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BEST PRACTICES - CY PRES DISTRIBUTION
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BACKGROUND

Our recent Report, PROTECTING CLASS ACTION SETTLEMENTS (2010), provides an overview of how the use of the cy pres doctrine has been approved by courts and counsel for the distribution of class action and parens patriae case awards and settlements. The report is gleaned from informational interviews, literature reviews and research. It contains a bibliography of available sources of information on the distribution of cy pres funds. It also contains a unique compilation of current practices used by courts and counsel in the distribution of cy pres funds. The interviews reflect the strategic thinking and interests of the various stakeholders; the Courts, Public Counsel, Private Plaintiff's Counsel, Public Interest Counsel, Cy Pres Fund Recipients, Class Members, Academic Blogs as well as relevant Statutory Regulations.

Class action lawsuits often end with a fund of money that cannot be returned to the people injured either because they cannot be found or it would be unreasonably expensive to find the injured individual(s). Enforceable standards for how these funds should be distributed are limited and, controversial. Sources of information to guide a distribution process are not comprehensive, partial, and not generally relied on. Rather, counsel and courts use their own proclivities to direct how class action funds are used. The results vary widely from case to case.

In many cases the funds are used in ways that are inappropriate and bring discredit to class actions. This raises three problems: 1) Individual members of the plaintiff class receive no benefit from the law suit, 2) The principles upon which class actions are based, restitution, disgorgement and prevention, are ignored, and 3) These questionable disbursements are used to argue that class action suits should be eliminated or severely limited.

In contrast, based on these principles, credible distribution plans have been used to provide significant indirect benefits to class members. To assure that funds are used to bring the benefits that the underlying suit intended and to retain access to the courts, generally accepted *Best Practices* need to be promulgated and adopted by courts and counsel.

The following *Best Practices*, Part 1 – Establishing a Cy Pres Distribution Framework and Part 2 – The Distribution Process, are based on our own experience in administering six settlement funds totaling \$65 million having 166 grants. They include lessons learned from cases reported in legal publications and the public press as well as editorial comment in the media. They also reflect information gathered during many interviews for *Protecting Class Action Settlement Funds* and a subsequent meeting and discussion by Judges, counsel, grant recipients, fund administrators, bar representatives and legal academics, sponsored by The California Consumer Protection Foundation on June 11, 2010.

These steps are common sense ways to implement the accompanying Best Practices and get the best results from the distribution of cy pres funds. Combined, these guides will help counsel reach consensus, receive court approval of a settlement plan, protect against adverse publicity and, hopefully, ward off unwarranted objections to the settlement. And, they will result in the most benefit to the class.

When a cy pres distribution is appropriate

Direct Distribution

If a direct distribution (when monetary proceeds are distributed to the individuals harmed) has been provided, and there are unclaimed funds left over, plaintiff counsel can decide if it is impractical to attempt a second direct distribution (i.e. the amount of unclaimed funds are too small to warrant a second notice to potential class members).

Direct Distribution Impractical

If an initial or second direct distribution is found to be impractical, plaintiff counsel can pursue an indirect distribution.

Indirect Distribution

If a direct distribution is found to be impractical, plaintiff counsel can pursue an indirect distribution (when monetary proceeds are distributed to charitable organizations with a close nexus to the purpose of the underlying litigation).

PART 1

Best Practices for Establishing the Legal Framework for a Cy Pres Distribution

- 1 Preliminary Approval of Class Action Settlement**

Plaintiff counsel will request the court preliminarily approve the proposed class action settlement, which contemplates a cy pres distribution, in order to authorize a distribution or to anticipate the possibility if funds cannot be distributed directly. This will avoid having to re-notice a court proceeding to separately authorize a cy pres distribution.

- 2 Preliminary Approval of Proposed Notice**

Plaintiff Counsel will request the court approve the proposed notice including, among other requirements, the proposed cy pres distribution plan.

