
“FAIR, REASONABLE, AND
ADEQUATE” ACCORDING TO WHO? *CY
PRES* DISTRIBUTIONS THAT RESULT IN
CHEAP SETTLEMENTS AND GENEROUS
ATTORNEY FEES, BUT NO FINANCIAL
BENEFIT TO CLASS MEMBERS

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In her recent article, Professor Rhonda Wasserman argues that class action settlements that distribute funds *cy pres* raise a very serious risk of prejudice to absent class members.¹ The problem, she asserts, is the temptation for class counsel to sell out the interests of absent class members in exchange for a discounted settlement for the defendant and a generous fee for class counsel. To illustrate her concern, she cites the \$9.5 million settlement in *Lane v. Facebook, Inc.*² that directed approximately \$6.5 million to a nascent charity that was controlled—at least partially—by the defendant, \$3 million to class counsel and nothing to the three million absent class members.³ Professor Wasserman argues that courts cannot have a *laissez faire* attitude toward protecting absent class members and she proposes a number of procedural reforms to ensure that *cy pres* distributions are only used when absolutely necessary.⁴ While her

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1. Rhonda Wasserman, *Cy Pres in Class Action Settlements*, 88 S. Cal. L. Rev. 97 (2014).

2. *Lane v. Facebook, Inc.*, 696 F.3d 811 (9th Cir. 2012), *aff'g* No. C08-3845 RS, 2010 U.S. Dist. LEXIS 24762 (N.D. Cal. March 17, 2010).

3. Wasserman, *supra* note 1, at 99.

4. Professor Wasserman identifies three factors that contribute to the problem. First, class counsel is not motivated to negotiate for a direct benefit to class members. Second, informational deficiencies prevent effective evaluation of proposed class action settlements. Finally, courts often fail to scrutinize the terms of proposed agreements. To redress the problem, Professor Wasserman proposes that: (1) courts reduce attorneys' fees whenever all or a portion of a settlement fund is distributed *cy pres*; (2) class counsel provide information to assess the viability of individual distributions to

proposals are likely to provoke increased judicial scrutiny of *cy pres* distributions, the article stops short of addressing the principal question: when, if ever, is a settlement that distributes funds *cy pres* “fair, reasonable and adequate” to the absent class members?⁵

Federal Rule of Civil Procedure 23(e) imposes a duty on courts to approve a class action settlement “only after a hearing and on finding that it is fair, reasonable, and adequate.”⁶ Remarkably, courts often base such fairness findings upon representations of class counsel rather than evidence. This practice is particularly troubling when the proposed settlement offers no direct benefit to absent class members because it distributes the entire fund *cy pres*. This Response addresses the principal question omitted from Professor Wasserman’s article and asserts that representations of counsel who are aligned in support of a proposed agreement and stand to gain from its approval are insufficient to find a proposed settlement agreement “fair, reasonable, and adequate.” Rather, Rule 23(e) demands that courts base a fairness finding upon objectively reliable evidence.

Courts agree on the basic parameters of the Rule 23(e) hearing: (1) the parties bear the burden of proving a proposed settlement agreement is fair, reasonable and adequate; (2) a fairness conclusion under Rule 23(e) rests upon factual findings; and (3) a fairness conclusion will be reversed only if it is clearly erroneous or an abuse of discretion.⁷ Circuit Courts, however, are split on the level of scrutiny demanded by Rule 23(e). On one end of the spectrum, the Third and Seventh Circuits advocate for strict scrutiny. These circuits direct district courts to apply “the highest degree of vigilance in scrutinizing proposed settlements of class actions,”⁸ and require an “independent, ‘scrupulous’ analysis of the settlement terms.”⁹ These

claimants, to ensure that efforts have been taken to maximize the number of claimants who submit claims and to evaluate the record of any proposed *cy pres* recipients; (3) courts appoint an advocate to oppose the settlement; and (4) courts allow *cy pres* distributions only when direct payments to individual class members are not viable. *Id.* at 101, 134–60.

5. Fed. R. Civ. P. 23(e).

6. Fed. R. Civ. P. 23(e). *See also* *Amchem Prods., Inc. v. Windsor*, 521 U.S. 591, 623 (1997) (The Rule 23(e) requirement “protects unnamed class members from unjust or unfair settlements affecting their rights”).

