Wasserman, *supra* note 68, at 110 (listing compensation, deterrence, and disgorgement as objectives of class-action settlements).

<sup>199</sup> *Id.* at 155; see also William B. Rubenstein, *The Fairness Hearing: Adversarial and Regulatory Approaches*, 53 UCLA L. Rev. 1435, 1453–56 (2006); Lahav, *supra* note 187, at 128; Susan P. Koniak & George M. Cohen, *Under Cloak of Settlement*, 82 VA. L. REV. 1051, 1109 n.190 (1996).

<sup>200</sup> See Wasserman, *supra* note 68, at 154 (citing this concern as justification for her objector proposal).

<sup>201</sup> *Id.* at 155–57 (listing necessary disclosures to be made by a court-appointed objector and the requirement that the court allow the objector to take discovery).

<sup>202</sup> See *id.* (detailing the objector's duties).

that the judge should approve the cy pres distribution only after finding, in a written order, that the recipient is appropriate under these standards.<sup>203</sup>

#### *D. Enforcement*

Courts can enforce our suggested reforms prospectively through ex ante specific orders and retrospectively through sanctions and other controls. Because class settlements demand heightened scrutiny,<sup>204</sup> and because Rule 23 gives courts broad authority to issue orders to manage the action,<sup>205</sup> courts should communicate early the expectation that parties must be transparent and communicative regarding cy pres. A model worthy of emulation is the Northern District of California’s Procedural Guidance for Class Action Settlements,<sup>206</sup> adopted in November 2018 and amended several times thereafter, which urges at the preliminary-approval stage:

If the settlement contemplates a cy pres award, the parties should identify their chosen cy pres recipients, if any, and how those recipients are related to the subject matter of the lawsuit and the class members’ claims. The parties should also identify any relationship they or their counsel have with the proposed cy pres recipients.<sup>207</sup>

The Guidance also urges the parties to file a post-distribution accounting documenting “the amounts distributed to each cy pres recipient.”<sup>208</sup>

Although it has had mixed success, the Guidance has increased transparency about cy pres distributions, especially when coupled with a specific order from the assigned judge directing the parties to comply with the Guidance.<sup>209</sup>

Absent a detailed and comprehensive standing order, courts should, when entering a settlement-approval order, include in the order a directive to the parties to comply with cy pres distribution expectations, including obtaining specific approval from the court, with full disclosure of all relevant cy pres information, prior to any cy pres distribution.<sup>210</sup>

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<sup>203</sup> *Id.* at 157–58 (proposing “that trial courts be required to make findings on certain issues before approving cy pres distributions” because “courts will take their responsibilities especially seriously when they are required to justify their conclusions in writing and when they can expect scrupulous appellate review”).

<sup>204</sup> *Amchem Prods., Inc. v. Windsor*, 521 U.S. 591, 620 (1997).

<sup>205</sup> FED. R. CIV. P. 23(d).

<sup>206</sup> U.S. DIST. CT., N. DIST. OF CAL., *supra* note 9.

<sup>207</sup> *Id.* Preliminary Approval § 8.

<sup>208</sup> *Id.* Post-Distribution Accounting § 1(a).

<sup>209</sup> *Prince et al.*, *supra* note 12, at 6–7.

<sup>210</sup> *See* FED. R. CIV. P. 23(e)(2)(C)(ii) (directing the court to consider “the effectiveness of any proposed method of distributing relief to the class, including the method of processing class-member claims”).

To enforce cy pres disclosures ex post, a court can withhold approval of a percentage of counsel or administrator fees until proper disclosure filings are completed.<sup>211</sup> Such power is consistent with the authority Rule 23 grants to the district judge in regulating attorney's fees.<sup>212</sup> In existing cases in which no indication of a cy pres distribution appears in the docket, courts should issue show-cause orders to determine whether a distribution was made.

In addition, sanctions are available to enforce compliance with cy pres norms or orders. Sanctions can remedy violations of a court order under the civil-contempt power<sup>213</sup> and misrepresentations in filed papers under Rule 11.<sup>214</sup> Absent a violation of a court order or a misrepresentation under Rule 11, it is not clear that sanctions are available for inappropriate cy pres distributions.

