

UNITED STATES BANKRUPTCY COURT
WESTERN DISTRICT OF TEXAS
SAN ANTONIO DIVISION

IN RE:

MARK NUTRITIONALS, INC.,

DEBTOR.

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CASE NO. 02-54469
CHAPTER 7

UNOPPOSED MOTION TO *CY PRES* RESTITUTION CLAIM PAYMENT

Comes now the State of Texas (“State” or “Texas”) by and through the Office of the Attorney General (“Texas Attorney General”) and respectfully files this unopposed Motion to *Cy Pres* Restitution Claim Payment of \$789,017.75 which cannot be meaningfully distributed to the two million consumers for whom restitution was sought. As set forth below, the State is seeking to utilize the doctrine of *cy pres* in order to disburse the proposed dividend on its restitution claim to consumer law clinics at two Texas law schools. In support of its motion, the State would show the Court as follows:

Summary of Relief Requested

The Trustee has informed the parties that there is \$789,017.75 available for distribution on the claims filed by the State of Texas, the Commonwealth of Pennsylvania and the class action plaintiffs. These claims dovetail and overlap in that they cover the claims of the approximate two million consumers who purchased bogus weight loss supplements from the Debtor pre-petition. As there is no meaningful way to distribute \$789,017.75 to two million people, the State of Texas respectfully requests that this Court utilize the doctrine of *cy pres* to disburse this amount to proposed consumer law clinics at the University of Houston Law Center and the Southern Methodist

University Dedman School of Law.

Background

1. From about 1999 through early 2003, the Debtor, Mark Nutritionals, Inc. was engaged in the business of selling weight loss products including “Body Solutions Evening Weight Loss Formula,” which is estimated to have generated 90% of its sales revenue. In 2001 and 2002, the Debtor’s marketing practices came under challenge by the State, the Federal Trade Commission, several other states and by private litigants. In addition, the Debtor’s labeling practice came under challenge by the states of Texas and Pennsylvania. The Debtor filed a voluntary Chapter 11 petition on September 17, 2002.

2. The Debtor’s own study showed that the “Body Solutions Evening Weight Loss Formula” (“Formula”) did not work for weight loss. In a Final Report dated January 31, 2003, the results of Debtor’s study showed “no statistical significance” for weight loss for any of the four study groups, two of which took Debtor’s Formula.

3. The Debtor’s pre-petition conduct violated state law, specifically the Texas Food Drug and Cosmetic Act (“TFDCA”), TEX. HEALTH AND SAFETY CODE ANN. §§ 431.001 *et seq.* and the Texas Deceptive Trade Practices Act (“DTPA”), TEX. BUS. & COM. CODE § 17.41 *et seq.* The State filed suit against the Debtor in state court and the Consumer Protection Division of the Office of the Texas Attorney General filed a proof of claim in this bankruptcy (Claim No. 190) in the estimated amount of one-hundred ninety million dollars (\$190,000,000.00), representing restitution for an estimated two million consumers nationwide who purchased the Debtor’s products prepetition.

4. The State's proof of claim overlaps with the proof of claim filed by the private litigants in the class action suits against the Debtor. (Claim No. 101, filed in the estimated amount of one-hundred ninety million dollars (\$190,000,000.00) by Francis Marie Sims on behalf of herself and all others similarly situated) ("private class action claim"). As set forth in numerous pleadings filed earlier in this case, the State action is deemed a *de facto* class action. *See Bara v. Major Funding Corporation Liquidating Trust*, 876 S.W.2d 469, 473 (Tex. App.- Austin, 1994, writ denied) (actions brought by the Attorney General seeking restitution for "identifiable persons" pursuant to the DTPA are deemed *de facto* class actions). The Texas DTPA authorizes the State to seek restitution for identifiable persons and such authority is not limited to Texas Resident Consumers.

5. The State of Pennsylvania also filed a proof of claim in the bankruptcy. (Claim No. 222, filed by the Commonwealth of Pennsylvania Office of the Attorney General in the amount of \$3,159,700.00). This claim is a subset of the Texas Attorney General's claim and the private class action claim (both of which claims seek restitution on a national basis).

6. Post-petition, the State found that during the pendency of the Chapter 11 proceedings in this case the Debtor-in-Possession committed substantial, repeated and continuous violations of state law with respect to product labeling and deceptive advertising, despite repeated inspections and warnings. These actions gave rise to an additional claim for post-petition consumer restitution and civil fines and penalties. Such claim was found by this Court to be entitled to administrative priority treatment in bankruptcy.