7. *See* *Lane*, 696 F.3d at 820, 822–24; *In re Baby Prods. Antitrust Litig.*, 708 F.3d 163, 175 (3d Cir. 2013); *In re Pet Food Prods. Liab. Litig.*, 629 F.3d 333, 350 (3d Cir. 2010); *Synfuel Techs., Inc. v. DHL Express (USA), Inc.*, 463 F.3d 646, 653 (7th Cir. 2006).

8. *Synfuel Techs.*, 463 F.3d at 652–53 (quoting *Reynolds v. Beneficial Nat’l Bank*, 288 F.3d 277, 279 (7th Cir. 2002))(comparing the obligation imposed by Rule 23(e) to the “high duty of care that the law requires of fiduciaries”).

9. *In re Pet Food Prods.*, 629 F.3d at 351.

circuits identify factors that should be considered to determine if Rule 23(e) is satisfied¹⁰ and place particular emphasis on comparing the amount offered in settlement to the expected value of continued litigation.¹¹ Recognizing that the net expected value of continued litigation is imprecise, district courts must nonetheless “insist[] that the parties present evidence that would enable [] possible outcomes, to be estimated,” so that the court can at least come up with a “ballpark valuation.”¹² Notably, district courts are warned not to “substitute the parties’ assurances or conclusory statements for its independent analysis of the settlement terms.”¹³

On the opposite end of the spectrum, circuit courts emphasize the importance of respecting arms-length, noncollusive negotiation between private parties.¹⁴ The Ninth Circuit expressly rejects the strict scrutiny approach, noting that a district court is not required:

to find a specific monetary value corresponding to each of the plaintiff class’s statutory claims and compare the value of those claims to the proffered settlement award. . . . Not only would such a requirement be onerous, it would often be impossible . . . making any prediction about recovery speculative and contingent.¹⁵

While the Ninth Circuit has endorsed similar factors to those identified by

10. The Third Circuit has articulated the following factors: “(1) the complexity, expense and likely duration of the litigation; (2) the reaction of the class to the settlement; (3) the stage of the proceedings and the amount of discovery completed; (4) the risks of establishing liability; (5) the risks of establishing damages; (6) the risks of maintaining the class action through the trial; (7) the ability of the defendants to withstand a greater judgment; (8) the range of reasonableness of the settlement fund in light of the best possible recovery; [and] (9) the range of reasonableness of the settlement fund to a possible recovery in light of all the attendant risks of litigation.” *In re Pet Food Prods.*, 629 F.3d at 350 (citing *Girsh v. Jepson*, 521 F.2d 153, 157 (3d Cir. 1975)). See also *Synfuel*, 463 F.3d at 653 (providing similar factors).

11. *Reynolds*, 288 F.3d at 285 (The net expected value of continued litigation is determined by “estimating the range of possible outcomes and ascribing a probability to each point on the range”). See also *In re Pet Food Prods.*, 629 F.3d at 351 (applying the *Girsh* factors).

12. *Synfuel*, 463 F.3d at 653 (alterations in original) (quoting *Reynolds*, 288 F.3d at 285).

13. *In re Pet Food Prods.*, 629 F.3d at 350–51. See also *Reynolds*, 288 F.3d at 283 (cautioning against “paint[ing] with too broad a brush [and] substituting intuition for . . . evidence and careful analysis”).

14. *Rodriguez v. West Publ’g Corp.*, 563 F.3d 948, 965 (9th Cir. 2009) (stating that district courts should be hesitant to drill down into settlement agreements to scrupulously analyze terms); *Hanlon v. Chrysler Corp.*, 150 F.3d 1011, 1027 (9th Cir. 1998) (“[T]he courts’ intrusion upon what is otherwise a private consensual agreement negotiated between the parties to a lawsuit must be limited to the extent necessary to reach a reasoned judgment that the agreement is not the product of fraud or overreaching by, or collusion between the negotiating parties, and that the settlement, taken as a whole, is fair, reasonable, and adequate to all concerned.” (citation omitted)).