- 3 Fairness Hearing (Cy Pres)**

When cy pres relief is requested, the Fairness Hearing conducted by the Court may determine the fairness, reasonableness, and adequacy of the cy pres distribution plan in the context of the proposed settlement as a whole, **AND** whether the cy pres distribution plan proposed has a sufficient nexus to the purpose of the underlying litigation ensuring the next best benefit to the plaintiff class of the litigation funds. In addition the plan may describe the means by which the fund recipient(s) will be held accountable for the cy pres use of the funds.

- 4 Order Approving Distribution of Funds on a Cy Pres Basis and Appointing Cy Pres Grant Administrator**

Plaintiff Counsel will file a motion asking the court to authorize distribution of the settlement funds or awards on a cy pres basis, the process of distribution, timeline and naming a cy pres grant administrator, including, a payment schedule based on reaching benchmarks.

- 5 Contract for Cy Pres Grant Administration**

Plaintiff Counsel will retain all grant making decisions, subject to court approval, and enter into a contract with a qualified independent consultant to conduct the cy pres grant administration pursuant to the terms of the court appointment or word the court order so that administration is authorized pursuant to the court order without further action.

- 6** **Cy Pres Grant Administration: Public Notice**
Administrator will submit to Plaintiff Counsel grant criteria and the Notice and Request for Proposals stipulating the approved grant criteria, the final proposal submission date, and links to the grant application forms and instructions.
- 7** **Cy Pres Grant Administration: Post Public Notice**
Administrator will broadly and publicly disseminate the Notice and Request for Proposals. Distribution may include, but not be limited to, contacts with specific organizations or individuals working in a field having a nexus to the purposes of the litigation.
- 8** **Cy Pres Grant Administration: Report and Recommendations on Grant Applications**
Administrator will receive and review grant applications and submit to Plaintiff Counsel a Report and Recommendations on Grant Applications.
- 9** **Cy Pres Grant Administration: Court Approval of Grant Recipients**
Plaintiff Counsel will file a motion and supporting documents for court approval of grant recipients (including declarations outlining the grant making process).
- 10** **Cy Pres Grant Administration: Grant Agreement Terms and Conditions**
Administrator will execute Grant Agreements with all court approved grant recipients specifying the terms and conditions of the grant.
- 11** **Cy Pres Grant Administration: Payments, Monitoring and Reporting**
Administrator will prepare a schedule of installment payments due and a schedule of grantee progress and expenditure reports to ensure compliance with the terms and conditions of the Grant Agreement.
- 12** **Cy Pres Grant Administration: Annual and Final Reports to Plaintiff Counsel**
Administrator will prepare Annual Reports to Plaintiff Counsel on the status of grants and grant expenditures to date **AND** submit a Final Report to Plaintiff Counsel at the completion of all grants.

PART 2

Best Practices for the Distribution Process (Grant Making)

PROTECT THE FUND:

- 1** **Avoid Taxes on the Fund**
Arrange for the Fund to be placed in an interest bearing, tax-free account. It is possible to avoid taxes if the fund is devoted to non-profit and/or governmental pro-social good. The terms of the cy pres distribution, in a settlement agreement or judgment should be drafted to support a claim of tax exemption. Non-profit tax counsel can provide the necessary language.
- 2** **Avoid Pressure from Potential Recipients**
Counsel and courts should not initially indicate to a particular organization or agency that they will receive cy pres funds. A favored position creates incentives to use the funds as a general support for the recipient rather than an effective and efficient project to benefit the class members. A favored organization or agency should be advised that funds will be granted after an open and competitive process and they should consider applying.
- 3** **Limit Unnecessary Expenses**
Administration expenses should not exceed 5% of the Fund and should be a firm contract amount, approved by the court. Grantee indirect expenses should not exceed 6%. Indirect expenses, those not clearly traced to the project such as Board of Director costs, general operation and overhead costs, etc. should be limited in the court order. Agencies are motivated to use grants to maintain and support ongoing projects and staff. Universities commonly seek indirect costs of 25% to 52% and some will seek to charge for receiving a grant. Many institutions will seek 10% to 25% for indirect costs. If a limit is clearly defined in the court order, grantees will gladly accept a grant limiting their indirect expenses to the court ordered maximum allowed.
- 4** **Separate Grant making Function From Banking Function**
The funds should be in an account held by a class action settlement firm. They are experienced in handling and accounting for class funds and they charges are reasonable. Banks charge substantially more and are difficult to deal with. Grantee checks should be released on the direction of Counsel or the Cy Pres Administrator. Counsel should authorize payments to the Cy Pres Fund Administrator.