7. The State commenced an adversary proceeding against the Debtor which sought a declaration that the claim post-petition fines and penalties incurred by the Debtor was entitled to

administrative priority status under 11 U.S.C. § 503. (Adversary Proceeding No. 03–5074).

8. The State and the Chapter 7 Trustee settled the State’s claims and filed a Joint Motion for Approval of Compromise and Settlement (Doc. 409) (“Settlement”), which was approved by this Court’s order dated February 9, 2004 (Doc. 469).

9. The Settlement provided meaningful restitution to post-petition consumers and paid out approximately \$1,000,000.00 to that group. The State and the Chapter 7 Trustee concurred that the funds were simply not sufficient to make meaningful restitution to the two million prepetition consumers, whose claims are estimated between \$179,000,000.00 and \$190,000,000.00.

10. The Trustee’s exceptionally diligent efforts and hard work since the time of that initial distribution to post-petition consumers have now brought additional unforeseen assets into the Estate. The Trustee has informed the parties that there is now an additional \$789,017.75 for distribution on these claims of the State of Texas, the Commonwealth of Pennsylvania and the class plaintiffs. This \$789,017.75 is separate and apart from all other claims being paid by this Estate (in accordance with the Bankruptcy Codes’ statutory scheme of prioritizing of payments). As discussed *supra*, these claims are overlapping.

11. As at the time of the prior Settlement between the State and the Trustee, the parties are faced with the unfortunate reality that there is no manner in which \$789,017.75 can be distributed in any meaningful fashion to two million consumers. Accordingly, as is set forth in more detail below, the State seeks to *cy pres* the bulk of the proposed dividend to consumer law clinics at two Texas law schools. The balance of the proposed dividend will pay the Commonwealth of Pennsylvania their entire *pro rata* share of the dividend and provide for a modest additional payment

to counsel for the class plaintiffs for their time and expenses in pursuing the various class actions.¹
Counsel for the class plaintiffs do not oppose this relief.

Proposal to *Cy Pres* Proposed Dividend

12. Once the State became aware that the Trustee would have some amount of money of additional money available for distribution on its claim, but that the amount would not be anywhere approaching an amount which could make meaningful restitution to the approximately two million pre-petition consumers, Consumer Protection Division of the Texas Attorney General's office began considering how the proposed dividend could be best utilized. After internal discussions, the Texas Attorney General proposes that the proposed dividend should be used to fund consumer law clinics. The Texas Attorney General reasons that as the aggrieved individuals in the instant bankruptcy case (the pre-petition consumers) cannot be made whole, the money would be best spent improving legal resources available without charge to consumers.

13. In furtherance of this idea, representatives of the Texas Attorney General contacted law schools to see whether they had existing consumer law clinics, or an interest in forming consumer law clinics, and could utilize some or all of the proposed dividend from this Estate to fund the clinics.

14. The Texas Attorney General asks this Court to *cy pres* funds in accordance with the proposals from the University of Houston Law Center and the Southern Methodist University Dedman School of Law.

¹ Class action counsel previously received _____ as part of the Compromise & Settlement on the 9019 discussed above at ¶'s 7 and 8.

15. The Center for Consumer Law at the University of Houston proposes the initiation of a Settlement/Mediation program to supplement the services offered by its Consumer Law Clinic. The proposed program seeks to provide assistance to consumers in the Houston metropolitan area who face problems dealing with defective goods or services, credit and debt collection problems (including identity theft), landlord-tenant problems, and bankruptcy. The Center proposes the implementation of the following forms of assistance: a comprehensive website compiling basic legal information, consumer tips and legal references; a telephone help line; an ombudsperson; and trained law student mediators.

16. The Southern Methodist University Dedman School of Law proposes a new Consumer Advocacy Project including a special focus on Spanish-speaking consumers. The proposed project would provide assistance to consumers in the following stages: consultation with a student consumer advocate to evaluate the matter for informal dispute resolution or consumer self-help; advocacy on behalf of consumers in informal dispute resolution; advocacy on behalf of consumers in formal mediation; evaluation for litigation and referral as appropriate to local attorneys or to the existing Southern Methodist University Civil Clinic; and consumer education through the public schools and/or periodic community radio appearances.

17. The Texas Attorney General proposes that the bulk of the proposed \$789,017.75 dividend be split equally between these two programs. The State has discussed this proposal with the class action counsel whose clients would arguably have a claim to this proposed dividend and counsel to class action plaintiffs do not oppose the State's motion. Under the structure of the State's proposal, the Commonwealth of Pennsylvania will be paid its entire *pro rata* share of the proposed dividend in full.

