

Notes

CLASS ACTION SETTLEMENTS, CY PRES AWARDS, AND THE *ERIE* DOCTRINE

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ABSTRACT—As class action settlement funds become more and more prevalent, cy pres awards have become a more common means of providing relief to absent class members. The primary purpose of cy pres awards is to provide a second-best form of relief when it is deemed impossible to directly compensate individual plaintiffs. Most often, these cy pres awards are given to some kind of charitable organization. Under federal law, class action settlements and cy pres awards are governed by Federal Rule of Civil Procedure 23(e). Rule 23(e)(2) requires all class action settlements to be “fair, reasonable, and adequate,” but provides no further guidance. Thus, federal courts look to judge-made standards to determine the validity of a cy pres award. Numerous states have codified cy pres laws with specific requirements into their statutory schemes. Every state has an unclaimed property law. Both the state cy pres statutes and unclaimed property laws may conflict with federal law. This Note will examine how a federal court sitting in diversity jurisdiction would and should respond where state and federal law conflict. In so doing, it will discuss the interplay of cy pres doctrine, the *Erie* doctrine, the Rules of Decision Act, and the Rules Enabling Act. This Note concludes by examining the proposal by the Rule 23 Subcommittee on Civil Rules to codify cy pres in Rule 23(e) and the Subcommittee’s subsequent withdrawal of the amendment. This conduct bolsters the conclusions that that a Rules Enabling Act analysis is more appropriate for these cy pres questions, and that federal cy pres awards may indeed violate the Rules Enabling Act.

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INTRODUCTION

As class action settlement funds become more and more prevalent, cy pres awards have become a more and more common means of providing relief. Cy pres comes from the French expression *cy pres comme possible*, which means “as near as possible.”¹ Thus, the purpose of cy pres in the class action context is to provide a second-best alternative form of relief when direct compensation of absent class members is not possible.² Most notably, cy pres awards generally refer to any class action award given to charitable or other nonprofit organizations that have a purpose related to the underlying cause of action.³ The use of cy pres awards as a tool to

¹ WILLIAM B. RUBENSTEIN, NEWBERG ON CLASS ACTIONS § 12.32 (5th ed.), Westlaw (database updated Dec. 2016).

² *Id.*; see also Stewart R. Shepherd, Comment, *Damage Distribution in Class Actions: The Cy Pres Remedy*, 39 U. CHI. L. REV. 448, 452 (1972) (suggesting that uncollected damages in a class action can be distributed to the “next-best” use based on the cy pres doctrine).

³ RUBENSTEIN, *supra* note 1; see also Christine P. Bartholomew, *Saving Charitable Settlements*, 83 FORDHAM L. REV. 3241, 3250 (2015) (discussing cy pres in the context of class action settlements).

distribute class action funds is extremely controversial.⁴ Critics suggest that attorneys and judges abuse cy pres distributions by dispersing the funds to causes completely unrelated to the cause of action, even to causes that are tied to the attorneys or judges.⁵ Supporters, on the other hand, argue that cy pres awards serve the interest of class members by approximating a related alternative to individual compensation while still deterring misbehaving defendants.⁶

The debate reached a climax with Chief Justice Roberts's comment in denying certiorari in *Marek v. Lane*.⁷ He wrote that, at some point, the Supreme Court should address "when, if ever, [cy pres] relief should be considered."⁸ In April 2015, seemingly in response to Chief Justice Roberts, the Rule 23 Subcommittee of the Advisory Committee on Civil Rules ("Rule 23 Subcommittee" or "Subcommittee")⁹ released a report suggesting an amendment to Federal Rule of Civil Procedure ("Federal Rule" or "Rule") 23(e),¹⁰ which would add specific guidelines for approving cy pres remedies in a settlement agreement.¹¹ Although the Rule 23 Subcommittee ultimately decided to remove the cy pres amendment

and noting that cy pres can refer to the distribution of leftover settlement funds to a charity or to a settlement that designated a charity as a recipient of funds at the outset).

⁴ RUBENSTEIN, *supra* note 1; see also Martin H. Redish, Peter Julian & Samantha Zyontz, *Cy Pres Relief and the Pathologies of the Modern Class Action: A Normative and Empirical Analysis*, 62 FLA. L. REV. 617, 641–51 (2010); Sam Yospe, Note, *Cy Pres Distributions in Class Action Settlements*, 2009 COLUM. BUS. L. REV. 1014, 1021–36; George Krueger & Judd Serotta, *Our Class-Action System Is Unconstitutional*, WALL ST. J. (Aug. 6, 2008, 12:01 AM), <http://www.wsj.com/articles/SB121798040044415147> [<https://perma.cc/PAT5-SRP7>]; Adam Liptak, *Doling Out Other People's Money*, N.Y. TIMES (Nov. 26, 2007), <http://www.nytimes.com/2007/11/26/washington/26bar.html> [<https://perma.cc/MJ4E-ZRMJ>].

⁵ Cecily C. Shiel, Note, *A New Generation of Class Action Cy Pres Remedies: Lessons from Washington State*, 90 WASH. L. REV. 943, 945 (2015).

⁶ Wilber H. Boies & Latonia Haney Keith, *Class Action Settlement Residue and Cy Pres Awards: Emerging Problems and Practical Solutions*, 21 VA. J. SOC. POL'Y & L. 267, 269–70 (2014).

⁷ 134 S. Ct. 8 (2013).

⁸ *Id.* at 9.

⁹ The Rule 23 Subcommittee is responsible for "becom[ing] fully informed about pertinent issues regarding Rule 23 practice . . . [and] keeping an eye out to identify pertinent developments and concerns." See RULE 23 SUBCOMMITTEE REPORT 1 (Apr. 2015), <https://classactionblawg.files.wordpress.com/2015/04/rule-23-subcommittee-report.pdf> [<https://perma.cc/9JWE-KPNK>] [hereinafter APRIL 2015 RULE 23 SUBCOMMITTEE REPORT]. The Subcommittee releases memoranda "to share with the full Committee the content and fruit of the Subcommittee's recent discussions . . . [and] present[] conceptual sketches of some possible amendments" to Rule 23. *Id.* at 2.

¹⁰ Rule 23 defines the rules for class actions, and Rule 23(e) describes the rules for "Settlement, Voluntary Dismissal, or Compromise." FED R. CIV. P. 23(e).

¹¹ See APRIL 2015 RULE 23 SUBCOMMITTEE REPORT, *supra* note 9, at 23–24. For a detailed discussion of the proposed amendment, see *infra* Part V.

from its current reform agenda,¹² cy pres awards are likely to stay in the public eye given Chief Justice Roberts's comments and growing scholarly criticism.

This Note, unlike previous scholarship on cy pres as a class action remedy, frames the discussion by examining whether a federal court sitting in diversity jurisdiction should apply federal or state law in determining the validity of a cy pres award as part of a class action settlement agreement. First, Part I of this Note discusses the history of cy pres law. Then, in Part II, this Note examines current choice of law doctrine. Based on current doctrine, it explores the tests federal courts sitting in diversity jurisdiction might apply to determine whether to permit cy pres settlements in accordance with federal law when the federal law conflicts with state law. The critical question that courts must answer to perform this analysis is whether federal cy pres doctrine is derived from Rule 23(e) or is a product of federal judge-made common law. Based on the Court's *Erie* line of cases, as this Note discusses in Part III, it is likely that courts will determine that judge-made common law controls cy pres doctrine. Thus, courts will use a Rules of Decision Act¹³ analysis. However, in Part IV, this Note argues that the more appropriate approach, in light of Justice Scalia's *Shady Grove Orthopedic Associates v. Allstate Insurance Co.*¹⁴ opinion in 2010, is to examine cy pres law as derived from Rule 23(e). If courts were to take this approach, they would conduct a Rules Enabling Act¹⁵ analysis and likely conclude that federal law should apply. Part V concludes that the Rule 23 Subcommittee's proposal to codify cy pres awards as a part of Rule 23(e) is a tacit acknowledgment that class action cy pres settlement remedies are in fact derived from Rule 23, even though the Subcommittee withdrew the recommendation. In fact, as Part V suggests, the very fact that the Subcommittee withdrew its proposal lends credence to the idea that cy pres remedies in class action settlement agreements may violate the Rules Enabling Act.

¹² See RULE 23 SUBCOMMITTEE REPORT 4, 46–47 (Nov. 2015), <http://www.classactioncountermeasures.com/files/2015/10/2015-1105-Rule-23-Subcommittee-Report.pdf> [<https://perma.cc/4DWY-GSL7>] [hereinafter NOVEMBER 2015 RULE 23 SUBCOMMITTEE REPORT].

¹³ The Rules of Decision Act states that “[t]he laws of the several states, except where the Constitution or treaties of the United States or Acts of Congress otherwise require or provide, shall be regarded as rules of decision in civil actions in the courts of the United States, in cases where they apply.” 28 U.S.C. § 1652 (2012).

¹⁴ 559 U.S. 393 (2010) (plurality opinion).

¹⁵ The Rules Enabling Act provides the Supreme Court the power to prescribe the Federal Rules of Civil Procedure and states that “[s]uch rules shall not abridge, enlarge or modify any substantive right.” § 2072(b).

I. THE DEVELOPMENT OF CY PRES

This Part will discuss the development of cy pres law. First, this Part will discuss the original use of cy pres awards in the law of trusts. Then, this Part will discuss the development of cy pres doctrine in the realm of class actions. Finally, this Part will discuss modern federal courts' use of cy pres awards as a class action remedy.

