

FLUID RECOVERY AND CY PRES: A FUNDING SOURCE FOR LEGAL SERVICES

By Brad Seligman and Jocelyn Larkin

With cutbacks and restrictions in federal legal services funding a reality, the search for new funding sources for legal services and public interest law becomes even more imperative. One potential funding source has been largely underutilized: class actions. Through a seldom-used device known as fluid recovery or *cy pres*, grants or distribution of unclaimed class action settlement funds may provide a source of funding for public interest and legal services organizations whose work can be said to further the interests of the class.

The Fluid Recovery Doctrine

Fluid recovery is often called "*cy pres*" distribution, because it is a means of distributing unclaimed class funds to their "next best use." Although most cases using fluid recovery have been in the area of consumer protection or anti-trust, the principles governing *cy pres* distributions apply equally in civil rights and poverty law cases.

Typically, fluid recoveries are used in several different situations. Fluid recovery may be appropriate where individual recoveries for all class members are impossible or impractical, such as where a large number of consumers have suffered small monetary losses. It may also be used in situations where a defendant's conduct has made it difficult to identify class members. In these circumstances, outright grants to public interest organizations are made in order to ensure that the defendant does not enjoy a windfall as a result of its own illegal conduct.

Even where class members may be identifiable, fluid recovery may be used as a means of distributing unclaimed funds remaining in a settlement or damage fund. In virtually all class actions, there will be some class members who cannot be located because of stale addresses, who will choose not to make claims, or who will neglect to cash settlement checks. In such cases, the residual may be granted to a public interest organization. To allow left-over funds to revert to a defendant in such situations would not only be a windfall but might also create an incentive for a defendant to be less than totally cooperative in locating and distributing damages.

The California Supreme Court has recognized the propriety of fluid recovery funds. In State of California v. Levi Strauss & Co., 41 Cal.3d 460 (1986), it discussed the general rules, as well as the acceptable forms of fluid recovery that could be fashioned by a lower court. The Court noted that "trial courts should have the full range of alternatives at their disposal," and that disposition of the residue "is a matter within the discretion of the trial court." *Id.* at 479. The Court explained:

Fluid recovery may be essential to ensure that the policies of disgorgement or deterrence are realized. [Citation omitted.] Without fluid recovery, defendants may be permitted to retain ill-gotten gains simply because their conduct harmed large numbers of people in small amounts instead of small numbers of people in large amounts.

41 Cal.3d at 472.

Although the Court ultimately remanded the case for the disposition of the residue, it noted that amici's suggestion of a consumer trust fund had "considerable merit." *Id.* at 479-80. The suggested plan was the establishment of a nonprofit corporation which would administer the consumer trust fund, and engage in consumer protection projects, including research and litigation. *Id.* at 466. On remand, a \$4,000,000 California Consumer Protection Foundation was established to distribute the class residue. Subsequent Supreme Court cases have confirmed the availability of this remedy in class action cases. Kraus v. Trinity Management Services, 23 Cal.4th 116 (2000); Granberry v. Islay Investments, 9 Cal. 4th 738 (1995).

State Law – Code of Civil Procedure § 384

The California Legislature gave the *cy pres* doctrine an important boost with the enactment of Code of Civil Procedure § 384. Section 384 requires in class action cases a determination of the total amount payable to class members and a subsequent accounting of unpaid class funds, and specifies that such funds shall be subject to *cy pres* distribution. Section 384 was amended in 2001 to enhance the ability of the court to distribute the money to a variety of groups. The unpaid residue plus interest is to be paid to:

non-profit organizations or foundations to support projects that will benefit the class or similarly situated persons, or that promote the law consistent with the objectives and purposes of the underlying cause of action, to child advocacy programs, or to nonprofit organizations providing civil legal services to the indigent.