15. *Lane v. Facebook, Inc.*, 696 F.3d 811, 823 (9th Cir. 2012).

the Third and Seventh Circuits,¹⁶ the factors are to be assessed according to the fairness of the agreement as a whole, rather than its individual components.¹⁷

Notwithstanding the divergent perspectives on judicial scrutiny, district courts hailing from both ends of the spectrum find the 23(e) fairness analysis challenging. Class counsel and defense counsel arrive in court aligned in support of the proposed agreement, possessing no incentive to provide information to the court that might shed a negative light on the proposal. Sandwiched between the demands of Rule 23 and the potentially self-serving representations of counsel, who seek approval of a proposed agreement, district courts are left ill-equipped to uncover weaknesses in the agreement that could prejudice the absent class members. In light of this situation, it is no wonder that district courts approve *cy pres* settlements without sufficient factual support.¹⁸

The fairness conclusion in *Lane v. Facebook* illustrates the problem. The district court noted that the proposed settlement was “achieved after intense and protracted arm’s-length negotiations conducted in good faith and free from collusion,” but recited no facts to ground the conclusion and identified no source of supporting evidence.¹⁹ Moreover, the court found that “Class Counsels’ [sic] reasonably concluded that the immediate benefits represented by the Settlement outweighed the possibility—perhaps remote—of obtaining a better result at trial” but failed to identify facts to support counsel’s opinion and failed to articulate the rationale that informed counsel’s judgment.²⁰ The court cited a declaration of Class Counsel, Scott A. Kamber, but failed to explain how, if at all, the declaration satisfied the rules of evidence. Particularly troubling is the fact that the court allowed Mr. Kamber to offer an opinion on the fairness of the proposed settlement without analyzing whether his testimony satisfied

16. *Id.* at 819.

17. *Id.*

18. See *In re Baby Prods. Antitrust Litig.*, 708 F.3d 163, 175 (3d Cir. 2013) (vacating approval of proposed settlement as fair, reasonable, and adequate for lack of factual support to determine if settlement was fair to class); *Dennis v. Kellogg Co.*, 697 F.3d 858 (9th Cir. 2012) (reversing approval of *cy pres* settlement distribution for lack of evidence regarding “mysteries” in the settlement agreement, including valuation); *Katrina Canal Breaches Litig. v. Bd. of Comm’rs*, 628 F.3d 185 (5th Cir. 2010) (reversing the district court’s approval of settlement lacking factual basis for assertion that the *cy pres* distribution would be fair, reasonable, and adequate). *But see In re Pet Food Prods.*, 629 F.3d at 333 (affirming the district court’s finding that *cy pres* distribution was fair, reasonable, and adequate based upon representations of counsel).

19. *Lane v. Facebook Inc.*, No. C08-3845 RS, 2010 U.S. Dist. LEXIS 24762 *4, *18–19 (N.D. Cal. March 17, 2010).

20. *Id.* at *19.

Federal Rule of Evidence 702. While Mr. Kamber likely qualifies as an expert in light of his education and experience, there is no analysis of whether his opinion is “the product of reliable principles and methods” or whether he “applied the principles and methods reliably to the facts of the case.”²¹ Indeed, there is no mention of his methodology at all. Even if he could have articulated a reliable theory for his opinion, the court failed to address the Model Rules of Professional Conduct Rule 3.7, which prohibit a lawyer from testifying in a case in which the lawyer is an advocate.²² Although Rule 3.7 offers several exceptions to its blanket prohibition, none is applicable here. The subject of the testimony is not “uncontested,” illustrated by the fact that the district court is charged with determining if a proposed agreement is fair. Furthermore, while Rule 3.7 allows counsel to testify to the “nature and value” of legal services rendered, counsel’s opinion regarding the fairness of the agreement extends well beyond this limited exception. Finally, disqualifying counsel from testifying does not impose a hardship on the parties when other witnesses are available to testify. Reliance upon the declaration of class counsel as the sole source of factual information to support a finding that the settlement agreement is fair creates the appearance of a conflict of interest and undercuts the credibility of the conclusion.

Circuit courts disagree on what is required to support a fairness conclusion under Rule 23(e), with some courts reversing district court decisions for lack of sufficient factual support²³ and others affirming district court decisions that rest merely upon representations of counsel.²⁴ These courts are unanimous, however, in failing to address the underlying

21. Fed. R. Evid. 702. *See also* Linda S. Simard & William G. Young, *Daubert's Gatekeeper: The Role of the District Court Judge in Admitting Expert Testimony*, 68 TUL. L. REV. 1457 (1994) (discussing when expert testimony is admissible).