Rule 23 imposes a duty on class counsel to "fairly and adequately represent the interests of the class."<sup>215</sup> We believe that class counsel violates this duty when enabling a distribution to an inappropriate cy pres recipient. But it is debatable as to whether the court has authority to enforce this duty—which is owed to the class members—through sanctions. We do believe that courts can take prior inappropriate cy pres distributions into account when considering whether to appoint that counsel in future class actions,<sup>216</sup> but such a sanction seems too light to us. Accordingly, to ensure that back-end sanctions are available, we urge courts to use the ex ante method described above of ordering the parties to disclose all appropriate information about proposed cy pres distributions prior to actual distribution.

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<sup>211</sup> Wasserman, *supra* note 68, at 145 ("[T]he court could simply delay awarding attorneys' fees until after the close of the claims period. Only then would it know the actual amount of the settlement fund distributed to class members and the amount distributed cy pres.").

<sup>212</sup> See FED. R. CIV. P. 23(h)(1) ("A claim for an award [of attorney's fees] must be made by motion . . . at a time the court sets.").

<sup>213</sup> See *Inst. of Cetacean Rsch. v. Sea Shepherd Conservation Soc'y*, 774 F.3d 935, 945 (9th Cir. 2014) (defining civil contempt as "a party's disobedience to a specific and definite court order by failure to take all reasonable steps within the party's power to comply").

<sup>214</sup> FED. R. CIV. P. 11(b).

<sup>215</sup> FED. R. CIV. P. 23(g)(B).

<sup>216</sup> FED. R. CIV. P. 23(g)(1)(ii) (directing the court to consider "counsel's experience in handling class actions"); FED. R. CIV. P. 23(g)(1)(B) (allowing the court to consider "any other matter pertinent to counsel's ability to fairly and adequately represent the interests of the class").

## V. CASE ILLUSTRATIONS

We illustrate these principles in action using cases from our dataset. The first set of cases illustrates circumstances surrounding problematic cy pres distributions. The second subsection describes one case that properly adheres to the cy pres guidelines we have proposed.

A. *Problematic Cases*

In *In re ITT Educational Services, Inc. Securities Litigation (Indiana)*,<sup>217</sup> the court approved distribution of a settlement fund, stating “if a second distribution is not economically feasible, the balance of the Net Settlement Fund shall be donated to an appropriate non-profit organization designated by Lead Counsel.”<sup>218</sup> That order appears to give class counsel permission to distribute residuals to cy pres recipients without further court authority. Although the order does constrain the selection of a cy pres recipient to “appropriate non-profit” organizations,<sup>219</sup> the court’s failure to insist on judicial preapproval leaves little practical constraint on class counsel’s selection. In this case, although no record of a cy pres selection or distribution appears in the docket, we obtained evidence that a cy pres distribution was, in fact, made to Gleaners Food Bank of Indiana in the amount of \$13,383.45.<sup>220</sup> Gleaners Food Bank’s mission is to “be a leader in the fight against hunger.”<sup>221</sup> While laudable, this mission appears to have no connection to the securities issues involved in the case or to the interests of the class, which consisted of certain shareholders of ITT Educational Services.<sup>222</sup> There is also no information as to whether class counsel has a relationship to the cy pres recipient.

Similarly, in *Silverstrand Investments v. AMAG Pharmaceuticals, Inc.*,<sup>223</sup> the court issued an order directing “that, if a second distribution is not economically feasible, the balance of the Net Settlement Fund shall be donated to one or more

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<sup>217</sup> *In re ITT Educ. Servs. Secs. Litig. (Ind.)*, No. 1:14-CV-01599, 2016 WL 1162534 (S.D. Ind. Mar. 24, 2016).

<sup>218</sup> Order Authorizing the Distribution of the Net Settlement Fund at 4, *In re ITT Educ. Servs. Secs. Litig. (Ind.)*, No. 1:14-CV-01599 (S.D. Ind. Nov. 21, 2017), ECF No. 114.

<sup>219</sup> *Id.*

<sup>220</sup> E-mail from CEO of an administrator to Scott Dodson, author (Nov. 6, 2023, 1:21 PM) (on file with author).

<sup>221</sup> *Our Story*, GLEANERS, <https://www.gleaners.org/our-story/> (last visited July 21, 2024).

<sup>222</sup> *ITT Educ. Servs.*, No. 1:14-CV-01599, 2016 WL 1162534 at \*1.