A. *The Historical Origin of Cy Pres in Trust Law*

The doctrine of cy pres has a long, historical background. It originated as a tool used in trust law to honor a testator's charitable gift as best as possible when it was impossible to honor the testator's specific intent.¹⁶ It is not totally clear where the legal concepts surrounding cy pres began, but evidence points to the Roman Empire.¹⁷ The *Digest of Justinian*, a collection of Roman law, directed that gifts left by the deceased intended to celebrate games that had become illegal instead be put to some legal use to honor the deceased's memory.¹⁸ Later, England adopted the concept of cy pres as an aspect of trust law, motivated by importance of charities and the role of the church.¹⁹ When honoring a charitable trust became impossible, the gift instead would be designated to a purpose that closely approximated the original intent of the testator.²⁰ In England, there were two distinct types of cy pres: judicial and prerogative.²¹ Under judicial cy pres, the chancellor was responsible for determining the original intent of the testator and ensuring that the ultimate recipient of the gift honored that intent.²² On the other hand, the king exercised prerogative cy pres with broad discretion and could designate charitable gifts to causes only loosely related—or sometimes completely unrelated—to the donor's original intent.²³ Both France and Spain also adopted cy pres as part of their civil law.²⁴

¹⁶ EDITH L. FISCH, *THE CY PRES DOCTRINE IN THE UNITED STATES* § 1.00, at 1 (1950).

¹⁷ *Id.* § 1.02, at 3.

¹⁸ *Id.* § 1.02, at 3–4.

¹⁹ *Id.* § 1.03, at 4; see also Hamish Gray, *The History and Development in England of the Cy-Pres Principle in Charities*, 33 B.U. L. REV. 30, 32–33 (1953) (noting that cy pres developed based on a presumption in favor of charity, and that charity in medieval England was “largely confined to the Church”). Often, the chancellor who exercised cy pres also was an official of the church, and suggested “property not specifically disposed of should be used by the executors for the good of the testator’s soul.” *Id.* at 33; see also *id.* (“[T]he motive of the testator in making bequests to charitable uses was closely linked with his own concern for the future of his soul.”).

²⁰ *A Reevaluation of Cy Pres*, 49 YALE L.J. 303, 305 (1939).

²¹ *Id.* at 303.

²² *Id.* at 304–05.

²³ *Id.* at 305.

²⁴ FISCH, *supra* note 16, § 1.03, at 4.

In America, courts originally rejected use of cy pres in trust law; this rejection was motivated by a fear that courts would have too much power and that the chancellor would use cy pres to benefit his own social and religious views rather than staying true to the donor's original intent.²⁵ Eventually, state courts affirmed cy pres to preserve charitable trusts, and currently, nearly every state has codified cy pres in trust law by statute.²⁶ In general, courts only apply cy pres to enforce a charitable trust when: (1) the gift is in fact a valid charitable trust, (2) it is impossible or impracticable to honor the original gift, and (3) the testator had some "general charitable intention" to make the gift.²⁷ Because the third requirement necessitates courts to judge the intent of the testator, a difficult if not impossible task, some states have modified or eliminated that factor.²⁸ In the latter half of the twentieth century, trust law cy pres doctrine crossed over into the class action context.

B. *The Development of Class Action Cy Pres Doctrine*

In 1966, the Federal Rules Advisory Committee dramatically altered Rule 23.²⁹ Most notably, the new Rule states that in nonmandatory classes, absent class members are presumed to be a part of the class unless they proactively opt out.³⁰ As a result, leftover funds from class-wide awards and class-wide settlements have become a common occurrence.³¹ Absent class members who never affirmatively join a class in the first place sometimes never claim their portion of the award, thus leaving a portion of the fund unclaimed.³² For example, in *West Virginia v. Chas. Pfizer & Co.*,³³ \$32 million of a \$100 million settlement was unclaimed.³⁴

²⁵ Jennifer Johnston, Comment, *Cy Pres Comme Possible to Anything is Possible: How Cy Pres Creates Improper Incentives in Class Action Settlements*, 9 J.L. ECON. & POL'Y 277, 280 (2013).

²⁶ Redish et al., *supra* note 4, at 628 & n.59 (citing the statutes of forty-six states and the District of Columbia).

²⁷ FISCH, *supra* note 16, § 5.00, at 128.

²⁸ Redish et al., *supra* note 4, at 629–30 (noting, for example, that the Pennsylvania legislature removed the intent requirement, the Connecticut Supreme Court eliminated the intent requirement, and in Massachusetts the intent requirement is presumed to be satisfied absent clear alternative intent).

²⁹ See Benjamin Kaplan, *Continuing Work of the Civil Committee: 1966 Amendments of the Federal Rules of Civil Procedure (I)*, 81 HARV. L. REV. 356, 356 (1967).

³⁰ Redish et al., *supra* note 4, at 630; see FED R. CIV. P. 23(c)(3)(B).

³¹ Johnston, *supra* note 25, at 281.

³² This often is the case when the damage awards are so small that individual absent plaintiffs are not sufficiently incentivized to fill out and mail the paperwork required to claim their part of the award. See Redish et al., *supra* note 4, at 631.

³³ 314 F. Supp. 710, 728 (S.D.N.Y. 1970), *aff'd*, 440 F.2d 1079, 1082 (2d Cir. 1971).

³⁴ Johnston, *supra* note 25, at 281 (citing *Pfizer*, 314 F. Supp. 710).

Traditionally, unclaimed class action settlement funds have simply reverted back to the defendants, but such a result was criticized because it decreased the deterrent impact of civil litigation on defendants' activities.³⁵ A 1972 student comment by Stewart Shepherd was the first to suggest an alternative: cy pres awards in the class action context.³⁶ Shepherd suggested that unclaimed funds could be distributed to the "next-best recipient" in a process "analogous to the doctrine of cy pres."³⁷ To distribute leftover funds through use of a cy pres award, he argued, courts should attempt to determine alternative recipients whom the legislature would prefer, trying to stay as true as possible to the legislature's intent.³⁸ He suggested three approaches: "(1) distribution to those class members who come forward to collect their damages, (2) distribution through the state in its capacity as *parens patriae* or by escheat, and (3) distribution through the market."³⁹ Although Shepherd acknowledged that the best option was to distribute the funds to injured parties, he argued that "[a]s it becomes more difficult, or even impossible, to ascertain which alternate recipients the legislature would prefer, it may be appropriate to devote the funds to a broader public service in order to maximize the benefit to society."⁴⁰ In 1987, new scholarship suggested that an acceptable "next best" form of compensation was a donation to a charity or nonprofit organization that is at least loosely related to the class members' injuries.⁴¹

³⁵ See Redish et al., *supra* note 4, at 631.

³⁶ See Shepherd, *supra* note 2, at 452.

³⁷ *Id.*

³⁸ *Id.* at 453; see also RUBENSTEIN, *supra* note 1, § 12.32 ("The class action analogy is strained but works by assuming that the court, as when it redirects a settlor's money from one set of beneficiaries to another, is simply redirecting money from one set of beneficiaries (absent class members) to an entity whose interests lie 'as near as possible' to that group—namely, a charity working on issues related to the group's underlying causes of action—rather than have the monies revert to the defendant." (footnote omitted)).

³⁹ Shepherd, *supra* note 2, at 453. *Parens patriae* is "[a] doctrine by which a government has standing to prosecute a lawsuit on behalf of a citizen." *Parens Patriae*, BLACK'S LAW DICTIONARY (10th ed. 2014). *Escheat* is the "[r]eversion of property . . . to the state." *Escheat*, BLACK'S LAW DICTIONARY (10th ed. 2014).

⁴⁰ Shepherd, *supra* note 2, at 452–53.

⁴¹ Redish et al., *supra* note 4, at 633–34 (noting that under this theory of cy pres, unclaimed funds would be formed into a charitable trust to be donated to an existing charitable organization or used to create a new charitable foundation); see also Kerry Barnett, Note, *Equitable Trusts: An Effective Remedy in Consumer Class Actions*, 96 YALE L.J. 1591, 1605 (1987); Natalie A. DeJarlais, Note, *The Consumer Trust Fund: A Cy Pres Solution to Undistributed Funds in Consumer Class Actions*, 38 HASTINGS L.J. 729, 759 (1987).

C. Class Action Cy Pres Awards in Federal Courts

In modern American law, federal courts use cy pres doctrine as a remedy in the class action context under two related but distinct scenarios. First, a cy pres award can be used when, after funds from a settlement are distributed to the class members, excess funds remain in the original settlement pot.⁴² The excess funds are often a consequence of failing to locate absent class members, absent class members failing to file their claims, or absent class members failing to cash their checks.⁴³ Alternatively, excess funds may result when it is economically impracticable to send awards to absent class members.⁴⁴ This most commonly occurs when individual damages are so low that the administrative costs of sending the funds are greater than the value of the individual awards themselves.⁴⁵ Second, cy pres remedies included as part of settlement agreements themselves have become more and more common.⁴⁶ In these instances, the plaintiff class and defendant agree, as part of the settlement, that a portion of the settlement money will go to a designated charity.⁴⁷

The first use of cy pres as a tool for determining a class action remedy in the federal courts came in *Miller v. Steinbach*⁴⁸ in 1974. The District Court for the Southern District of New York recognized that there was no precedent for or against a cy pres award as a portion of a settlement agreement and that a cy pres award would “certainly not . . . benefit those on whose behalf the action was brought.”⁴⁹ Nevertheless, because “individual recoveries would be de minimus by almost any standard,” the court approved the settlement agreement—including the cy pres award—noting that “no alternative [was] realistically possible.”⁵⁰ Since *Miller*, no clear judicially enforced standard has developed to determine the validity

⁴² Shiel, *supra* note 5, at 950.