ASSURE BENEFIT TO THE CLASS:

Define Clear Goals that Benefit the Class as Closely as Possible to the Harm Incurred

5 Quick exploration will provide demographic and geographic information that combined with a definition of the purpose of the suit and harm to the class will help identify criteria for the use of the funds. Include such criteria in the Settlement Agreement approved by the Court.

6 Be Careful with Large National Organizations, They Have Huge Ongoing Projects and Rarely will Design New Projects, Even within Their Mission to Meet Class Needs

Many worthy organizations with excellent reputations seem to be “safe” recipients for funds but they rarely will establish new or targeted projects to help the class avoid similar problems in the future. For example, grants to the American Heart/Cancer/Breast Cancer/ or XYZ Association, are often used to fund national ongoing programs not providing any but the most diluted benefit to the class. The nexus exists in name only.

7 Use the Best Grant making Practices

Grant making that is philanthropic and strategic has the best chance of meeting the fund’s goals and providing long-term benefit. Grant making that is charitable will have limited result, benefiting a few for a short period. Grants for purposes or projects that would not otherwise happen should be favored. These are special funds and projects should be able to be clearly identified as designed to benefit the class. The Grant Agreement should specify that cy pres funds are not to be used to supplant other funds that would be used and are available for the proposed project. This is a common “non-supplant” clause often used to prevent a cy pres grant causing a reduction of other sources of funds.

8 Attorneys and Judges are Experts in the Law and Direct Remedies for Plaintiff

They are not grant makers or experts in the fields of nutrition, clean air or water, banking, pharmaceutical manufacturing and the like. Settlements where Counsel or Court gives cy pres funds to respected charities are not likely to benefit the class.¹

¹ An example is a grant from a case involving overcharges in auto insurance policies to a national group opposed to drunk driving. There were no conditions that the money is used to prevent auto insurance overcharges, or that the money is used in the state where the class resides. The grant was more a feel good gift, which ignored the injury to the class.

- 9** **Criteria for Grants Should be to Achieve a Desired Benefit for the Class Rather than a Specific Type of Project**
For example, in a case involving air pollution, criteria to “Reduce emissions and improve air quality” will produce proposals with a variety of methods to accomplish that goal. If the criteria is “ To smog check and eliminate vehicles with excessive emissions” Counsel will have decided based on limited experience, specifically how the funds should be used and the proposals will be very limited and narrow. Since cy pres funds are limited, they should be used for long lasting and specific benefits wherever possible. A competitive process will identify the best strategy to reach that goal.
- 10** **Require Periodic Payments of the Grant Based on the Grantee Achieving Specific Benchmarks and Timelines. Grants should be Made on a “Not to Exceed” basis, for Funds Actually Spent to Reach a Benchmark**
Cy pres funds should be used in an accountable manor to implement the grant proposal approved. Funds not spent to implement the grant project should not be automatically distributed because the grant was for more than the expenditures.
- 11** **Protect Counsel, the Court and the integrity of the Grant Process**
Refer all calls, questions and requests to the Court appointed Grant Administrator in order to avoid pressure from friends, colleagues and special pleaders. This preserves the transparency and competitive grant making process. It also prevents Counsel from having to object to an applicant favored by co-Counsel. This also provides a wall between Counsel and the grant making process.

In order to advance the field of cy pres relief we encourage comments and suggestions for revising and updating *Best Practices*. We welcome your help.

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