<sup>223</sup> *Silverstrand Invs. v. AMAG Pharms., Inc.*, No. 1:10-CV-10470, 2011 WL 3566990 (D. Mass. Aug. 11, 2011).

secular Section 501(c)(3) organization(s).”<sup>224</sup> As in *ITT Educational Services*, this order appears to allow a cy pres distribution without further approval by the court.<sup>225</sup> This order lacks even *ITT Educational Services*’s directive that the recipient be “appropriate.”<sup>226</sup> We obtained evidence that a cy pres distribution was, in fact, made to the Jessie Rees Foundation in the amount of \$50,000.<sup>227</sup> The Foundation is based in southern California, with a mission to support children battling cancer.<sup>228</sup> The class action was filed in Massachusetts and makes no allegations relating to cancer.<sup>229</sup> Again, there appears to be no rational relationship to the underlying litigation or to the interests of the class. There is also no information as to whether class counsel has any relationship to the recipient.

The dockets in these cases do not reflect any identification of the ultimate cy pres recipients, their connections to the interests of the class, or their connections to any of the participants in the litigation. Our own investigation reveals no connection between the cy pres recipients and the interests of the classes. Although we could not find any obvious conflicts of interest between the participants involved in the case and the cy pres recipients, we cannot rule them out. We surmise that, had class counsel been required to identify the proposed cy pres recipients to the court, along with an explanation of how the distribution would advance the interests of the class and disclosure of any conflicts of interest, the distributions could very well have been to different organizations. Arguably, the distribution in *ITT Educational Services*, to an organization unlikely to advance the interests of the class, violated the court order that the cy pres recipient be “appropriate.” The court would be warranted, in that case, in issuing a show-cause order as to why the food bank was designated by class counsel as an “appropriate” cy pres recipient.

We have also identified distributions to ILEP in cases in which Pomerantz was class counsel, and we documented some of the potential conflicts that relationship presented.<sup>230</sup> In those cases, we found no indication in the docket

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<sup>224</sup> Order Re: Distribution of Class Settlement Fund at 3, *Silverstrand Invs. v. AMAG Pharms., Inc.*, No. 10-CV-10470 (D. Mass. Sept. 21, 2017), ECF No. 176.

<sup>225</sup> *Id.*

<sup>226</sup> Compare *id.*, with Order Authorizing the Distribution of the Net Settlement Fund at 3, *In re ITT Educ. Servs. Secs. Litig. (Ind.)*, No. 1:14-CV-01599 (S.D. Ind. Nov. 21, 2017), ECF No. 114.

<sup>227</sup> E-mail from CEO of an administrator to Scott Dodson, author (Nov. 6, 2023, 1:21 PM) (on file with authors).

<sup>228</sup> *About – NEGU, JESSIE REES FOUND.*, <https://negu.org/about/> (last visited May 8, 2024).

<sup>229</sup> See generally Complaint, *Silverstrand Invs. v. AMAG Pharms., Inc.*, No. 1:10-CV-1047 (D. Mass. Mar. 18, 2010), ECF No. 1.

<sup>230</sup> See *supra* text accompanying notes 141–144.

that Pomerantz had disclosed those potential conflicts to the court. As with the other examples just presented, had class counsel disclosed its connections to ILEP, we suspect the court would have considered directing the residual funds to a different entity. In all these examples, the court is primarily responsible for setting a tone of disinterest in cy pres, such that cy pres selections are made without due attention to their purpose. Had the courts adopted solutions we propose in Part IV, we believe distributions of class funds would have been better aligned with class interests.

### B. *Successful Case*

In contrast to these problematic examples, *Nathanson v. Polycom, Inc.*,<sup>231</sup> despite being settled prior to the adoption of the Northern District’s Class-Settlement Guidance,<sup>232</sup> demonstrates that our proposed guidelines are both feasible and effective. We note that, of all the cases in our dataset, *Polycom* appears to be the only one in which the court rejected cy pres proposals multiple times.<sup>233</sup>

*Polycom* was a securities-fraud class action filed in 2013 in the Northern District of California.<sup>234</sup> Pomerantz was appointed lead counsel.<sup>235</sup> The court approved a settlement in September 2016.<sup>236</sup> Distributions commenced, and, in April 2017, the court ordered that the unclaimed balance remaining in the net settlement fund be “donated to a legal non-profit organization to be proposed by Lead Counsel and approved by the Court.”<sup>237</sup> The court’s instruction to class counsel to seek specific approval of a cy pres recipient served as an effective communication to counsel regarding the importance of cy pres transparency. It also established a foundation for the imposition of sanctions for noncompliance.