⁴³ *Id.*

⁴⁴ *Id.*

⁴⁵ *Id.*

⁴⁶ See Redish et al., *supra* note 4, at 653.

⁴⁷ See Johnston, *supra* note 25, at 284 (“In its modern form [cy pres] permits the distribution of funds to uninterested parties before there are even any residual funds left over.”); see also Bartholomew, *supra* note 3, at 3250. Although Professor Bartholomew attempts to distinguish charitable settlements—in which a charity is chosen to receive money as part of the settlement—from other cy pres awards, she acknowledges that no other scholar has made that distinction. *Id.* This Note will consider charitable settlements as a form of cy pres.

⁴⁸ No. 66 Civ. 356, 1974 WL 350 (S.D.N.Y. Jan. 3, 1974).

⁴⁹ *Id.* at *2.

⁵⁰ *Id.*

of cy pres awards.⁵¹ Instead, cy pres awards have been evaluated somewhat inconsistently under both the requirements of Rule 23(e) and judge-made common law.⁵² According to Rule 23(e), the court must approve class action settlements,⁵³ and for settlements to be upheld, they must be “fair, reasonable, and adequate.”⁵⁴ However, the Federal Rules do not specify a judicial standard for determining whether a settlement passes the Rule 23(e) test, and to fill this void, federal courts have created common law requirements.⁵⁵

The Supreme Court first addressed cy pres awards as a class action remedy in 2013. In *Lane v. Facebook, Inc.*,⁵⁶ plaintiffs filed a class action against Facebook. They alleged that Facebook violated their privacy rights as a result of the Beacon program, which updated Facebook members’ profiles based on actions the members took on websites that contracted with Facebook.⁵⁷ The parties agreed to a \$9.5 million settlement; \$6.5 million took the form of a cy pres award to a new charity organization to provide education on online privacy law.⁵⁸ Notably, Facebook’s Director of Public Policy was one of three individuals selected to serve on the board of directors of the new organization, and counsel for Facebook sat on the organization’s Board of Legal Advisors.⁵⁹ Thus, because Facebook maintained significant control over the cy pres recipient—the new charity organization—there were serious concerns about the award and a potential conflict of interest.⁶⁰ The Ninth Circuit affirmed the settlement, holding that the settlement as a whole—including the cy pres award—was “fundamentally fair,” satisfying the requirements of Rule 23(e).⁶¹ The court held that it was both infeasible to provide monetary payments to the absent

⁵¹ See Shiel, *supra* note 5, at 951; see also Bartholomew, *supra* note 3, at 3256 (noting that courts have a “great deal of judicial discretion” in considering the validity of cy pres awards, leading “to inconsistent decisions over similar charitable settlements”); Goutam U. Jois, *The Cy Pres Problem and the Role of Damages in Tort Law*, 16 VA. J. SOC. POL’Y & L. 258, 263 (2008) (noting that “courts are free to do almost anything with undistributed class funds,” leading “to a system that is ad hoc, unpredictable, unguided by any normative principle, and open to the possibility of abuse”).

⁵² For a discussion on the implications of the determination as to whether class action cy pres awards are controlled by Rule 23(e) or judge-made common law, see *infra* Parts III–V.

⁵³ FED. R. CIV. P. 23(e).

⁵⁴ FED. R. CIV. P. 23(e)(2).

⁵⁵ See *infra* Section III.A.

⁵⁶ 696 F.3d 811 (9th Cir. 2012), *reh’g denied*, 709 F.3d 791 (9th Cir. 2013), *cert. denied sub nom. Marek v. Lane*, 134 S. Ct. 8 (2013).

⁵⁷ *Id.* at 816.

⁵⁸ *Id.* at 817.

⁵⁹ *Id.* at 817–18.

⁶⁰ See Rhonda Wasserman, *Cy Pres in Class Action Settlements*, 88 S. CAL. L. REV. 97, 133 (2014).

⁶¹ *Facebook*, 696 F.3d at 825.

class members and that there was a sufficient nexus between the organization and the harm that the plaintiffs suffered.⁶² Judge Andrew Kleinfeld dissented and asserted that the settlement failed to meet the “higher standard of fairness” required to satisfy Rule 23(e).⁶³ Judge Kleinfeld was concerned about the incentive for collusion, as he noted that “there [was] nothing to stop Facebook and class counsel from managing the charity to serve their interests.”⁶⁴

Even though the Supreme Court denied certiorari, Chief Justice Roberts took the unusual step of issuing a statement from the bench, stating that when a more suitable case presents itself, the Court should consider “when, if ever, [cy pres] relief should be considered” and should “clarify the limits on the use of such remedies.”⁶⁵ Specifically, Chief Justice Roberts was interested in examining “how to assess . . . fairness [of cy pres] as a general matter,” how to choose entities to receive the cy pres award, whether new entities could be formed as part of the relief, how to delineate responsibility between the judge and parties in forming the cy pres remedy, and “how closely the goals of any enlisted organization must correspond to the interests of the class.”⁶⁶ As demonstrated by Chief Justice Roberts’s statement accompanying this denial of certiorari, the law regarding federal cy pres awards as part of class action settlement agreements is in flux.

D. Cy Pres Class Recovery and State Law

For purposes of this Note, it is necessary to examine two types of state law that may conflict with federal cy pres law. First, unlike the Federal Rules Advisory Committee, many state legislatures have explicitly codified cy pres awards as a form of class action remedy that can be agreed to in a settlement. These statutes differ in the type of remedy they allow, and therefore the state statutes’ cy pres guidelines may conflict with federal cy pres law’s flexible requirements. Second, every state has an unclaimed property law allowing a state to collect property that goes unclaimed. In the class action context, unclaimed settlement funds may be considered unclaimed property. Thus, the question becomes whether unclaimed settlement funds can be distributed to a cy pres recipient per federal law or should escheat to the state based on the state’s unclaimed property statute.

⁶² *Id.* at 821.

⁶³ *Id.* at 831 (Kleinfeld, J., dissenting) (quoting *Hanlon v. Chrysler Corp.*, 150 F.3d 1011, 1026 (9th Cir. 1998)).

⁶⁴ *Id.* at 834.

⁶⁵ *Marek v. Lane*, 134 S. Ct. 8, 9 (2013).

⁶⁶ *Id.*

1. *State Cy Pres Laws.*—Twenty-one states have codified specific rules regarding cy pres awards.⁶⁷ These state laws have varying levels of restrictiveness.⁶⁸ The states of Colorado, Illinois, Indiana, Kentucky, Montana, North Carolina, Oregon, Pennsylvania, South Carolina, South Dakota, Washington, and Wisconsin require that settlement funds be disbursed to legal aid organizations.⁶⁹ On the other hand, California, Hawaii, Louisiana, Massachusetts, New Mexico, and Tennessee have

⁶⁷ The states with codified cy pres rules are: California, Colorado, Connecticut, Hawaii, Illinois, Indiana, Kentucky, Louisiana, Maine, Massachusetts, Montana, Nebraska, New Mexico, North Carolina, Oregon, Pennsylvania, South Carolina, South Dakota, Tennessee, Washington, and Wisconsin. See MEREDITH MCBURNEY, AM. BAR ASS'N, LEGISLATION AND COURT RULES PROVIDING FOR LEGAL AID TO RECEIVE CLASS ACTION RESIDUALS (2017), http://www.americanbar.org/content/dam/aba/administrative/legal_aid_indigent_defendants/ATJReports/ls_cypres.authcheckdam.pdf [<https://perma.cc/GS7K-6XX3>].

⁶⁸ See Emily C. Baker & Lynsey M. Barron, *Cy Pres . . . Say What? State Laws Governing Disbursement of Residual Class-Action Funds*, <http://www.jonesday.com/files/Publication/d5da170f-e20d-4f96-aec1-12cf62115d70/Presentation/PublicationAttachment/fbbc24cf-ffcd-43ed-98ba-be026d39ef17/cypres2.pdf> [<https://perma.cc/3EG3-GEZ9>] (“There is wide variation . . . in terms of whether the *cy pres* statutes are mandatory, the default, or merely suggested.”).