The statute expands the *cy pres* doctrine in two ways. First, the express legislative intent allows distribution "to promote justice for all Californians," a goal much broader than traditional *cy pres* which requires some nexus to the class. Second, the statute prohibits or substantially limits the possibility of a "reverter" of unclaimed funds to the defendant, and thus requires some form of *cy pres* in nearly all circumstances. See Granberry v. Islay Investments, 9 Cal.4th 738,750-751, and 760-761 (Kennard, J., dissenting)(1995). See also In re Vitamin cases, 107 Cal.App.4th 820 (2003) (so long as notice is given, § 384 does not require members of the class be allowed to make individual claims rather than awarding entire sum to charitable or non-profit organizations). While the statute exempts public entities and employees from its reach, it does not preclude recourse to traditional non-statutory *cy pres* remedies against such defendants.

Federal Law

Plaintiffs with California state law claims litigated in federal court under the pendent jurisdiction doctrine can plausibly argue that C.C.P. §384 is substantive and thus is applicable to a class case. Cf. Mangold v. PUC, 67 F.3d 1470 (9th Cir 1995) (state attorneys fee statute applied to state claims). Even without C.C.P. §384, however, there is favorable federal precedent for the use of the fluid recovery doctrine.

The Ninth Circuit approved the use of the *cy pres* doctrine in Six Mexican Workers v. Arizona Citrus Growers, 904 F.2d 1301 (9th Cir. 1990). There, the class members were undocumented workers who successfully proved violations of the Farm Labor Contractor Registration Act by defendant ACG, a non-profit marketing cooperative. The district court awarded \$1.8 million in

statutory damages, and adopted a fluid recovery plan for any unclaimed funds. The ACG objected that the class action was unmanageable because many class members could not be located. The court was unsympathetic to this contention, finding that this difficulty was attributable to defendant's own violation of statutory record-keeping requirements.

The Court also rejected defendant's argument that Ninth Circuit law prohibited fluid recovery, holding that "[f]ederal courts have broad discretionary powers in shaping equitable decrees for distributing unclaimed class action funds." The Court further held that "the district court's choice among distribution options should be guided by the objectives of the underlying statute and the interests of the silent class members," citing Levi Strauss, 904 F.2d at 1307. Ultimately, the Ninth Circuit disagreed with the district court's selection of the *cy pres* recipient, which it concluded was not the "next best" distribution, and remanded. Id. at 1308.

Many federal courts have concluded that legal organizations and law schools are the "next best" alternative for receipt of unclaimed settlement funds. In re Wells Fargo Securities Litigation, 991 F. Supp. 1193 (N.D. Cal. 1998)(approving distribution to law school securities program instead of bar association); Drennan v. Van Ru Credit Corp., 1997 U.S. Dist. LEXIS 7776 (N.D. Ill. 1997)(distribution to Mid-Minnesota Legal Assistance Foundation); In Re Folding Carton Litigation, 934 F.2d 323 (7th Cir. 1991)(over \$2 million to National Association for Public Interest Law); Jones v. National Distillers, 56 F.Supp. 2d 355 (S.D.N.Y. 1999)(allowing distribution to Legal Aid Society Civil Division despite "thin" tie to purpose of litigation fund).

Perhaps the most interesting use of *cy pres* distribution was made in Superior Beverage Co. v. Owens Illinois, 827 F.Supp. 477 (N.D.Ill. 1993), a glass container anti-trust action resulting in a \$2 million fund of unclaimed funds. The district court published a notice inviting grant applications for *cy pres* funds. The district court held a hearing with all applicants and ultimately distributed the money to fourteen non-profit legal groups, law schools and an art museum.