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<sup>231</sup> *Nathanson v. Polycom, Inc.*, 87 F. Supp. 3d 966 (N.D. Cal. 2015).

<sup>232</sup> See U.S. DIST. CT., N. DIST. OF CAL., *supra* note 9 (adopted in 2018).

<sup>233</sup> See Order Denying Plaintiff’s Motion for an Order Designating Cy Pres Recipients; Directing Further Submissions, *Nathanson v. Polycom, Inc.*, No. 4:13-CV-03476 (N.D. Cal. Mar. 22, 2018), ECF No. 132 (ordering plaintiffs to propose a cy pres recipient with no connections to law firms in the matter); Order to Show Cause RE Monetary Sanctions for Failure to Respond to Order Denying Motion for Cy Pres Designation, *Nathanson v. Polycom, Inc.*, No. 4:13-CV-03476 (N.D. Cal. Apr. 26, 2018), ECF No. 135.

<sup>234</sup> Complaint, *Nathanson v. Polycom, Inc.*, No. 4:13-CV-03476 (N.D. Cal. July 26, 2013), ECF No. 1.

<sup>235</sup> *Nathanson*, 87 F. Supp. 3d at 970.

<sup>236</sup> Final Judgment and Order of Dismissal with Prejudice, *Nathanson v. Polycom, Inc.*, No. 4:13-CV-03476 (N.D. Cal. Sept. 7, 2016), ECF No. 126.

<sup>237</sup> Order Re: Distribution of Class Settlement Funds at 2, *Nathanson v. Polycom, Inc.*, No. 4:13-CV-03476 (N.D. Cal. Apr. 28, 2017), ECF No. 130.

Settlement distribution continued until a residual of \$10,042 remained.<sup>238</sup> Counsel then proposed contributing the residual in equal amounts to the Bay Area Legal Aid Society and the Institute of Law and Economic Policy (ILEP).<sup>239</sup> Counsel disclosed that Marc Gross, a partner with Pomerantz, would be the next president of ILEP but argued that ILEP would “protect and promote the interests of class members in this case, as well as investors generally” because ILEP organizes conferences on securities law.<sup>240</sup>

The Court rejected ILEP as a recipient, stating:

Plaintiffs propose to allocate 50% of the remaining settlement funds to the Institute of Law and Economic Policy . . . . Plaintiffs indicate that next year a partner at Pomerantz LLP will serve as President of the ILEP. The record reflects that Pomerantz LLP represents plaintiffs in this matter. The Court requires plaintiffs to propose a cy pre recipient which has no connection to the law firms appearing in this matter.<sup>241</sup>

Class counsel then sought distribution of the residual to the Bay Area Legal Aid Society and the Center for Judicial Studies at Duke Law School,<sup>242</sup> and asserted, without additional support, that distributions to these entities “would be consistent with efforts to protect and promote the interests of class members in this case, as well as investors generally.”<sup>243</sup> Once again, the court rejected the designated recipients, this time on the ground that they would not advance the interests of the class.<sup>244</sup> Reasoning that “Cy Pres distributions must account for the nature of the plaintiffs’ lawsuit, the objectives of the underlying statutes, and the interests of the silent class members, including their geographic diversity,” the court concluded the proposed recipients did not appear to meet that standard and ordered class counsel to “recommend an appropriate entity or explain how the proffered awardees are related to the subject matter of the lawsuit.”<sup>245</sup>

Class counsel filed a third motion, seeking to designate the Investor Justice Clinic operated by the University of San Francisco School of Law as the cy pres

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<sup>238</sup> Lead Plaintiff’s Motion for an Order Designating Cy Pres Recipients, *Nathanson v. Polycom, Inc.*, No. 4:13-CV-03476 (N.D. Cal. Mar. 19, 2018), ECF No. 131.

<sup>239</sup> *Id.* at 1.

<sup>240</sup> *Id.* at 1–2.

<sup>241</sup> Order Denying Plaintiffs’ Motion for an Order Designating Cy Pres Recipients; Directing Further Submissions at 1, *Nathanson v. Polycom, Inc.*, No. 4:13-CV-03476 (N.D. Cal. Mar. 22, 2018), ECF No. 132.

<sup>242</sup> Now Bolch Judicial Institute of Duke Law School.

