# Tab H

# Memo Regarding Cy Pres or "Fluid Recovery" Awards in Texas Class Action Lawsuits

June 5, 2023

1. On August 1, 2022, Chief Justice Hecht assigned to the Supreme Court Advisory Committee consideration of adopting a rule of procedure relating the cy pres awards of funds in class action lawsuits brought in Texas courts. The Chief Justice's letter read:

> Texas Rule of Civil Procedure 42. At least eleven states have rules or statutes that expressly address distribution of residual class action funds to legal aid. Five of those states (Indiana, Kentucky, North Carolina, Pennsylvania, and South Dakota) require a minimum distribution to legal aid. Massachusetts requires notice to legal aid before the court enters judgment or approves a settlement-similar to a 2002 proposal from the Texas Access to Justice Commission. The Court now asks the Committee to consider whether to amend Rule of Civil Procedure 42 in line with other states and to draft any recommended amendments. The Committee's discussion at its September 21-22, 2002 meeting and *Highland Homes, Ltd. v. State*, 448 S.W.3d 403 (Tex. 2014) may inform its work.

Committee Chair Chip Babcock referred the matter to the Subcommittee on Rules 16-165a.

2. The cy pres award, sometimes called a "fluid recovery" award, is a practice that is widely used in class action proceedings in courts around the United States, but which is subject to controversy.

3. The cy pre doctrine, said to arise out of the Code of Justinian and later English law, in Law French is called "cy pres comme possible," meaning "as near as possible." When the charitable purpose of an irrevocable charitable trust becomes impossible to fulfill, a court might be required to terminate the trust. Under the cy pres doctrine, instead of terminating the trust, a court can alter the purpose of the charitable trust to keep it in force, provided that that alternative use is as close as possible to the settlor's original intent. As stated by the Internal Revenue Service:

> The cy pres doctrine is a principle of law that courts use to save a charitable trust from failing when a charitable objective is originally or later becomes impossible or impracticable to fulfill. In such a case, the court may

substitute another charitable object which is believed to approach the original charitable purpose as closely as possible. (The term cy pres comes from French law and means "so near" or "as near (as possible".)) This legal doctrine is based on the theory that a court has the power to revise a charitable trust where the maker (also called the creator, settlor, or - in the case of a trust under a will - testator) had a charitable intent in order to meet unexpected emergencies or changes in conditions which threaten the trust's existence.[1]

4. Early American case law was restrictive on the courts' power to change the terms of a charitable trust, but over time the doctrine has been loosened to give judges more latitude to change beneficiaries or terms of distribution. In the United States, trust law is primarily state law, and the approach of courts in applying cy pres varies. A number of states have adopted cy pres statutes. The Texas statute reads:

> Sec. 5.043. REFORMATION OF INTERESTS VIOLATING RULE AGAINST PERPETUITIES.
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> (a) Within the limits of the rule against perpetuities, a court shall reform or construe an interest in real or personal property that violates the rule to effect the ascertainable general intent of the creator of the interest. A court shall liberally construe and apply this provision to validate an interest to the fullest extent consistent with the creator's intent.
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> (b) The court may reform or construe an interest under Subsection (a) of this section according to the doctrine of cy pres by giving effect to the general intent and specific directives of the creator within the limits of the rule against perpetuities.
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> © If an instrument that violates the rule against perpetuities may be reformed or construed under this section, a court shall enforce the provisions of the instrument that do not violate the rule and shall reform or construe under this section a provision that violates or might violate the rule.

[1] <https://www.irs.gov/pub/irs-tege/eotopice81.pdf>, link to *the Cy Pres Doctrine: State Law and Dissolution of Charities* (1981).

> (d) This section applies to legal and equitable interests, including noncharitable gifts and trusts, conveyed by an inter vivos instrument or a will that takes effect on or after September 1, 1969, and this section applies to an appointment made on or after that date regardless of when the power was created.

The Texas statute tells the courts, in reforming or construing an interest in order to avoid the rule against perpetuities, to give effect to the "ascertainable general intent and specific directives of the creator ...."

