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7th Circuit: Posner Explains Notice Requirements & Utility of *Cy Pres* Decrees in Small Class Actions

After a double dose two weeks ago and last week off, the Hoosier Litigation Blog returns this week with a case that your author has called the perfect Hoosier Litigation Blog post case. It is a case authored by influential Seventh Circuit Judge Richard A. Posner that is postured in the styling of "gather round and let me pontificate upon the law." It is also a very insightful case into some aspects of class actions that have often been overlooked by case law. There is also a very important paragraph that may have a major impact on class action cases going forward.

Because I want readers to understand that there is one extremely important statement in this case that cannot be overstated and may represent a substantial development in class action procedures on a going forward basis, I am going to toss the quoted excerpt in right at the beginning with no explanation as an enticement to read the rest of the post and understand it.

> A time-saving alternative might be a class action with the stated purpose, at the outset of the suit, of a collective award to a specific charity. We are not aware of such a case, but mention the possibility of it for future reference.

The decision, *Hughes v. Kore of Indiana Enterprise, Inc.*, stems from the alleged violations of ATM fee notification requirements under the federal Electronic Funds Transfer Act (EFTA) by two ATM units located in Indianapolis. Due to the fact that the specific provision that was at issue has since been removed and the hyper-technical nature of the violation, we shall dispense with the specifics of the alleged violations of the Act. However, an important note of the EFTA is the provision providing for recovery for violations. In short, individuals may bring claims for actual damages or statutory damages that can be awarded on a discretionary range between $100 and $1,000. In addition, the individual can recover attorney's fees and costs. However, the statutory damages provision is a per lawsuit recovery not a per occurrence recovery. If the action is brought as a class action, the recovery is limited to the lesser of $500,000 **or** 1% of the defendant's net worth. In this case, like most cases with federal consumer protection statutes including such class action caps, the lesser amount is the 1% of the defendant's net worth. Specifically, the parties agreed that the cap was $10,000.

The case reached the Seventh Circuit on discretionary appeal after the trial court decertified the class. District Judge Magnus-Stinson, one of the finest District Judges around, ordered the class decertified for two reasons: (1) "the class members would do better bringing individual suits" and (2) that the notice requirement of Rule 23(b)(3) could not be satisfied. For those not familiar with class action litigation, in federal court, class actions are governed by Rule 23. The Seventh Circuit granted review and reversed. The court stated its reasoning for granting appellate review as follows:

> We have decided to allow the appeal in order to further the development of class action law regarding issues of notice in cases in which the potential damages per class member are very slight, and the suitability of class action treatment of such cases.

In keeping with this purpose for the appeal, as I said to begin this post, the posture of the decision resembles a professorial lecture rather than the typical appellate decision.

The first piece of insight from the opinion, though far from novel, was to address the propriety of a class action in a case in which individual actions stood to garner more recovery for individual class members. After examining the $10,000 cap against the 2,800 transactions that constituted the class, the court recognized that the per occurrence recovery for the class would only be $3.57. Mind you, the fee per transaction was only $3, so this is not all that alarmingly small of a potential recovery. However, as Judge Magnus-Stinson recognized, the baseline recovery for a successful individual plaintiff would be $100.

Judge Posner, and by extension the Seventh Circuit, chose to apply a more pragmatic and realist approach to analyzing the viability of individual recovery. The court noted that even if a person made 100 transactions, the most the person could recover on individual damages would then be $300. Although the statutory damages ranges between $100 and $1,000, the court was at a loss for how a technical violation of the EFTA would merit a substantial increase above the $100 minimum threshold. Thus, the true reality would be the requirement that plaintiffs procure an attorney to prosecute a $100 claim. Recognizing the "paucity of litigation" in which this has occurred and the practical problems, such as determining what a reasonable attorney fee is for a $100 recovery, the court found that this alternative was not viable.

The pragmatic approach is in keeping with other recent Seventh Circuit cases, such as *Butler v. Sears I* and *Butler v. Sears II*, in which the court recognized the predominance requirement of Rule 23(b)(3) to be fundamentally a question of efficiency.

After noting that class action treatment is more appropriate when the stakes are small to each victim, the court noted a rather interesting proposition: that the recovery for class members in this case are "probably too small even to warrant the bother, slight as it may be, of [class members] submitting a proof of claim in the class action proceeding." Due to this reality, the court noted, "[T]he best solution may be what is called (with some imprecision) a 'cy pres' decree." A *cy pres* decree, in the context of class action law, is typically a decree that the portion of a damages award that cannot be returned to the class member is to be directed to a charity with some parallel interest to the underlying suit. Here, the court noted that an appropriate charity would likely be one concerned with consumer protection. *Cy pres* decrees in class actions are a solution to a common sense problem. An interesting note is that while courts, such as the First and Ninth Circuits require that the charity have interests parallel to the class, the Seventh Circuit, recognizing that a *cy pres* award is punitive in the absence of complimentary interests, permits an award to an unrelated charity.