<sup>243</sup> Lead Plaintiffs’ Motion for an Order Designating Cy Pres Recipients at 2, *Nathanson v. Polycom, Inc.*, No. 4:13-CV-03476 (N.D. Cal. Apr. 11, 2018), ECF No. 133.

<sup>244</sup> Order Denying Motion re Cy Pres Awardees, *Nathanson v. Polycom, Inc.*, No. 4:13-CV-03476 (N.D. Cal. Apr. 16, 2018), ECF No. 134.

<sup>245</sup> *Id.*

recipient.<sup>246</sup> Counsel explained that the Clinic’s law students represent investors in actions, arbitrations, and other proceedings involving allegations of wrongdoing by securities firms.<sup>247</sup> Counsel added that the Clinic had been the recipient of prior cy pres awards.<sup>248</sup> This time, the court approved the proposed recipient and granted the distribution motion.<sup>249</sup>

Despite the fact that the cy pres amount was only around \$10,000, the court exercised appropriate scrutiny to avoid distributing funds to an entity potentially selected through self-dealing and to entities with no relationship to the class interests. The court’s efforts reflect the close attention to cy pres distributions warranted by the “next best” standard, and that close attention appears to have resulted in an appropriate cy pres selection. We note only that, had the court imposed in the settlement-approval order or in a subsequent order a presumption of cy pres designation—as we propose in Part IV—the court could have more efficiently avoided multiple rejections of class counsel proposals.

#### CONCLUSION

This paper sheds empirical light on an understudied but important facet of class-settlement administration: cy pres distributions. The data validate several theoretical concerns regarding cy pres practice, including the risk of distributions to unrelated or conflicted recipients. We theorize that our observations are caused primarily by benign neglect, but we cannot exclude the possibility of self-dealing by class counsel in a material number of settlements. To improve cy pres practice, we offer a set of normative solutions, including avoiding cy pres by considering distribution of residuals through a lottery in which the probabilities of success are weighted by the relative dollar values of each claimant’s recovery. For cy pres distributions, we urge greater involvement by the court, greater transparency from the parties, and the use of other presumptions for the selection of recipients. And we direct courts to the Northern District of California’s Guidance on class-action practice as a starting point for reforming cy pres practice.

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<sup>246</sup> See Lead Plaintiffs’ Motion for an Order Designating Cy Pres Recipients at 2, *Nathanson v. Polycom, Inc.*, No. 4:13-CV-03476 (N.D. Cal. Apr. 27, 2018), ECF No. 136.

<sup>247</sup> *Id.*

<sup>248</sup> *Id.* at 2. Interestingly, this motion was filed beyond the time ordered by the court because, according to class counsel, “[t]he motion was the responsibility of Marc I. Gross,” the Pomerantz partner who was to serve as President of ILEP, who “was engaged in organizing and running ILEP’s annual conference last week, and failed to give this matter the appropriate attention.” *Id.*

<sup>249</sup> Order Designating Cy Pres Recipient, *Nathanson v. Polycom, Inc.*, No. 4:13-CV-03476 (N.D. Cal. May 1, 2018), ECF No. 137.

## APPENDIX A

*Fields of Data Collected*

SCAC internal index number; issuer defendant; filing date of the first complaint; case docket ID; dollar amount of settlement; total amount of attorney's fees and expenses; attorney's fees award; attorney's expenses award; total attorney's fees and expenses as percentage of settlement; attorney's fees as percentage of settlement; attorney's expenses as percentage of settlement; court and judge where case was pending; case status;<sup>250</sup> the same information related to a second complaint (if one was filed); date of proposed settlement; date of settlement approval order; law firms involved; company providing claims administration for the settlement; company designated as cy pres recipient, including the first document and the date where the cy pres recipient was identified; dollar amount distributed to the cy pres recipient; the first document specifying the dollar amount and the date of filing of such document; date of a cy pres order, if any; date of the distribution order; identity of the plaintiff (individual or institutional investor); whether the claim administrator was granted the right to destroy the claims within a set period of time; and name and date of the review.

Each row represents a settlement (not necessarily a case, because multiple settlements could exist). Updated docket information from Bloomberg, but all public filings. Column F comes from an approved settlement agreement. Columns G–H come from filings for approved attorney's fees. In Column AE, "No" means no information in the docket.<sup>251</sup>

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<sup>250</sup> Except for one case, the status of all cases was "closed" as it appeared on the court docket.

<sup>251</sup> All data on file with the authors.