⁶⁹ See COLO. R. CIV. P. 23(g) (“[N]ot less than fifty percent (50%) of the residual funds shall be disbursed to the Colorado Lawyer Trust Account Foundation (COLTAF) to support activities and programs that promote access to the civil justice system for low income residents of Colorado”); 735 ILL. COMP. STAT. 5/2-807 (2017) (requiring that at least 50% of residual funds be disbursed to “eligible organizations,” which must “promot[e] or provid[e] services that would be eligible for funding under the Illinois Equal Justice Act”); IND. R. TRIAL P. 23(F)(2) (“[N]ot less than twenty-five percent (25%) of the residual funds shall be disbursed to the Indiana Bar Foundation to support the activities and programs of the Indiana Pro Bono Commission and its *pro bono* districts.”); KY. R. CIV. P. 23.05(6)(b) (“[N]ot less than twenty-five percent (25%) of the residual funds shall be disbursed to the Civil Rule 23 Account . . . to be allocated to the Kentucky Civil Legal Aid Organizations . . . to support activities and programs that promote access to the civil justice system for low-income residents of Kentucky.”); MONT. R. CIV. P. 23(i)(3) (“[N]ot less than fifty percent (50%) of the residual funds shall be disbursed to an Access to Justice Organization to support activities and programs that promote access to the Montana civil justice system.”); N.C. GEN. STAT. § 1-267.10(b) (2016) (“[T]he court . . . shall direct the defendant to pay the sum of the unpaid residue . . . to the Indigent Person’s Attorney Fund and to the North Carolina State Bar for the provision of civil legal services for indigents.”); OR. R. CIV. P. 32(O) (“At least 50 percent of the amount not paid to class members [shall] be paid or delivered to the Oregon State Bar for the funding of legal services provided through [Oregon’s] Legal Services Program”); PA. R. CIV. P. 1716 (“Not less than fifty percent (50%) of residual funds in a given class action shall be disbursed to the Pennsylvania Interest on Lawyers Trust Account Board to support activities and programs which promote the delivery of civil legal assistance to the indigent in Pennsylvania by non-profit corporations”); S.C. R. CIV. P. 23(e)(2) (“[N]ot less than fifty percent of residuals must be distributed to the South Carolina Bar Foundation to support activities and programs that promote access to the civil justice system for low income residents of South Carolina.”); S.D. CODIFIED LAWS § 16-2-57 (2017) (requiring that at least 50% of residual funds be disbursed “to the Commission on Equal Access to Our Courts”); WIS. STAT. § 803.08(2) (2017) (“[N]ot less than fifty percent of the residual funds shall be disbursed to [the Wisconsin Trust Account Foundation] to support direct delivery of legal services to persons of limited means in non-criminal matters.”); WASH. SUPER. CT. CIV. R. 23(f)(2) (“[N]ot less than twenty-five percent (25%) of the residual funds shall be disbursed to the Legal Foundation of Washington to support activities and programs that promote access to the civil justice system for low income residents of Washington State.”).

codified cy pres awards but do not specify a particular charitable organization to receive the funds; these states expressly allow—but do not mandate—legal aid organizations to be the recipient.⁷⁰ Finally, Connecticut, Maine, and Nebraska have codified class action cy pres awards by specifying particular legal aid charities to receive the award, but provide the court and litigants discretion to choose a different charitable organization that may do a better job of representing the interests of the plaintiff class and may better serve as a second-best alternative to compensating the class members directly.⁷¹

While the states which have codified specific rules regarding cy pres give some direction as to distribution, they give no guidance as to whether a federal court sitting in diversity should follow state or federal law. Thus, if a federal court sitting in diversity jurisdiction in any of these twenty-one states is confronted with a cy pres remedy, must the court follow the specific requirements of the state law or the requirements of federal law?⁷²

2. *State Unclaimed Property Laws.*—The other state law source of guidance for distributing unclaimed settlement funds are unclaimed property statutes. State unclaimed property laws require that holders of certain types of intangible property give the property to the state if the property is unclaimed for a specified time period.⁷³ All fifty states and the

⁷⁰ See CAL. CODE CIV. P. § 384(b) (providing that residual funds should be distributed “to nonprofit organizations or foundations to support projects that will benefit the class or similarly situated persons, or that promote the law consistent with the objectives and purposes of the underlying cause of action, to child advocacy programs, or to nonprofit organizations providing civil legal services to the indigent”); HAW. R. CIV. P. 23(f) (providing that residual funds can be distributed to various nonprofit organizations, including legal aid organizations); LA. SUP. CT. R. XLIII(2) (providing that cy pres funds “may be disbursed . . . to one or more non-profit or governmental entities . . . including the Louisiana Bar Foundation”); MASS. R. CIV. P. 23(e)(2) (providing that “residual funds . . . shall be disbursed to one or more nonprofit organizations or foundations (which may include nonprofit organizations that provide legal services to low income persons)”); N.M. R. CIV. P. DIST. CT. 1-023(G)(2) (providing that residual funds can be disbursed to, amongst other options, “nonprofit organizations that provide legal services to low income persons”); TENN. R. CIV. P. 23.08 (providing that the “[d]istribution of residual funds to a program or fund which serves the pro bono legal needs of Tennesseans . . . is permissible [sic] but not required”).

⁷¹ See CONN. R. SUPER. CT. CIV. R. 9-9(g)(2) (providing that residual funds should be disbursed “for the purpose of funding those organizations that provide legal services for the poor in Connecticut” absent a designation by the parties); ME. R. CIV. P. 23(f)(2) (providing that residual funds should be disbursed to the Maine Bar Foundation unless the parties agree on another entity to receive the funds); NEB. REV. STAT. § 25-319.01 (2017) (providing that residual funds should be paid to the Legal Aid and Services Fund “unless [the court] orders otherwise to further the purposes of the underlying cause of action”).

⁷² For a discussion of the answer to this question, see *infra* Parts III–V.

⁷³ Ethan D. Millar & John L. Coalson, Jr., *The Pot of Gold at the End of the Class Action Lawsuit: Can States Claim It as Unclaimed Property?*, 70 U. PITT. L. REV. 511, 515 (2009).

District of Columbia have unclaimed property laws.⁷⁴ According to all of the states' unclaimed property laws, when the unclaimed property reverts to the state from the holder, the title of the property stays with the owner of the unclaimed property, rather than with the state, and the owner of the unclaimed property can always reclaim the property from the state.⁷⁵ The main purpose of unclaimed property laws is to help owners reclaim missing property.⁷⁶ However, courts have also recognized a secondary purpose: "to give the state . . . the benefit of the use of the property until the owner reclaims it (or never reclaims it)."⁷⁷

In the class action settlement context, plaintiff class members are the owners and the defendant is the holder of the unclaimed property—the funds leftover in a settlement fund that were supposed to go to members of the plaintiff class as specified in the settlement agreement.⁷⁸ For purposes of this Note, state unclaimed property laws are relevant in situations where a federal district court, sitting in diversity jurisdiction, decides to distribute unclaimed funds from a class action settlement fund to a charity or nonprofit via a cy pres award despite the requirement of the relevant state's unclaimed property law that unclaimed property must revert to the state.⁷⁹

II. *ERIE* AND CHOICE OF LAW DOCTRINE

When a federal court sits in diversity jurisdiction, if one party believes that the court should use federal law and the other party believes the court should use state law, the federal court must decide which law should apply. This decision has been and continues to be one of great confusion. For purposes of this Note, it is necessary to understand the important myth debunked by Chief Justice Warren in *Hanna v. Plumer*⁸⁰ with respect to the *Erie* doctrine. The myth stated that the *Erie* line of cases provided the appropriate test to determine the applicability of the Federal Rules of Civil Procedure in a federal court sitting in diversity jurisdiction where a Rule

⁷⁴ *Id.*

⁷⁵ *Id.* at 516 ("The state . . . acts as a mere custodian or conservator for the owner.").

⁷⁶ *Id.* at 516–17 (noting that the state must affirmatively try to find the owner of unclaimed property, and if unsuccessful, must hold the property until the owner collects it).

⁷⁷ *Id.* at 517 (citing cases).

⁷⁸ *Id.* at 515.

⁷⁹ *See, e.g.,* All Plaintiffs v. All Defendants, 645 F.3d 329, 331 (5th Cir. 2011). In this situation, a state may argue that the court must apply the state's unclaimed property law—requiring that unclaimed funds be remitted to the state—rather than federal cy pres law. *Id.* at 332. The settling parties and cy pres beneficiary, on the other hand, will likely argue that the court should apply federal law and allow the cy pres distribution, specifically pointing to Rule 23(e) governing settlement agreements. *Id.* For a discussion on this disagreement, see Parts III–IV.

⁸⁰ 380 U.S. 460 (1965).

conflicts with state law.⁸¹ Professor John Ely masterfully articulated the clear distinction drawn by Chief Justice Warren in this case:

[W]here there is no relevant Federal Rule of Civil Procedure or other Rule promulgated pursuant to the [Rules] Enabling Act and the federal rule in issue is therefore wholly judge-made, whether state or federal law should be applied is controlled by the Rules of Decision Act, the statute construed in *Erie* and *York*. Where the matter in issue is covered by a Federal Rule, however, the Enabling Act—and not the Rules of Decision Act itself or the line of cases construing it—constitutes the relevant standard.⁸²

In other words, where one party argues that federal law controls, and the other party argues that state law controls, the first question a federal court sitting in diversity jurisdiction must ask is whether the federal law is covered by a Federal Rule promulgated by the Supreme Court pursuant to the Rules Enabling Act.

The subsequent analysis conducted by a court is dramatically different depending on whether the question of federal law is controlled by a Federal Rule. If there is no Federal Rule providing the federal standard—and instead, the federal law in question stems from judge-made common law—the Rules of Decision Act controls the court’s choice of law analysis. The Rules of Decision Act states that “[t]he laws of the several states, except where the Constitution or treaties of the United States or Acts of Congress otherwise require or provide, shall be regarded as rules of decision in civil actions in the courts of the United States, in cases where they apply.”⁸³

On the other hand, if a Federal Rule does control the federal standard, a federal court sitting in diversity jurisdiction need not consider the Rules of Decision Act or the Court’s *Erie* line of cases in determining whether to apply the state or federal law. Instead, the court must look to the Rules Enabling Act, which states that “[t]he Supreme Court shall have the power to prescribe general rules of practice and procedure [i.e., the Federal Rules of Civil Procedure] . . . for cases in the United States district courts . . . and courts of appeals.”⁸⁴ The Act requires that the Federal Rule “shall not abridge, enlarge or modify any substantive right.”⁸⁵ Under a Rules Enabling

⁸¹ *Id.* at 469–70.

