Potential Changes to Rule 23 and Class Actions: Cy Pres and Objectors

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T his article is Part II of a three-part series covering six "conceptual sketches" of possible amendments to Federal Rule of Civil Procedure 23, recently offered by the Rule 23 Subcommittee of the Civil Rules Advisory Committee on the Federal Rules of Civil Procedure ("Subcommittee"). As set forth in Part I of this series, these "conceptual sketches" "are not intended as initial drafts of actual rule change proposals, and should not be taken as such," but the Subcommittee has determined that "[t]he time has come for moving beyond purely topical discussion." The Subcommittee is scheduled to hold a mini-conference in September 2015, at which time it hopes to present proposed amendments. Those proposals, if adopted, may be in effect as early as 2018, so it is important to understand the potential effects of the conceptual sketches as possible precursors to the anticipated Rule change proposals.

The six conceptual sketches can be found here. The sketches cover (1) Settlement Approval Criteria; (2) Settlement Class Certification; (3) Cy Pres Treatment; (4) Dealing with Objectors; (5) Rule 68 Offers and Mootness; (6) Issue Classes; and (7) Notice. This article addresses the third and fourth of the Subcommittee's conceptual sketches. The first article in this series covered the first two conceptual sketches. A future article will address the remaining sketches.

Conceptual Sketch #3: Cy Pres Treatment

Class action settlements often include a "*cy pres*" provision, pursuant to which portions of unclaimed settlement funds are distributed to entities other than class members, such as charitable organizations. Courts considering whether to approve class settlements have been critical of *cy pres* provisions in recent years, recognizing that, to the extent possible, settlement funds should be distributed directly to class members, not non-parties.

In light of this body of case law, and the fact that Rule 23 does not directly address *cy pres* provisions, the Subcommittee has sketched an amendment to Rule 23(e), based largely on Principles set forth by the American Law Institute. The amendment sketch states:

> *… The court must apply the following criteria in determining whether a cy pres award is appropriate:*

(A) If individual class members can be identified through reasonable efforts, and the distributions are sufficiently large to make individual distributions economically viable, settlement proceeds must be distributed directly to individual class members;

(B) If the proposal involves individual distributions to class members and funds remain after distributions, the settlement must provide for further distributions to participating class members unless the amounts involved are too small to make individual distributions economically viable or other specific reasons exist that would make such further distributions impossible or unfair;

(C) … if the court finds that individual distributions are not viable under Rule 23(e)(3)(A) or (B), a cy pres approach may be employed if it directs payment to a recipient whose interests reasonably approximate those being pursued by the class. [The court may presume that individual distributions are not viable for sums of less than $100.] [If no such recipient can be identified, the court may approve payment to a recipient whose interests do not reasonably approximate the interests being pursued by the class if such payment would serve the public interest.]

The Subcommittee intends this proposal to signify that *cy pres* awards are permitted "as a last resort, not a first resort," and "[u]nless it is clear that class members have no plausible legal right to receive additional money, they should receive additional distributions."

Critics of this proposal suggest that the Subcommittee's sketch does not address several of the concerns surrounding *cy pres* awards, including, for instance, the fact that *cy pres* distributions are often used to justify heightened attorneys' fees awarded to plaintiffs' counsel. If the rule is to be revised, the defense bar has suggested including a provision barring class counsel from basing their fee request on the value of *cy pres*. Detractors are also critical of the Subcommittee's inclusion of the "presum[ption] that individual distributions are not viable for sums of less than $100," which they argue would "virtually assur[e] that most consumer class actions will focus on a *cy pres* remedy …" Others question whether the fact that individual distributions are not viable should instead mean that the class is not sufficiently defined or ascertainable, and that class certification is inappropriate for settlement purposes. Finally, critics question whether enshrining *cy pres* into Rule 23 would violate the Rules Enabling Act by creating a remedy that otherwise does not exist. Some suggest that "banning resort to *cy pres* is the only option that will address the many policy concerns it causes."

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Such a ban, on the other hand, would likely result in new questions and concerns. For instance, if significant settlement funds remain unclaimed by class members, should those few claimants who came forward receive a windfall of all additional funds, no matter how large, or should those funds revert to the defendant? Would banning *cy pres* and permitting reverters render settlements with low claims rates too favorable to defendants? Or would it incentivize plaintiffs to ensure robust notice and claims procedures during settlement to result in the highest claim rate possible? The Subcommittee may need to grapple with whether *cy pres* is ever appropriate before creating procedural rules that implicitly bless its use.

Conceptual Sketch #4: Dealing With Objectors

A. Reporting Requirement

Rule 23(e) currently permits absent class members to object to class settlements, and states that "the objection may be withdrawn only with the court's approval." The Subcommittee suggests adding a "reporting obligation" to the Rule, such that "the parties must file a statement identifying any agreement made in connection with the withdrawal." This proposed obligation is meant to "slightly amplif[y]" Rule 23(e), and curtail the practice of some objectors who use settlement objections to "hold up" valid agreements and "extract" money from settling parties.

The Subcommittee questions whether this addition would be more effective than various alternatives, and notes that "[i]f . . . the current provision requiring court approval for withdrawing an objection does the needed job, there may be no reason to add this reporting obligation." In reality, both parties are typically pleased when an objection is withdrawn, so neither challenges the objector's withdrawal or the underlying purpose of the objection. The Subcommittee also does not address how courts would evaluate agreements between withdrawing objectors and parties, or what the Court should do upon evaluation of the agreement. Should the side agreement be a basis for refusing to approve the withdrawal? That seems counter-productive. The Subcommittee may need to clarify the interplay between a reporting obligation and court approval of withdrawals before this conceptual sketch results in a proposed rule change.

B. Sanctions

The Subcommittee also suggests an addition to Rule 23(e) that instructs courts to consider entering sanctions against objectors. Such a provision is similarly based on the Subcommittee's recognition that "there are … some bad objectors who seek to profit by delaying final consummation of the deal," and the desire to deter this practice. The Subcommittee offers two alternative provisions to that end, one which provides that class members may object "subject to Rule 11," while the other instructs that "[i]f the court finds that an objector has made objections that are insubstantial [and] {or} not reasonably advanced for the purpose of rejecting or improving the settlement, the court [should] {may} impose sanctions on objectors or their counsel {under applicable law}."

Rule 11 already applies to objectors, however. The Rule provides that every paper filed with the court should be signed by an attorney or unrepresented party, those signatures certify that representations are not made for improper purposes, and if they are, sanctions may be entered. The first proposal is therefore arguably redundant. The second option arguably does little more than restate Rule 11 in other terms. If it is to be more meaningful, notes clarifying what constitutes an "insubstantial" objection, or one that is not "reasonably advanced," may be worthwhile. Otherwise, it may prove easy for objectors to provide facially credible reasons for their objections — a settlement, as a result of compromise, can in theory always be improved — even when made to "extract" money from settlements.

The final article in this series will cover the Subcommittee's conceptual sketches of proposed Rule 23 amendments that would (1) address whether Rule 68 offers to named plaintiffs moot class claims, (2) clarify the requirements for certification of issue classes, and (3) amend class notice requirements.

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