22. Model Rules of Prof'l Conduct R. 3.7 (“(a) A lawyer shall not act as advocate at a trial in which the lawyer is likely to be a necessary witness except where: (1) the testimony relates to an uncontested issue; (2) the testimony relates to the nature and value of legal services rendered in the case; or (3) disqualification of the lawyer would work substantial hardship on the client.”). Admittedly, this rule expressly limits a lawyer from testifying at trial, not at an evidentiary hearing. However, the evil addressed by the rule seeks to prohibit a lawyer from advocating a position and then personally providing the evidence to substantiate that position. While a 23(e) hearing is not a trial, counsel is advocating for the fairness of the proposed agreement and then personally providing the evidence to substantiate that position. Moreover, if the testimony is accepted and the agreement is deemed fair, the 23(e) testimony is in lieu of a trial.

23. *See* cases cited *supra* note 18.

24. *Lane v. Facebook, Inc.*, 696 F.3d 811 (9th Cir. 2012) (affirming the district court’s approval of settlement as fair, reasonable, and adequate based upon counsel’s representations); *In re Pet Food Prods. Liab. Litig.*, 629 F.3d 333 (3d Cir. 2010) (affirming district court’s finding that *cy pres* distribution was fair, reasonable, and adequate based upon representations of counsel).

question: how should a district court acquire reliable evidence to evaluate the fairness of a proposed agreement?

Rule 23(e) is silent on the types of evidence that may form the basis for a fairness conclusion. Yet, it strains logic to suggest that district courts may reach findings of fact without supporting evidence. The rules of evidence provide the standard method for determining when evidence is sufficiently reliable to form the basis for a just and fair outcome of a legal dispute,²⁵ and it follows that a fairness conclusion should similarly rest upon evidence that meets the indicia of reliability articulated in the rules of evidence. While a fairness hearing does not invoke jury concerns, the rules of evidence provide valuable guidance for district court judges to determine when evidence is sufficiently reliable to support a credible fairness conclusion. Indeed, one might argue that a fairness conclusion lacking a shred of admissible evidence for support would be an abuse of discretion.

In order to determine when, if ever, a proposed *cy pres* settlement is “fair, reasonable, and adequate” to absent class members, courts should seek admissible evidence to inform the conclusion. Ideally, such evidence would be offered in the form of expert testimony. An expert witness, qualified by knowledge, skill, experience, training, or education, would be able to offer an opinion on the overall fairness of a proposed agreement, as well as the criteria that have been identified by the courts for determining fairness. The expert would explain the basis for the opinions by testifying to the underlying methodology and reasoning as applied to the particular proposal under consideration.²⁶ The court would be encouraged to question the expert regarding issues of concern that relate to the expert’s opinion, methodology, reasoning, fairness criteria, and the terms of the proposed agreement.

Two obvious critiques of this proposal come to mind. First, requiring expert testimony may result in a battle of experts on the contested issues in the underlying litigation, resulting in a mini (or not so mini) trial on the merits. This critique misconstrues the substance of the expert testimony. This proposal does not seek expert testimony on the issues in the underlying litigation. Rather, the proposal seeks expert testimony on the substance of the settlement agreement in relation to the likelihood of success if the litigation is continued. Thus, an expert witness for a Rule 23(e) hearing might be a lawyer, mediator, or fund administrator who specializes in class action settlements, not an engineer testifying to

25. Fed. R. Evid. 102.

26. Fed. R. Evid. 702.

causation in the underlying cause of action. The second obvious critique of this proposal is that expert testimony presented by counsel aligned in support of the agreement is unlikely to present a negative view of the agreement. Yet, by eliciting testimony regarding the expert's qualifications, as well as the theory and reasoning supporting the expert's opinion the judge gains valuable insights regarding the reliability of the expert's opinion and will be in a superior position to probe weaknesses in the expert's testimony. Moreover, if the court appoints an adversary to oppose the proposal, as suggested by Professor Wasserman, the adversary may produce expert testimony regarding the fairness of the proposal. Such evidence will serve as a counterweight to the evidence produced by the parties and provide the court with a fuller perspective from which to make a Rule 23(e) determination.

Reliable evidence is a fundamental component of any factual finding, and a conclusion lacking evidentiary support is inherently suspect. A proposed settlement seeking to distribute funds *cy pres* may only be considered "fair, reasonable, and adequate" if there is evidence supporting this conclusion. While Professor Wasserman's proposals are likely to enhance judicial scrutiny of *cy pres* settlements, without reliable evidence to reach credible findings of fact, courts will remain ill equipped to adequately protect the interests of absent class members.