⁸² John Hart Ely, *The Irrepressible Myth of Erie*, 87 HARV. L. REV. 693, 698 (1974); *see also* Shady Grove Orthopedic Assocs. v. Allstate Ins. Co., 559 U.S. 393, 417 (2010) (Stevens, J., concurring in part and concurring in the judgment) (noting that when “no federal rule applies, a federal court must follow the Rules of Decision Act . . . [b]ut when a situation is covered by a [F]ederal [R]ule, the Rules of Decision Act inquiry by its own terms does not apply [and] [i]nstead, the Rules Enabling Act . . . controls” (citing *Hanna*, 380 U.S. at 471)).

⁸³ 28 U.S.C. § 1652 (2012).

⁸⁴ *Id.* § 2072(a).

⁸⁵ *Id.* § 2072(b).

Act analysis, the court must first determine whether the Federal Rule applies to the disputed issue, and then must determine whether the Rule complies with the requirements of the Rules Enabling Act.⁸⁶

This Part will discuss how a court is to determine whether the federal law is controlled by a Federal Rule or judge-made common law. Then, this Part will discuss the analytical steps a federal court sitting in diversity jurisdiction must perform to determine whether state or federal law governs under either scenario.

A. Choosing Between the Rules of Decision Act and Rules Enabling Act

Although Chief Justice Warren’s distinction between the Rules Enabling Act and Rules of Decision Act may seem clear, it requires an additional line of analysis: courts must first actually determine whether the issue is covered by a Federal Rule before determining whether to conduct a Rules Enabling Act or Rules of Decision Act analysis.⁸⁷ Generally, as one scholar has stated, the court determines if a Federal Rule is “pertinent” to the disputed issue.⁸⁸ Often, a court asks whether the Rule is “sufficiently broad” to “control” or “govern” the legal issue facing the court.⁸⁹ Such a determination is not as straightforward as one might expect.

On several occasions, the Court has held that the scope of the Federal Rules is somewhat narrow. In other words, the Court has implied that when there is doubt, it should be assumed that common law rather than the Federal Rules of Civil Procedure creates the federal standard, and thus, a Rules of Decision Act analysis should be used.⁹⁰ For example, in *Gasperini v. Center for Humanities, Inc.*,⁹¹ a federal court sitting in diversity jurisdiction had to decide if it should use federal or state law in determining whether to order a new trial based on an excessive jury verdict.⁹² New York law allowed courts to order a new trial for excessive verdicts “when the

⁸⁶ Robert J. Condlin, *Is the Supreme Court Disabling the Enabling Act, or Is Shady Grove Just Another Bad Opera?*, 47 SETON HALL L. REV. 1, 1–2 (2016).

⁸⁷ See *Shady Grove Orthopedic Assocs.*, 559 U.S. at 398 (plurality opinion) (“The framework for our decision [as to whether state or federal law should apply] is familiar. We must first determine whether [the Federal Rule of Civil Procedure] answers the question in dispute.”); Adam N. Steinman, *Our Class Action Federalism: Erie and the Rules Enabling Act After Shady Grove*, 86 NOTRE DAME L. REV. 1131, 1145 (2011) (“Put simply, there is a difference between state law conflicting with a Federal Rule of Civil Procedure . . . and state law conflicting with the federal judiciary’s gloss on a Federal Rule whose text provides only a vague or ambiguous standard . . .”).

⁸⁸ Condlin, *supra* note 86, at 1–2.

⁸⁹ *Walker v. Armco Steel Corp.*, 446 U.S. 740, 749–51 (1980).

⁹⁰ See, e.g., *Gasperini v. Ctr. for Humanities, Inc.*, 518 U.S. 415, 437 n.22 (1996); *Walker*, 446 U.S. at 749–53.

⁹¹ 518 U.S. 415.

⁹² *Id.* at 418–19.

jury's award 'deviate[d] materially from what would be reasonable compensation.'"⁹³ By contrast, Federal Rule 59 governs motions for a new trial in the case of an excessive jury verdict.⁹⁴ But as the Court held, Rule 59 says nothing about the judicial standard to be used.⁹⁵ The federal law test used to determine whether compensation is excessive is the "shock the conscience" test, a test that came from judge-made law.⁹⁶ Thus, under *Hanna*, the Court held that a Rules of Decision analysis was appropriate.⁹⁷

On the other hand, however, the Court does not always hold such a narrow view. In *Hanna*, for example, the Court determined that the Court should only use a Rules of Decision Act analysis if the Federal Rule is inapplicable to the federal law at issue.⁹⁸ Likewise, in *Shady Grove*,⁹⁹ the Court faced the decision of whether a New York federal district court sitting in diversity jurisdiction must follow Federal Rule 23, which permits class certification in all cases so long as one of the 23(a) and one of the 23(b)(3) requirements are met,¹⁰⁰ or instead follow a New York statute, which completely bars class actions for penalty interest cases.¹⁰¹ Justice Scalia wrote the opinion for the Court.¹⁰² First, writing for a five-Justice

⁹³ *Id.* at 418 (quoting N.Y. C.P.L.R. § 5501(c) (McKinney 1995)).

⁹⁴ *See* FED. R. CIV. P. 59.

⁹⁵ *Gasperini*, 518 U.S. at 437 n.22.

⁹⁶ *Id.* at 429.

⁹⁷ *Id.* at 437 n.22; *see* Adam N. Steinman, *Kryptonite for CAFA?*, 32 REV. LITIG. 649, 675 (2013) (noting that the *Gasperini* Court held that "[t]he shock-the-conscience standard was a kind of federal procedural common law, not a standard dictated by Rule 59 itself"). For an additional Supreme Court decision holding that a Rules of Decision Act analysis should be used where there is a judicially created standard regarding a Federal Rule, *see Walker v. Armco Steel Corp.*, 446 U.S. 740, 749–53 (1980) (holding that Federal Rule of Civil Procedure 3 does not cover the choice of law issue of when a statute of limitations begins to run, and thus employed a Rules of Decision Act analysis).

⁹⁸ *See Hanna v. Plumer*, 380 U.S. 460, 469–71 (1965); *see also Shady Grove Orthopedic Assocs. v. Allstate Ins. Co.*, 559 U.S. 393, 398 (2010) (plurality opinion) ("We do not wade into *Erie*'s murky waters unless the Federal Rule is inapplicable or invalid." (citing *Hanna*, 380 U.S. at 469–71)).

⁹⁹ 559 U.S. 393.

¹⁰⁰ *See id.* at 398 (noting that Rule 23 allows a "'class action [to] be maintained' if two conditions are met": (1) the suit satisfies the prerequisites of Rule 23(a) and (2) fits into one of the categories of Rule 23(b) (quoting FED. R. CIV. P. 23)).

¹⁰¹ *Id.* at 398–99; *see* N.Y. C.P.L.R. § 901(b) (McKinney 2017) ("Unless a statute creating or imposing a penalty, or a minimum measure of recovery specifically authorizes the recovery thereof in a class action, an action to recover a penalty, or minimum measure of recovery created or imposed by statute may not be maintained as a class action.").

¹⁰² Justice Scalia was joined by Chief Justice Roberts, Justice Thomas, Justice Sotomayor, and Justice Stevens, a five-person majority, for Part II.A of his opinion which discussed whether the federal law was controlled by Rule 23. For the rest of his opinion, however, Justice Scalia did not garner a majority. For Parts II.B and II.D, Justice Scalia was joined by only Chief Justice Roberts, Justice Thomas, and Justice Sotomayor, and for Part II.C, Justice Scalia was joined by only Chief Justice Roberts and Justice Thomas.

majority, Justice Scalia held that Rule 23 and § 901(b) do in fact conflict.¹⁰³ The majority also held that Rule 23, rather than judicial common law, governed the federal law at issue.¹⁰⁴ Thus, according to a majority of the Court, a Rules Enabling Act analysis was appropriate. Even though Justice Scalia could only garner a plurality for the rest of his opinion,¹⁰⁵ unlike the majority opinions in *Walker* and *Gasperini*, the Court in *Shady Grove* held that a Federal Rule was broad enough to trigger a Rules Enabling Act analysis and displace the state law.

In *Shady Grove*, the Federal Rule was found to control even though some of the Rule 23 requirements are anything but clear. For example, the class action at issue in *Shady Grove*—like most controversial class actions—invokes Rule 23(b)(3), requiring that “questions of law or fact common to class members *predominate* over any questions affecting only individual members, and that a class action is *superior* to other available methods for fairly and efficiently adjudicating the controversy.”¹⁰⁶ As one scholar recognizes, the terms “predominate” and “superior” are particularly vague; there is “no precise formula” for how a court should determine predominance and superiority, “and the text of Rule 23 provides no answers.”¹⁰⁷ Instead, federal courts develop common law to define these terms. This judge-made federal law could take either a more hostile or a more tolerant position toward class action certification than state law.¹⁰⁸ Nevertheless, as noted above, a majority of the Court joined Justice Scalia’s opinion holding that Rule 23 “answers the question in dispute.”¹⁰⁹

¹⁰³ *Shady Grove Orthopedic Assocs.*, 559 U.S. at 399 (holding that Rule 23 and § 901(b) “attempt[] to answer the same question,” whether the suit “may not be maintained as a class action because of the relief it seeks” (internal quotation marks omitted)). The *Shady Grove* dissent, by contrast, held that “Rule 23 does not collide with § 901(b) . . . [because] Rule 23 prescribes the considerations relevant to class certification and postcertification proceedings—but it does not command that a particular remedy be available when a party sues in a representative capacity.” *Id.* at 446 (Ginsburg, J., dissenting). In other words, Justice Ginsburg argued that “Rule 23 governs procedural aspects of class litigation” while the New York state statute “control[s] the size of [the] monetary award a class plaintiff may pursue.” *Id.* at 446–47.