5. According to one account, the idea of transporting cy pres to class actions law suits was first suggested in an article published by a Chicago law student.[2] The question was what to do with funds recovered from the defendant in a class-action suit that were not claimed by class members or could not feasibly be distributed to class members, due to inability to identify injured parties, or because the recovery was de minimis such that the cost of distribution would exceed the amount distributed. Something must be done with unclaimed funds. The choices are (I) return unclaimed funds to the defendant; (ii) let the funds escheat to the government; (iii) over-compensate known class members; or (iv) donate unclaimed funds to a third party, such as a charity or governmental or non-governmental entity. The doctrine of cy pres has been used to justify the fourth choice, turning over unclaimed funds to third parties. In practice recipients have varied from foundations or institutes who lobby or advocate or educate on the very issues embraced in the class action, to a local chapter of the American Board of Trial Advocates,[3] to law schools that were class counsel's alma maters, to charities in which the judge's spouse was a trustee,[4] to charitable foundations created as a result of the settlement of the class action in which the class-action defendant had a prominent management role, to the

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[2] Stewart R. Shepherd, *Damage Distribution in Class Actions: The Cy Pres Remedy*, 39 U. Chicago Law Review 448 (1971), this student article is credited as being first to mention cy pres in class action suits. See James R. Copeland, *Update: Cy Pres*, p. 3 (Manhattan Institute 2019).

[3] *Williams v. Heritage Operating, LP.,* Case No. 05-7822-C1-11, in the 6th Judicial Circuit of Penallas County, Florida Feb. 27, 2018 ($100,000 awarded to the ABOTA Foundation "for the benefit of the Tampa Bay Chapter of ABOTA" to be distributed in the discretion of the local chapter).

[4] *Nachshin v. AOL, LLC*, 663 F.3d 1034 (2011) (Judge's husband was one of fifty volunteer attorneys who served on the board of directors of the Legal Aid Foundation of Los Angeles, a cy pres grantee).

office of a state attorney general who was about to personally engage in a campaign for higher office.

6. If you opt for the fourth choice, to distribute the unclaimed funds to third parties, the question becomes first, who decides what third parties will receive the plaintiffs' money (i.e., class counsel and defendant vs. independent panel of advisors vs. the court), second, how to describe the trial judge's duty to ensure that the settlement and choice of non-party cy pres beneficiaries is not influenced by improper factors (i.e., require a hearing with evidence of how and why cy pres beneficiaries were chosen, with assurances from the non-party entity on how funds will be used), and third, how to empower appellate courts, through the standard of review, to provide meaningful oversight to the entire process (i.e., de novo review rather than abuse of discretion review). The inescapable problem is that the choice of cy pres recipients is at best a subjective policy choice, and policy preferences will vary from judge to judge, and from justice to justice. This variability can be somewhat reduced by a statute or rule of procedure that sets out the standard (how close the nexus must be between the cy pres recipient the harm addressed by the class action), and even more by nudging the parties and trial judges to consider a particular governmental entity (that provides legal services to the indigent), or in the extreme it can take away discretion (by mandating that all or part of a cy pres award be paid to a government agency that provides legal services to the indigent).

7. The essence of a class action is to aggregate individual claims that are unlikely to be asserted individually into an assemblage large enough to warrant the cost of litigation, with the hope of affording recoveries to members of the class to compensate for their losses when they otherwise likely would never receive compensation. With the rise of opt-out classes (where normally a very small percentage of potential plaintiffs opt out and those who do not opt out are therefore bound by the class action outcome), defendants in class action suits have the prospect of settling nearly all claims that could be brought individually in one settlement, if they can just get the consent of class representatives and class counsel and the approval of the judge overseeing the case. Even more problematic are class-action cases that settle with an agreement to certify a class, especially where class representatives and class counsel agree to expand the scope of the class to include more potential claimants who will be paid trivial sums. And even more problematic are class action settlements that are "cy-pres only," meaning that no class members receive compensation so that the damages paid by the defendant go first the class representatives and class counsel and the rest goes to charities or foundations or entities chosen by the class representatives, class counsel, and the class-action defendant, subject to the approval of the judge. In the cy-pres only instances, no injured party is

compensated for harm. Concerns about potential conflicts of interest in cy pres settlements are stated in the Amicus Brief of the Attorneys General of Arizona, Alabama, Alaska, Arkansas, Georgia, Idaho, Indiana, Louisiana, Michigan, Mississippi, Missouri, North Dakota, Ohio, Oklahoma, South Carolina and Texas, *Perryman v. Romero*, No. 18-1074, in the Supreme Court of the United States[5] (where class members get to share $225,000 and some arguably worthless coupons, while $3 to $9 million goes to cy pres recipients and $8.7 million goes to class counsel).