18. The State proposes the following distribution of the proposed dividend: \$59,000.00 to class plaintiffs and their counsel to reimburse some of their attorneys fees and/or expenses which were previously disallowed in Bankruptcy Court²; \$13,018.79 to the Commonwealth of Pennsylvania, representing their pro rata share of claimed damages (1.65% of the total claimed on behalf of consumers in this bankruptcy case); and the balance of approximately \$716,998.96 split equally between the Programs proposed by the University of Houston Law Center and the Southern Methodist University Dedman School of Law, resulting in a payment of \$358,499.48 to each program.

Legal Support for State's Request to *Cy Pres*

19. *Cy pres* is the equitable doctrine under which a court reforms a written instrument with a gift to charity as closely to the donor's intention as possible so that the gift does not fail. It is also used to distribute unclaimed portions of a class action judgment or settlement funds to a charity that will advance the interests of the class. BLACK'S LAW DICTIONARY (8th ed. 2004).

20. In the Bankruptcy context, the doctrine has been used to preclude distribution of the income and corpus of a charitable trustee to the Chapter 7 Trustee when the debtor was benefitted by such trust. *In re Bishop Coll.*, 151 B.R. 394 (N.D. Tex. 1993).

² The \$59,000 is to be allocated as follows:

Hubbard & Biederman, L.L.P.	2,450.00
Provizer & Phillips, P.C.	29,000.00
James, Hoyer, Newcomer & Smiljanich	3,800.00
The Mason Law Firm	100.00
Cohen Milstein Hausfeld & Toll	550.00
Milberg Weiss Bershad Hynes & Lerach	9,750.00
The Landskroner Law Firm, Ltd.	1,500.00
Hancock, Rothert & Bunshoft, LLP	2,500.00
remainder to Bingham & Lea, P.C.	9,350.00

21. The State has not located any Bankruptcy court decisions in which the *cy pres* doctrine was utilized solely because payments of consumer restitution claims were not feasible. However, at least one Bankruptcy court has utilized the doctrine to distribute funds remaining unclaimed in a class action settlement fund. *Turner v. Tri-State Plant Food, Inc. (In re Tri-State Plant Food, Inc.)*, Ch. 11 Case No. 00-3889-WRS, Adv. Pro. No. 00-182-WRS (M.D. Ala. Oct. 10, 2003) (unpublished). In *Tri-State*, the court considered four alternatives: *cy pres* distribution, distribution to the claiming class members, escheating to a government entity, and returning the unclaimed funds to the defendant. The court's determination was influenced by: 1) the defendant was not seeking return of the funds, 2) class counsel proposed a *cy pres* distribution, and 3) the costs to distribute the funds were high in relation to the amount class members would receive. The court heard requests for the funds and signed an order issuing the excess funds to a youth program.

22. Outside the bankruptcy context, federal district courts have used the *cy pres* doctrine to distribute funds remaining in class action settlement funds. *In re Motorsports Merch. Antitrust Litig.*, 160 F. Supp. 2d 1392 (N.D. Ga. 2001). In class actions, *cy pres* is also called "fluid recovery." See *Six (6) Mexican Workers v. Arizona Citrus Growers*, 904 F.2d 1301 (9th Cir. 1990). In *Six Mexican Workers*, the court reviewed the district court's *cy pres* distribution for abuse of discretion. *Id.* at 1304. The court reasoned that the lower court's use of *cy pres* was involved only to distribute the damages, not to avoid proof of individual damages. *Id.* at 1306. The district court determined that the only interests in the remaining funds were the non-claiming class members and stated that federal courts have "broad discretionary powers in shaping equitable decrees for distributing unclaimed class action funds." *Id.* at 1307. Thus, the Ninth Circuit did not disapprove the application of *cy pres* by the district court, however they found abuse of discretion in the

selection of the organization to receive the funds as too remote from the group to be benefitted. *Id.* at 1308. They directed the district court to fashion a “next best” distribution after the expiration of the claims period to better reach the goals of the statute and of the non-claiming class members. *Id.* at 1309.

23. *In re Motorsports*, 160 F. Supp 2d at 1393, involved a class action by consumers for conspiracy to fix prices of NASCAR souvenirs. After all claims were settled, \$2,100,000 remained in the fund. The district court evaluated the legal rights of the defendants and the claiming class members, both of which sought the excess funds, and determined that neither group had a legal interest. *Id.* They further determined that the only group having an equitable right to the funds were the non-claiming class members, thus the court used the *cy pres* principle to distribute the funds in a way that would indirectly benefit that group. *Id.* At 1394. The court noted that other courts have expanded the *cy pres* doctrine to charitable distributions to organizations not directly related to the original claims. *Id.* Distributions of the fund were made to nine organizations. *Id.* at 1396-98.