¹⁰⁴ *Id.* at 406 (majority opinion) (“Rule 23 unambiguously authorizes *any* plaintiff, in *any* federal civil proceeding, to maintain a class action if the Rule’s prerequisites are met.”).

¹⁰⁵ While both Justice Scalia’s plurality opinion and Justice Stevens’s concurrence determined that Rule 23 did not violate the Rules Enabling Act, Justice Stevens took an approach more deferential to state law. See Steinman, *supra* note 87, at 1140–41; see also *infra* note 134.

¹⁰⁶ FED R. CIV. P. 23(b)(3) (emphasis added).

¹⁰⁷ Steinman, *supra* note 87, at 1145.

¹⁰⁸ *Id.*

¹⁰⁹ *Shady Grove Orthopedic Assocs.*, 559 U.S. at 398 (plurality opinion); see Condlin, *supra* note 86, at 26; Steinman, *supra* note 87, at 1138.

Such an approach may suggest that the scope of the Federal Rules may be broader than it appeared after *Gasperini* and *Walker*.¹¹⁰

B. Conducting Rules of Decision Act and Rules Enabling Act Analyses

After determining whether judge-made common law or a Federal Rule controls the federal law, a federal court sitting in diversity jurisdiction must conduct a Rules of Decision Act analysis (for judge-made common law) or a Rules Enabling Act analysis (for a Federal Rule of Civil Procedure) and determine whether the federal or state law should apply.

First, to determine whether the Rules of Decision Act requires a federal court sitting in diversity jurisdiction to use state law, courts rely on the *Erie* line of cases.¹¹¹ In *Hanna*, the Court developed the “modified outcome determination test”,¹¹² under this approach, a court analyzes a Rules of Decision Act question based on “the twin aims of the *Erie* rule: discouragement of forum-shopping and avoidance of inequitable administration of the laws.”¹¹³ The *Hanna* modified outcome determination test replaced the former *Guaranty Trust Co. v. York* “outcome-determination” test,¹¹⁴ which required the court to ask whether “it significantly affect[ed] the result of a litigation for a federal court to disregard a law of a State that would be controlling in an action upon the same claim by the same parties in a State court.”¹¹⁵ While the *Hanna* Court described the modified outcome determination test as having “twin aims,” in reality, the test comes down to the single concern: whether the difference in outcome from using the state as opposed to federal law would result in an unfair result to the litigants.¹¹⁶ If the difference in outcome would result

¹¹⁰ See *supra* notes 90–97 and accompanying text.

¹¹¹ See Ely, *supra* note 82, at 698. This line of cases began in 1938, when the Court held that where federal law and state law conflict, under the Rules of Decision Act a federal court sitting in diversity jurisdiction must apply the substantive law of the state. See *Erie R.R. v. Tompkins*, 304 U.S. 64, 78 (1938). The Court’s *Erie* decision overruled the *Swift v. Tyson* doctrine, which allowed federal courts to apply their own federal common law. 41 U.S. (16 Pet.) 1 (1842).

¹¹² Martin H. Redish & Carter G. Phillips, *Erie and the Rules of Decision Act: In Search of the Appropriate Dilemma*, 91 HARV. L. REV. 356, 360 (1977) (referring to the *Hanna* test as the “modified outcome determination test”).

¹¹³ *Hanna v. Plumer*, 380 U.S. 460, 468 (1965).

¹¹⁴ *Id.* at 468; see Redish & Phillips, *supra* note 112, at 362.

¹¹⁵ *Guaranty Trust Co. v. York*, 326 U.S. 99, 109 (1945).

¹¹⁶ See Redish & Phillips, *supra* note 112, at 373 (“While the Court identified [the twin aims of *Erie*] as distinct, it seems clear that its focus reduces to a single concern: fairness to the litigants . . . [and] how forum shopping brings about unfairness or inequality.”); see also *Gasperini v. Ctr. for Humanities, Inc.*, 518 U.S. 415, 428 (1996) (stating that the Court must determine whether using federal law would “have so important an effect upon the fortunes of one or both of the litigants that failure to [apply] it would [unfairly discriminate against citizens of the forum State, or] be likely to cause a plaintiff to choose the federal court” (alteration in original) (quoting *Hanna*, 380 U.S. at 468 n.9)).

in an unfair result, under the modified outcome determination test, the court must defer to state law.¹¹⁷

Nearly twenty years after *Hanna*, Justice Ginsburg further complicated the analysis. In *Gasperini*,¹¹⁸ Justice Ginsburg invoked *Byrd v. Blue Ridge Rural Electric Cooperative, Inc.*¹¹⁹ The *Byrd* case, decided seven years prior to *Hanna*, involved the question of whether a factual issue should be decided by a judge, per state law, or by a jury, per federal law.¹²⁰ In *Byrd*, the Court created a balancing test to examine Rules of Decision Act questions. The Court considered (1) the state's interest in state substantive policy serving as controlling law in diversity cases,¹²¹ (2) the federal interest in using federal procedure in federal courts,¹²² and (3) the litigant's interest in not having the outcome turn on whether the case is adjudicated in federal or state court,¹²³ and then balanced those three interests.¹²⁴

In *Gasperini*, Justice Ginsburg held that an “outcome-determination test” was an insufficient guide in cases presenting countervailing federal interests.¹²⁵ According to Justice Ginsburg's interpretation, based on the Court's holding in *Byrd*, countervailing federal interests are at play where the diversity suit involves “the allocation of trial functions between judge and jury” or “the allocation of authority to review verdicts.”¹²⁶ Justice Ginsburg held that in these situations, where the distribution of factfinding responsibility between the judge and the jury is at issue, instead of simply looking to whether there is an impact on fairness to the litigants, the *Byrd* balancing test is appropriate.¹²⁷

¹¹⁷ *Hanna*, 380 U.S. at 467–68.

¹¹⁸ 518 U.S. 415 (1996).

¹¹⁹ 356 U.S. 525 (1958).

¹²⁰ *Id.* at 533–34.

¹²¹ *Id.* at 535–36 (examining whether the procedure at dispute was “bound up” with the substantive state “rights and obligations” of the parties being enforced).

¹²² *Id.* at 538 (examining the federal interest in using the federal procedure and requiring a jury).

¹²³ *Id.* at 537 (examining whether “the outcome would be substantially affected by whether the issue . . . is decided by a judge or a jury”).

¹²⁴ See Redish & Phillips, *supra* note 112, at 362–63. For a discussion of three possible approaches to the *Byrd* balancing approach, see *id.* at 364–66.

¹²⁵ *Gasperini v. Ctr. for Humanities, Inc.*, 518 U.S. 415, 432 (1996).

¹²⁶ *Id.*

¹²⁷ See *id.* at 431–32; see also LINDA MULLENIX, MARTIN REDISH & GEORGENE VAIRO, UNDERSTANDING FEDERAL COURTS AND JURISDICTION 680–81 (2d ed. 2015) (noting that when an *Erie* issue involves the functions of the judge and the jury, the *Byrd* balancing test applies); Thomas D. Rowe, Jr., *Not Bad for Government Work: Does Anyone Else Think the Supreme Court Is Doing a Halfway Decent Job in Its Erie-Hanna Jurisprudence?*, 73 NOTRE DAME L. REV. 963, 1014 (1998) (recognizing that when the allocation of power between the judge and jury is in dispute, the analysis

On the other hand, the analysis of an issue contained in the Federal Rules under the Rules Enabling Act is quite different. When a court determines that an issue is controlled by a Federal Rule, the federal court sitting in diversity jurisdiction must apply the federal law rather than state law unless the Federal Rule violates the Rules Enabling Act or the Constitution.¹²⁸ In other words, the court must apply the Federal Rule so long as the Rule is a “rule[] of practice and procedure” and does “not abridge, enlarge or modify any substantive right.”¹²⁹ Only if the Rule violates the Rules Enabling Act will the court apply state law. Because the Federal Rules of Civil Procedure are promulgated and approved by the Advisory Committee on Civil Rules, the Judicial Conference, and the Supreme Court, the rules have a presumption of validity.¹³⁰ In *Burlington Northern Railroad Co. v. Woods*, the case that established the current Rules Enabling Act analysis standard,¹³¹ the Court held that if a Federal Rule is “reasonably necessary to maintain the integrity of th[e] system of rules,” then even a Rule that “incidentally affect[s] litigants’ substantive rights do[es] not violate [the Rules Enabling Act].”¹³² The *Burlington Northern* test is very deferential to the Federal Rules. Indeed, the Court has “rejected every statutory challenge to a Federal Rule that has come before [it].”¹³³ If the Supreme Court were to hold that a Federal Rule was in violation of the Rules Enabling Act, it would be forced to invalidate a Rule it chose to promulgate. Such an outcome is highly unlikely. Thus, when a court determines that a Federal Rule controls the federal law, the analysis is almost always over before it begins, and the court will almost certainly apply the federal law.

should include a balancing of whether the state rule is “bound up” with substantive state rights and whether there is a strong federal interest in using federal procedure).

¹²⁸ Steinman, *supra* note 97, at 664.