8. Some (perhaps many--there is no way to know how many) cy pres class-action settlements give money to NGOs whose activities closely align with the interests of the injured class. Some would say that the *least likely* way to ensure a close link between the interests of class members who do not claim their share of damages and the cy pres recipients who receive their unclaimed money is to allow settling class representatives and class counsel and the defendant in the class action to pick who gets the unclaimed funds, followed what has often proven to be lax oversight by trial judges. A lenient abuse-of-discretion standard of appellate review will allow many arrangements to pass muster that benefit the negotiating parties but not the owners of the funds who are being given away.

9. Several states have adopted class-action Cy Pres statutes, to make the state's policy on this practice clear. An example is California Code of Civil Procedure, which reads:

> CHAPTER 5. Permissive Joinder, Section 384.
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> (a) It is the policy of the State of California to ensure that the unpaid cash residue and unclaimed or abandoned funds in class action litigation are distributed, to the fullest extent possible, in a manner designed either to further the purposes of the underlying class action or causes of action, **or to promote justice for all Californians**. The Legislature finds that the use of funds for these purposes is in the public interest, is a proper use of the funds, and is consistent with essential public and governmental purposes.
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> (b) Except as provided in subdivision ©, before the entry of a judgment in a class action established pursuant to Section 382 that provides for the payment of money to members of the class, the court shall determine the total amount that will be payable to all class members if all class members

[5] <http://hlli.org/wp-content/uploads/2013/02/18-1074.state-AG-amicus.pdf>.

are paid the amount to which they are entitled pursuant to the judgment. The court shall also set a date when the parties shall report to the court the total amount that was actually paid to the class members. After the report is received, the court shall amend the judgment to direct the defendant to pay the sum of the unpaid residue or unclaimed or abandoned class member funds, plus any interest that has accrued thereon, to nonprofit 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 court shall ensure that the distribution of any unpaid residue or unclaimed or abandoned class member funds derived from multistate or national cases brought under California law shall provide substantial or commensurate benefit to California consumers. For purposes of this subdivision, "judgment" includes a consent judgment, decree, or settlement agreement that has been approved by the court.

© This section shall not apply to any class action brought against any public entity, as defined in Section 811.2 of the Government Code, or against any public employee, as defined in Section 811.4 of the Government Code. However, this section shall not be construed to abrogate any equitable cy pres remedy that may be available in any class action with regard to all or part of the cash residue or unclaimed or abandoned class member funds. [Italics added; bolding added]

The bolded language of the statute reflects that the California legislature has broadened the cy pres doctrine for class actions to allow a wide range of recipients of unclaimed funds who have no correlation to the harm made the basis of the class action. Is this a tax? Is this a deprivation of property without due process of law? These questions have been asked.

Tennessee is more specific than California. Their Rule of Procedure 23 says:

RULE 23. CLASS ACTIONS

Any order entering a judgment or approving a proposed compromise of a class action certified under this rule may provide for the disbursement of residual funds. Residual funds are funds that remain after the payment of

all approved: class member claims, expenses, litigation costs, attorneys' fees, and other court-approved disbursements to implement the relief granted. Nothing in this rule is intended to limit the parties to a class action from suggesting, or the trial court from approving, a settlement or order entering a judgment that does not create residual funds.

*It shall be within the discretion of the court to approve the timing and method of distribution of residual funds and to approve the recipient(s) of residual funds.* **A distribution of residual funds to a program or fund which serves the pro bono legal needs of Tennesseans including, but not limited to, the Tennessee Voluntary Fund for Indigent Civil Representation is permissible but not required.**

Upon motion of any party to a settlement or judgment of a class action certified under this rule or upon the court's own initiative, orders may be entered after an approved settlement or judgment to address the disposition and disbursement of residual funds in a manner consistent with this rule.