Some federal courts have limited the use of *cy pres* if the alternative of distribution to class members has not been fully exhausted. In re Holocaust Victim Assests Litigation, 311 F.Supp.2d 407 (E.D.N.Y. 2004) (objectors' proposal to allocate potential unclaimed funds to non-profit organizations via *cy pres* award rejected where funds for original *cy pres* awards not fully exhausted); In re Wells Fargo Securities Litigation, 991 F. Supp. 1193 (N.D. Cal. 1998)(modifying fluid recovery plan to require additional pro rata distribution to class members with shares large enough to justify expense); Weber v. Goodman, 1999 U.S. Dist. LEXIS 22832 (E.D.N.Y. 1998)(fluid recovery premature until damage funds fully distributed); Fogie v. Thorn, 190 F.3d 889 (8th Cir. 1999)(same). See also In re Matzo Food Products Litigation, 156 F.R.D. 600 (D.N.J. 1994)(refusing to approve class settlement with only *cy pres* distribution).

Most recently in Molski v. Gleich, 318 F.3d 937 (9th Cir. 2003), the Ninth Circuit rejected the proposed consent decree finding that it failed to protect the interests of absent class members because the *cy pres* award replaced individual damages. Id. at 954 (under the consent decree, class members could not pursue any claims unless for physical injury). The court found that in this case, "there is no evidence that proof of individual damages would be burdensome or that distribution would be costly." Id. at 955. Further, the court found that the *cy pres* award ran

afoul of the Rules Enabling Act by “circumventing individualized proof requirements and altering substantive rights at issue.” *Id.* The court did not rule on whether, in this circuit, *cy pres* awards could replace actual damages.

Finally, while a few federal courts have rejected the use of *cy pres* in class actions, these precedents involved an entirely different – and distinguishable – use of the doctrine. Specifically, courts have refused to allow the use of the *cy pres* doctrine as a means of overcoming manageability concerns – the difficulty of proving individual damages – raised at class certification. Windham v. American Brands, 565 F.2d 59, 72 (4th Cir. 1977); In re Hotel Telephone Charges, 500 F.2d 86, 89-90 (9th Cir. 1974); Eisen v. Carlisle & Jacquelin, 479 F.2d 1005, 1018 (2d. Cir. 1972); In re Phenylpropanolamine Products Liability Litigation, 214 F.R.D. 614 (W.D. Wash. 2003). These cases do not, however, undermine the use of *cy pres* in the more typical circumstances of unclaimed settlement funds.

LSC Grantee Use

Because some legal services organizations face restrictions on class action litigation, they may have limited ability to use a *cy pres* remedy except in settlements of non-class cases. However, such legal services organizations may nonetheless be the recipients of such grants in cases brought by private litigants and groups not subject to the class action limitations.

Practice Pointers

Successful class representatives should be able to make a strong argument for fluid recovery grants in appropriate circumstances. In non-class cases where court approval is not required, there is, of course, maximum flexibility in fashioning such relief, provided the defendant agrees. If done in the settlement context in a class action, the application for approval of the settlement should include information about the purposes and goals of the proposed grantee, and an explanation of how a grant would further the interests of the class. Generally, a grant broadly consistent with the statute, rather than a very narrow and geographically limited grant, is acceptable. Thus, in sex discrimination cases involving blue collar jobs, grants have been approved to nonprofit organizations who represent the interests of women in the trades generally; in housing litigation, grants to groups advocating for housing rights in Northern California have been approved in cases where the class is limited to a single city.

In selecting recipients, plaintiffs should take care that there is no conflict or appearance of a conflict of interest with the class. If, for example, the named plaintiff or its counsel is an organization, it should not name itself as a recipient of the unclaimed settlement funds. This circumstance might create an incentive for the named plaintiff to deter the filing of claims by class members and has the appearance of self-dealing. An alternative to specifying the *cy pres* beneficiary in the settlement is to establish a procedure for selecting the beneficiaries. Such procedures would include a notice mechanism for requesting proposals, criteria for selection, and ultimate judicial approval of the selection.

While elaborate reporting requirements are not required, it may make sense to anticipate a court's concern with financial accountability and supervision by advocating a plan with simple but

effective reporting requirements for the grantee.

In any event, settlement negotiators should adamantly resist any "reverter" of unclaimed funds to defendants or to the state. Such reverters undermine the deterrent effect of the action and, at least against private defendants, violate the spirit of Code of Civil Procedure §384.

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