¹²⁹ 28 U.S.C. § 2072 (2012); see *Sibbach v. Wilson & Co.*, 312 U.S. 1, 9–10 (1941) (“Congress has undoubted power to regulate the *practice and procedure* of federal courts . . . but it has never essayed to declare the *substantive* state law . . .” (emphasis added)).

¹³⁰ *Burlington N. R.R. Co. v. Woods*, 480 U.S. 1, 6 (1987).

¹³¹ For a discussion of the Supreme Court decisions describing a Rules Enabling Act analysis prior to *Burlington Northern*, see Condlin, *supra* note 86, at 5–20.

¹³² *Burlington Northern*, 480 U.S. at 5; see also *Shady Grove Orthopedic Assocs. v. Allstate Ins. Co.*, 559 U.S. 393, 407 (2010) (plurality opinion) (“The test is not whether the rule affects a litigant’s substantive rights; most procedural rules do.”).

¹³³ *Shady Grove Orthopedic Assocs.*, 559 U.S. at 407 (plurality opinion); see Condlin, *supra* note 86, at 3 (“[T]he Supreme Court never has found a Federal Rule invalid . . .”); Millar & Coalson, *supra* note 73, at 540–41 (“Federal Rules of Civil Procedure are entitled to a strong presumption of validity [and] [i]n fact, no Federal Rule of Civil Procedure has ever been declared invalid under either the U.S. Constitution or the Rules Enabling Act.”).

It is also critical to stress that unlike a Rules of Decision Act analysis, when performing a Rules Enabling Act analysis, courts are generally not concerned with the state law at issue or the state law’s substantive or procedural purpose. “[T]he validity of a Federal Rule depends entirely upon whether it regulates procedure,” and if it does, it is valid “regardless of its incidental effect upon state-created rights.”¹³⁴ Thus, that a state law may conflict with the federal law is wholly irrelevant to the analysis.

The remainder of this Note explores whether a federal court sitting in diversity jurisdiction would likely use state or federal law in determining the validity of a cy pres award to distribute unclaimed settlement funds where the state and federal law conflict. Part III, consistent with the Court’s precedent in *Gasperini*, hypothesizes that courts will determine that the standard for enforcement of cy pres is one of judicial common law, and thus conduct a Rules of Decision Act analysis. Part IV, on the other hand, suggests that a Rules Enabling Act analysis is more appropriate because cy pres awards are derived from Rule 23(e), consistent with Justice Scalia’s opinion in *Shady Grove*. As will be discussed, the two analyses lead to different results. If a federal court sitting in diversity jurisdiction uses a Rules of Decision Act to analyze a conflict between federal and state law, the result will depend on the nature of the conflict—whether the federal law conflicts with a state cy pres statute or a state unclaimed property statute. By contrast, if a federal court sitting in diversity jurisdiction uses a Rules Enabling Act analysis, the court is likely to apply federal law. Finally, Part V will argue that the Rule 23 Subcommittee’s April 2015 proposal to codify cy pres awards as a part of Rule 23(e)—and the Subcommittee’s subsequent withdrawal of the proposal in November 2015—lends support to the argument that cy pres awards are in fact derived from Rule 23(e) and may even violate the Rules Enabling Act.

¹³⁴ *Shady Grove Orthopedic Assocs.*, 559 U.S. at 410 (plurality opinion); see also MULLENIX ET AL., *supra* note 127, at 670 (“The [*Shady Grove*] Court emphasized that for purposes of [a Rules Enabling Act] analysis, it is not the substantive or procedural nature or purpose of the affected state law that matters, but rather the substantive or procedural nature of the federal rule.”). Note, however, that in his *Shady Grove* concurrence, Justice Stevens suggested an “application of the [Rules] Enabling Act [that] shows sensitivity” to the state law. 559 U.S. at 424 (Stevens, J., concurring in part and concurring in the judgment) (internal quotation marks omitted). Justice Stevens concluded that sometimes a federal court sitting in diversity must apply the state procedural rule; he stated that a

[F]ederal [R]ule . . . cannot govern a particular case in which the rule would displace a state law that is procedural in the ordinary use of the term but is so intertwined with a state right or remedy that it functions to define the scope of the state-created right. And absent a governing federal rule, a federal court must engage in the traditional Rules of Decision Act inquiry, under the *Erie* line of cases.

Id. at 423–24.

III. THE LIKELY APPROACH: A RULES OF DECISION ACT ANALYSIS

It is likely that a federal court sitting in diversity jurisdiction would conduct a Rules of Decision Act analysis to determine whether federal or state *cy pres* law should apply where they conflict. First, the court would likely determine that federal common law—not Rule 23(e)—governs *cy pres* awards. Judges have created requirements to determine the validity of *cy pres* remedies. Second, the court would conduct a Rules of Decision Act analysis using the modified outcome determination test.

A. *The Argument That Judge-Made Common Law
Governs Cy Pres Awards*

The argument that a Rules of Decision Act analysis applies would start by highlighting that federal *cy pres* doctrine in the class action context developed through judge-made common law, and therefore, *cy pres* awards are not controlled by Rule 23(e)(2). It would point to the fact that Rule 23(e) does not define any specific test to determine whether a settlement involving a *cy pres* award is “fair, reasonable, and adequate.”¹³⁵ Instead, according to this line of reasoning, courts have created common law requirements, and “judicial interpretation differs [in applying these requirements], resulting in confusion and inconsistent outcomes.”¹³⁶

First, judges have created a “trigger requirement,” requiring some difficulty in distributing settlement awards to class members in order to justify a *cy pres* remedy.¹³⁷ Courts vary, however, in how challenging effective distribution of funds to the actual class members must be. For example, some courts require that it be “infeasible” to compensate actual class members before providing a *cy pres* award to a nonprofit organization,¹³⁸ while others have no such requirement.¹³⁹

Second, courts have designed a “nexus requirement,” mandating “there be a connection—or nexus—between the harm that the plaintiffs

¹³⁵ Bartholomew, *supra* note 3, at 3252; *see* FED. R. CIV. P. 23(e)(2).

¹³⁶ Bartholomew, *supra* note 3, at 3252.

¹³⁷ *Id.* at 3252–53.

¹³⁸ *See, e.g.,* Pearson v. NBTY, Inc., 772 F.3d 778, 784 (7th Cir. 2014) (holding that a settlement agreement including a \$1.13 million *cy pres* award to the Orthopedic Research and Education Foundation was invalid because it was feasible to mail \$3 checks to each of the plaintiffs); *In re Matzo Food Prods. Litig.*, 156 F.R.D. 600, 605 (D.N.J. 1994) (“Typically, the court employs *cy pres* where . . . distribution [is] economically impossible.”).

¹³⁹ *See, e.g., In re Baby Prods. Antitrust Litig.*, 708 F.3d 163, 173 (3d Cir. 2013) (holding that it is not the job of the court “to determine whether the settlement is the fairest possible resolution” and thus declining “to hold that *cy pres* distributions are only appropriate” where further individual distributions are economically infeasible).

have suffered and the benefit the *cy pres* distribution will provide.”¹⁴⁰ For instance, the Ninth Circuit has held that to meet the nexus requirement, “[a] *cy pres* award must be guided by (1) the objectives of the underlying statute(s),” “(2) the interests of the silent class members,” and (3) “must not benefit a group too remote from the plaintiff class.”¹⁴¹ In contrast, the Third Circuit recently added the requirement that courts must evaluate *cy pres* awards as part of a class settlement based on “the degree of *direct benefit* provided to the class.”¹⁴² The Seventh Circuit, on the other hand, has held that *cy pres* remedies lacking any direct or indirect benefits to the class could be valid.¹⁴³

Advocates for a Rules of Decision Act analysis would also point to Supreme Court precedent that takes a narrow approach to interpreting the Federal Rules.¹⁴⁴ They would contend that the judge-made trigger and nexus requirement tests used to determine whether a *cy pres* settlement is fair under Rule 23(e) are akin to the shock the conscience test used to determine whether a verdict is excessive as to warrant a new trial under Rule 59 in *Gasperini*.¹⁴⁵ Therefore, a court could reason that just as the Court in *Gasperini* held that a federal court sitting in diversity jurisdiction should use a Rules of Decision Act analysis to determine whether to apply federal or state law in the context of a motion for new trial due to excessive damages, so too should a federal court sitting in diversity jurisdiction use a Rules of Decision Act analysis to determine whether to apply federal or state law in the context of evaluating the validity of a *cy pres* award as an aspect of a class action settlement agreement.

The Fifth Circuit—the only federal appellate court to examine a conflict of federal and state law relating to a *cy pres* award—determined

¹⁴⁰ RUBENSTEIN, *supra* note 1, § 12.33; *see also id.* § 12.33 n.3 (discussing circuit and district court cases requiring a nexus from the First, Third, Fifth, Eighth, Ninth, Tenth, Eleventh, and D.C. Circuits).

¹⁴¹ *Dennis v. Kellogg Co.*, 697 F.3d 858, 865 (9th Cir. 2012) (citations and internal quotation marks omitted); *see also* *Nachshin v. AOL, LLC*, 663 F.3d 1034, 1038–39 (9th Cir. 2011). This nexus requirement focuses on the purpose of the statute rather than the specific claim. In other words, “it is enough for a charitable distribution to advance judicial access or consumer protection research; the distribution’s use need not perfectly align with the specific facts of the case.” *Bartholomew*, *supra* note 3, at 3254–55.