Tennessee has chosen to use the cy pres doctrine to encourage the funding of legal services to the poor, without regard to the nature of the harm that is the basis for the class action and the justification for the payment of damages.

Washington state, Civil Rule 23(f) moves past to a suggestion to a mandate:

(f) Disposition of Residual Funds.

(1) "Residual Funds" are funds that remain after the payment of all approved class member claims, expenses, litigation costs, attorneys' fees, and other court-approved disbursements to implement the relief granted. Nothing in this rule is intended to limit the parties to a class action from suggesting, or the trial court from approving, a settlement that does not create residual funds.

(2) Any order entering a judgment or approving a proposed compromise of a class action certified under this rule that establishes a process for identifying and compensating members of the class shall provide for the disbursement of residual funds. In matters where the claims process has been exhausted and residual funds remain, **not less than fifty percent**

> **(50%) of the residual funds shall be disbursed to the Legal Foundation of Washington to support activities and programs that promote access to the civil justice system for low income residents of Washington State.** The court may disburse the balance of any residual funds beyond the minimum percentage to the Legal Foundation of Washington or to any other entity for purposes **that have a direct or indirect relationship to the objectives of the underlying litigation or otherwise promote the substantive or procedural interests of members of the certified class**.
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> [Adopted effective July 1, 1967; Amended effective January 3, 2006; April 28, 2015; September 1, 2017.]

The residual part of this rule adheres to the traditional basis for cy pres, which is to benefit the designated beneficiaries "as close as possible," but only after taking a ½ bite out of the residual funds to use to provide legal services for low income residents of the state.

These policies in California, Tennessee, and Washington nakedly abandon the primacy in the cy pres doctrine of settlor's intent in favor of appropriating funds belonging to someone but defended by no one, to meet shortfalls in funding that result from the legislature's decision not to fund them.

10. Part of the problem with cy pres awards in class actions that some say can corrupt the judicial process is attributable to cases that should not qualify as class actions in the first place. This position was argued by the U.S. Chamber of Commerce in its amicus curiae brief filed in *Frank v. Gaus*, No. 17-961, in the Supreme Court of the United States. The Brief says:

> [T]he Chamber is submitting this brief in support of neither party to urge the Court that the first solution to the concerns raised by cy pres settlements is to police rigorously the requirements for class certification at the front end. More fundamentally, the Chamber seeks to highlight that the explosion of cy pres settlements in class-action litigation is symptomatic of a much deeper problem — the failure of lower courts to comply with this Court's precedents and rigorously police the requirements of Rule 23.

In this light, the issue of how to regulate cy pres awards can be partially addressed by courts not approving settlements in opt-out classes that create broad classes of claimants

who will recover little or nothing from the class action, while large sums of money go to class counsel for fees that are justified by large unclaimed funds that are doled out to groups and governmental or non-governmental entities that suffered no injury. Allowing such settlements amounts to court-approval of defendants buying a res judicata bar on claims of hundred or thousands of injured persons in exchange for rewarding class representatives with modest recoveries and class counsel with millions of dollars of fees for no benefit to nearly all of the persons who were actually harmed. If class actions that will not result in significant benefits to class members are certified only for injunctive relief to bar pernicious practices, and class counsel fees are scaled back in proportion to the actual recovery to class members, and not based on large cy pres award to third parties, the prophylactic effect of class actions against wrongdoers is preserved, and the opportunity for exploiting the class-action procedure would be lessened. If class action rules were changed to provide that class counsel fees must be measured based on the benefits recovered for class members, without regard to large set-asides to third parties under the cy pres doctrine, many of these problems would go away.

11. This issue is reminiscent of the litigation regarding the use of interest on IOLTA trust accounts to fund legal services for the poor. In *Phillips v. Washington Legal Foundation*, 524 U.S. 156 (1998), the U.S. Supreme Court held that "the interest income generated by funds held in IOLTA accounts is the 'private property' of the owner of the principal," (i.e., the client). In *Brown v. The Legal Foundation of Washington*, 538 U.S. 216 (2003), the high court ruled that taking these funds to use to pay for legal services to the poor was not an "administrative taking" that required just compensation to the clients because the pecuniary loss to the clients was zero. This analysis would seem to suggest that a court directing that unclaimed funds belonging to class plaintiffs be paid to third parties is a taking, and the question is whether the pecuniary loss is zero.