Cy pres decrees arise because you have a situation wherein the defendant has committed a certain amount of harm and should not benefit from its actions. As the court said, "[T]he reason . . . is to prevent the defendant from walking away form the litigation scot-free because of the infeasibility of distributing the proceeds . . . to the class members." However, you also lack the ability to properly return the damages to the class members who were harmed. Thus, there is a pot of money that needs to go somewhere. It may seem to make sense that the money should go to the class attorneys, and certainly many attorneys would agree, but the reality is that such payouts would have the natural consequence of incentivizing class attorneys to be less studious in locating class members. The answer then is the one we have: a donation to a charity.

In addition to the *cy pres* aspects of the decision, the court launched into an invaluable discussion of the notice requirements of a Rule 23(b)(3) class. Because Rule 23(b)(3) classes afford the class members the option of opting out of the class and pursuing claims on their own, the notice requirement to class members is considered to be a very important part of the procedural safeguards in certifying a class. However, there are instances, such as this case, in which notice is a near impossibility. Here, the ATMs were located at bars frequented by college students with identification limited to a number that identified the bank from which the account was drawn and then a transaction number. Thus, it may be necessary to subpoena over one hundred banks and pay the costs of production just to identify the actual class members.

In order to determine what kind of notice was required, the court looked to Rule 23(c)(2)(B) that governs notice for a Rule 23(b)(3) class. The notice rule only requires the "best notice that is practicable under the circumstances[.]" Here, the cost of determining individuals would virtually destroy the entire fund available for class members. Thus, the members cannot be identified through reasonable effort, "effort commensurate with the stakes." In the absence of individual notice, notice by publication may be substituted. In this case, the proposed notice that the court found acceptable was to place stickers on the side of each of the ATMs and to publish "notice in the principal Indianapolis newspaper and on a website."

The court also applied a pragmatic approach to the potential problem that the EFTA only applies to "consumer users of ATMs." The court stated that the problem that business users would have to be excluded from the class "is more theoretical than real in the circumstances of this case; for it is unlikely that ATMs in bars are commonly used for business transactions."

With the notice aspect resolved, the court launched into what it called "a deeper question." That is, "whether a class action should be permitted when the stakes, both individual and aggregate, in a class action are so small—so likely to be swamped by the expense of litigation[.]" The court observed that the smallness should not be a bar, especially where the smallness is individual claims and not the aggregate impact, as "that's the type of case in which class action treatment is most needful." The reason for this position is that class actions contain a deterrent objective in addition to compensating the wronged persons.

The court then observed that due to the small size of potential individual recoveries, "the cy pres remedy may be the only one that makes sense[.]" The court also recognized that the small award in cases such as this may do less to protect consumers through payment to the harmed individuals than it would through a *cy pres* remedy. That is when the court tossed in the interesting paragraph:

> A time-saving alternative might be a class action with the stated purpose, at the outset of the suit, of a collective award to a specific charity. We are not aware of such a case, but mention the possibility of it for future reference.

In light of this theoretical possibility, it seems there will be many future class cases that follow this advice. If counsel is able to, from the outset, identify that all funds are to be paid to a charity in lieu of return to individual plaintiffs, then this may provide a substantial aid in overcoming some of the challenges to certification of a Rule 23(b)(3) class. Rule 23(b)(3), in addition to the prerequisites of Rule 23(a), requires that a class action be superior to other alternatives and that common issues predominate. These requirements are generally referred to as "superiority" and "predominance." However, in assessing whether these requirements are met, the rule also provides a list of nonexclusive factors to be considered. One of those factors is manageability. It would seem that the removal of the need to make individual payments would go a long way toward overcoming manageability issues and tend to aid a finding of superiority. It seems highly likely that this approach may yield to a split among federal circuits and ultimately a decision by the Supreme Court.

All of this is mere speculation. The only thing that is certain is that it seems like Judge Posner has lobbed a grenade into the landscape of class actions that is hidden within a seemingly innocuous decision. Only time will tell what impact this paragraph has on a going forward basis.

Join us again next time for further discussion of developments in the law.

<u>Sources</u>

- *Hughes v. Kore of Ind. Enter., Inc.*, --- F.3d ---, No. 13-8018, 2013 WL 4805600 (7th Cir. Sept. 10, 2013).

- Electronic Funds Transfer Act – codified at 15 U.S.C. § 1693b.

- Federal Rule of Civil Procedure 23.

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