24. *In Superior Beverage Co. V. Owens-Illinois, Inc.*, 827 F.Supp. 477 (N.D. Ill. 1993), the settlement agreement in the antitrust class action provided that the court would distribute the excess funds by the doctrine of *cy pres*. *Id.* at 477, 78. The court explored the scope and limits of the doctrine by acknowledging that it was historically limited to finding the “next best” use for the intended funds, but also took note of more flexible applications in recent years. *Id.* at 478. The court said that while the best *cy pres* application was for a use closely related to the original purpose for which the funds were designated, the doctrine and the broad equitable powers of the court permit other uses. *Id.* at 479. These other uses can be educational, charitable, or other public service organizations. *Id.* Thus, the court approved distributions of the slightly more than \$2,000,000 in

the fund to fifteen organizations including the University of Chicago Law School Legal Aid Clinic, University of Illinois College of Law, Loyola University of Chicago College of Law, Northwestern University Law School as well as various legal assistance groups and a museum. *Id.* at 480-87.

25. *In re Corrugated Container Antitrust Litig.*, 556 F.Supp. 1117 (S.D. Tex. 1982), the court made a *cy pres* distribution of about \$990,000, raising the issue on its own motion. *See Residual Funds from Box Settlement will Be Distributed to 9 Organizations*, 53 Antitrust & Trade Reg. Rep. (BNA) 711 (Nov. 5, 1987). The distributions were ultimately made to four Texas law schools, law schools at University of Pennsylvania and Stanford University, the National Association of Attorneys General, and two packaging foundations. *Id.* The court found that the cost to distribute to the class as a whole would consume too much cost in administrative expenses, accordingly the court used *cy pres* doctrine to distribute the funds. *Id.*

26. In *New York v. Reebok Int'l.Ltd.*, 903 F. Supp. 532 (S.D.N.Y. 1995), *aff'd* 96 F.3d 44 (2nd Cir. 1996), the settlement agreement provided that the entire settlement fund would be distributed to public non-profit and/or charitable organizations. *Id.* at 534. *Reebok* was a *parens patriae* suit alleging price fixing filed by all fifty states, the District of Columbia, Puerto Rico, and the Virgin Islands. *Id.* To determine whether to make a *cy pres* distribution, the court looked at several factors. *Id.* at 537. First, the court balanced the likely benefit of direct restitution to the consumers against the costs of making such direct restitution and found that the costs far outweighed the benefits. *Id.* The court also found that because so few consumers keep receipts for purchases of this type that the risk of fraudulent claims outweighed individual restitution. *Id.* The states had the choice of taking a proportionate share (based on population) of either Reebok products or monies for distribution to the public non-profit and/or charitable organizations. *Id.* at 534. The monetary

distributions were to be for the express purpose of funding athletic services or programs. See *Id.*

27. Texas state courts also make *cy pres* settlements in class actions. See *Northrup v. Southwestern Bell Telephone*, 72 S.W.3d 16 (Tex. App.-Corpus Christi 2002), *reh'g overruled*. The Court noted that the trial court had considered the appropriate factors to make a complete *cy pres* distribution: the amounts due each plaintiff were extremely small and the costs of the distribution outweigh the amounts they would receive. *Id.* At 22. Further, the *cy pres* distribution would further class action litigation goals by deterring similar conduct and disgorging wrongfully gained profits from the defendant. *Id.* The court noted that other Texas cases could not be located that utilized *cy pres* in distributing a class action settlement, but cited to *In re Motorsports, Reebok*, and *Superior Beverage Co.*

WHEREFORE, the State respectfully requests that this Court utilize the doctrine of *cy pres* to effectuate its proposed distribution of the funds held by the Trustee. The State asserts that the amount of money presently available for distribution, while of enough significance to provide for the implementation of consumer law clinics to provide services and resources to consumers, is not sufficient to provide meaningful restitution to pre-petition consumers. Accordingly, the State respectfully requests that the Court grant its motion to allow the proposed dividend to be paid in the matter set forth above.

Respectfully submitted,

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CERTIFICATE OF SERVICE

I hereby certify that a true and correct copy of the foregoing was served upon parties listed below on September 19, 2005, either by the Court's Electronic Filing System or by regular U.S. Mail postage prepaid.

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