12. Some have argued that a court order directing that unclaimed class action funds be given to organizations that take positions on political or social issue violates the First Amendment rights of class members. Reference is made to *Janus v. AFSCME*, 585 U.S. ___, 138 S.Ct. 2448 (2018), where the U.S. Supreme Court decided:

> Under Illinois law, public employees are forced to subsidize a union, even if they choose not to join and strongly object to the positions the union takes in collective bar gaining and related activities. We conclude that this arrangement violates the free speech rights of nonmembers by compelling them to subsidize private speech on matters of substantial public concern.

This issue was revisited when the U.S. Supreme Court ruled in *Keller v. State Bar of California*, 496 U.S. 1 (1990), that–

> Compulsory dues may not be expended to endorse or advance a gun control or nuclear weapons freeze initiative; at the other end of the spectrum petitioners have no valid constitutional objection to their compulsory dues being spent for activities connected with disciplining members of the Bar or proposing ethical codes for the profession.

And more recently, in *McDonald v. Longley*, 4 F. 4th 229 (5th Circuit 2021), the Fifth Circuit Court of Appeals ruled against the State Bar of Texas' collection of mandatory dues, saying: "In sum, the Bar is engaged in non-germane activities, so compelling the plaintiffs to join it violates their First Amendment rights."

When class representatives and class counsel and defendants and the court take money belonging to class members and award it to organizations who advocate political or policy issues, constitutional issues arise.

13. The choice is between (I) returning unclaimed funds to the defendant; (ii) letting the funds escheat to the government; (iii) over-compensating known class members; or (iv) donating unclaimed funds to a third party, such as a charity or of other NGO. Perhaps the best suggestion is (iv), but providing for an open and more neutral process for selecting third-party beneficiaries, such as an independent panel of advisors, with a proviso that there must be a nexus between the injury suffered by the class and the goals and established record of the third party's activities. In specifying by rule specific beneficiaries who may or must receive cy pres awards, we should be clear-eyed about the fact that we are untethering the courts from the self-imposed restriction they at one time felt necessary--that when substituting the court's judgment for the donor's intent the court must as close as possible to the donor's intent. On the other hand, letting class counsel and defendants select beneficiaries subject loose oversight by trial courts and even looser oversight by appellate courts applying an abuse of discretion standard, a uniform step moving everyone away from *cy pres comme possible* to an obviously legitimate cy pres recipient is probably more faithful to the doctrine of cy pres than allowing litigants and their lawyers select who gets the plaintiffs' money.

14. On September 12, 2002, the Texas Access to Justice Commission made a proposal to the Supreme Court Advisory Committee on a proposed change to Tex. R. Civ. P. 42:

> In any action certified pursuant to T.R.C.P. 42 in which the settlement or judgment includes a monetary award (by way of damages, equitable restitution, or other payment due from the defendant(s) to the class(es)), each party must serve on the Texas Equal Access to Justice Foundation notice of any hearing for preliminary approval of the settlement or judgment and notice of any final hearing to approve the settlement or judgment, and such notice must be served concurrent with notice to any other party of any such hearing. In any such action in which actual distribution to each affected class member is not reasonably and economically feasible, or in which there may be unclaimed funds by virtue checks that are not cashed or proofs of claim not submitted, the court shall have the discretion to issue a finding of fact as to whether those funds should be used to support access to civil legal services to the poor. If the court makes a finding of fact that those funds should be used to support access to civil legal services for the poor, the court shall direct the appropriate party to remit such undistributable funds to the Texas Equal Access to Justice Foundation. The Foundation shall use the remitted funds to support increased access to civil legal services for the poor.

14. The choices may be clear, but which choice is make is perhaps far from clear. Please send your comments, and preferences for what the subcommittee should recommend.

Thanks.

Richard R. Orsinger
Subcommittee Chair