¹⁴² *Baby Prods. Antitrust Litig.*, 708 F.3d at 174 (emphasis added). The court held that in evaluating direct benefit, it can consider “among other things, the number of individual awards compared to both the number of claims and the estimated number of class members, the size of the individual awards compared to claimants’ estimated damages, and the claims process used to determine individual awards.” *Id.*

¹⁴³ *See* *Hughes v. Kore of Ind. Enter., Inc.*, 731 F.3d 672, 676 (7th Cir. 2013).

¹⁴⁴ *See supra* note 97 and accompanying text (discussing the Court’s narrow interpretation of Rule 59 in *Gasperini* and Rule 3 in *Walker*).

¹⁴⁵ *See supra* notes 91–96 and accompanying text.

that *cy pres* was governed by judge-made common law.¹⁴⁶ Thus, to determine if state or federal law should apply, the court utilized a Rules of Decision Act analysis. The court stressed that “Rule 23(e) . . . contains no categorical rule entitling plaintiffs to *cy pres* distribution—and, in fact, does not mention *cy pres* distribution at all.”¹⁴⁷ The Rule “merely empowers a district court to approve a settlement [and] does not mention the district court’s discretion—or even its authority—to extinguish the right of recovery of identified class members through a later *cy pres* order.”¹⁴⁸ Other courts may well follow the Fifth Circuit’s lead in future cases examining conflicts between state and federal law.

B. Rules of Decision Act Analysis

If a federal court sitting in diversity jurisdiction decides that a Rules of Decision Act analysis is appropriate, as it likely would, it would use the modified outcome determination test to decide whether federal or state law should apply. Courts must examine whether the difference in outcome from using state or federal law would meaningfully impact forum shopping or result in an inequitable administration of justice.¹⁴⁹ Federal law regarding the issue of *cy pres* remedies as a class action settlement may conflict with two different kinds of state laws: state *cy pres* statutes or state unclaimed property statutes. Under a Rules of Decision Act analysis, the answer to whether state or federal law should apply would depend on the specific nature of the conflict.

First, twenty-one states have *cy pres* statutes that codify specific requirements for *cy pres* awards as a part of a class action settlement agreement.¹⁵⁰ Some state statutes mandate that unclaimed settlement funds be distributed as a *cy pres* remedy to legal aid organizations.¹⁵¹ Other state statutes codify *cy pres* awards as valid forms of class action relief but do not designate specific legal aid charities as recipients.¹⁵² These requirements may conflict with the federal common law requirements for *cy pres* remedies. Depending on the language of each specific state statute, the

¹⁴⁶ *All Plaintiffs v. All Defendants*, 645 F.3d 329, 335–37 (5th Cir. 2011).

¹⁴⁷ *Id.* at 333.

¹⁴⁸ *Id.* at 334.

¹⁴⁹ See *supra* notes 113–16 and accompanying text. The issue of whether a *cy pres* remedy is an available option as part of a settlement agreement does not impact the judge–jury allocation of power. Therefore, the *Byrd* balancing test is not appropriate.

¹⁵⁰ See *supra* Section II.D.1.

¹⁵¹ See *supra* note 69 and accompanying text (Colorado, Illinois, Indiana, Kentucky, Montana, North Carolina, Oregon, Pennsylvania, South Carolina, South Dakota, Washington, and Wisconsin).

¹⁵² See *supra* notes 70–71 and accompanying text (California, Connecticut, Hawaii, Louisiana, Maine, Massachusetts, Nebraska, New Mexico, and Tennessee).

statute may or may not require a “trigger” or “nexus” between the absent class members and the charity organization. Moreover, federal cy pres rules, unlike some state statutes, do not require or suggest specific legal aid charities as recipients and do not place minimums on the percent of unclaimed settlement funds that must be disbursed to the specified organization.

Despite the difference between federal and state cy pres law, under the modified outcome determination test, it is likely that where federal cy pres law and a state cy pres statute conflict, a federal court sitting in diversity jurisdiction would use federal law. The difference in outcome from using federal law as opposed to the state law is unlikely to lead to unfair treatment of the litigants and unlikely to impact forum shopping or result in an inequitable administration of justice. As long as some sort of cy pres award is available to plaintiffs as an option for settlement, the outcome for the plaintiff class will be largely the same: a sizeable settlement involving a cy pres award. The only difference may be what specific organization receives the cy pres award. Moreover, while some state statutes—unlike federal cy pres law—mandate cy pres awards, they do so out of the proportion of settlement funds that go unclaimed. Those distinctions are unlikely to matter to plaintiffs, to meaningfully impact forum shopping, or to result in an inequitable administration of justice.

The second possible conflict between state and federal law in the cy pres context involves state unclaimed property laws. Every state has an unclaimed property statute.¹⁵³ In instances where funds remain after settlement, courts must determine whether to distribute the funds as a cy pres award to the charitable organization specified in the settlement or to allocate the funds to the state based on the unclaimed property law. The Fifth Circuit confronted such a conflict in *All Plaintiffs v. All Defendants*,¹⁵⁴ a class action antitrust lawsuit filed against various oil companies.¹⁵⁵ The parties agreed to a settlement, but there were over \$10 million of unclaimed funds due to uncashed checks, checks returned as undeliverable, and settlement awards that were of a de minimis amount.¹⁵⁶ The district court distributed the leftover funds through a cy pres remedy to the Center for Energy and Environmental Resources at the University of Texas.¹⁵⁷ The issue in the case was whether the unclaimed funds should have instead been governed by Texas’s Unclaimed Property Act and therefore been

¹⁵³ See *supra* note 74 and accompanying text.

¹⁵⁴ 645 F.3d 329 (5th Cir. 2011).

¹⁵⁵ *Id.* at 330.

¹⁵⁶ *Id.*

¹⁵⁷ *Id.* at 331.

returned to the state.¹⁵⁸ If the court instead were to honor the *cy pres* agreement under federal law, it would be forced to ignore the state statute governing unclaimed property.

The Fifth Circuit determined that Rule 23(e) does not govern federal *cy pres* doctrine¹⁵⁹ and instead conducted a Rules of Decision Act analysis. And under a Rules of Decision Act analysis, the court held that the state unclaimed property act must apply, and the unclaimed settlement funds therefore must escheat to the state.¹⁶⁰ The court analyzed forum shopping and inequitable administration of justice as part of *Hanna*'s "twin aims" test.¹⁶¹ First, the court summarily concluded that "the availability of *cy pres* does not pose a significant threat of forum-shopping by plaintiffs."¹⁶² This part of the court's analysis leaves something to be desired. It is possible, for example, that if federal *cy pres* law, and not a state's unclaimed property law, applied in federal courts, parties could seek to litigate in federal court to avoid any possible impact that an unclaimed property law may have in settlement negotiations.¹⁶³

Nevertheless, the Fifth Circuit correctly determined that "permitting federal courts to disregard the Unclaimed Property Act in favor of *cy pres* distribution, while state courts follow the Act, would lead to the inequitable administration of justice."¹⁶⁴ As the court held, if the federal court could apply federal *cy pres* law and disregard Texas's unclaimed property act, "identified class members who would have a right to recover their property from the State under the Act would instead lose that right of recovery forever . . . solely because the case was in federal court."¹⁶⁵ In addition, the court stressed that Texas's possessory interest in the unclaimed funds would be extinguished, and Texas would lose its "enforceable property right in the income from [the] unclaimed property," again purely because

¹⁵⁸ *Id.*; see TEX. PROP. CODE ANN. §§ 72.001–74.710 (West 2016).

¹⁵⁹ *All Plaintiffs*, 645 F.3d at 333–35.

¹⁶⁰ *Id.* at 337.

¹⁶¹ *Id.* at 336. The Fifth Circuit, however, misinterpreted *Gasperini*, incorrectly concluding that the *Byrd* balancing test functioned "side by side" with *Hanna*. *Id.* The court failed to recognize that Justice Ginsburg specified a specific situation where the *Byrd* test is applicable: when judge–jury allocation of power was at issue. See *supra* notes 125–27 and accompanying text. Thus, the court's consideration of *Byrd* balancing, see *All Plaintiffs*, 645 F.3d at 337, was in error. In any event, the court's *Byrd* discussion was brief and did not impact the court's analysis of forum shopping and the inequitable administration of justice; therefore, it did not appear to influence its opinion.

¹⁶² *All Plaintiffs*, 645 F.3d at 336.

¹⁶³ See Millar & Coalson, *supra* note 73, at 545 (noting though that "such a prospect is dubious at best").

¹⁶⁴ *All Plaintiffs*, 645 F.3d at 337.

¹⁶⁵ *Id.*

the “case happened to be settled in federal, rather than state, court.”¹⁶⁶ The Fifth Circuit’s reasoning is sound, and the court was correct that this situation presented an “inequitable administration of justice.”¹⁶⁷ Put simply, if the court were to use federal rather than state law, the difference in outcome would cause “an unfair result to the litigants.”¹⁶⁸ Therefore, under a Rules of Decision Act analysis, a federal court sitting in diversity jurisdiction should honor state unclaimed property statutes, even at the expense of disregarding a settlement containing a cy pres award that would otherwise be valid under federal law.

IV. AN ALTERNATE APPROACH: RULES ENABLING ACT ANALYSIS

In contrast to the Rules of Decision Act analysis discussed in Part III, it is more appropriate for a federal court sitting in diversity jurisdiction to use a Rules Enabling Act analysis to determine whether to apply federal or state law where they conflict on the issue of class action cy pres remedies. Federal Rule of Civil Procedure 23(e) clearly outlines the requirements for class action settlements. All aspects of a class action settlement, including a cy pres award, must comply with the Rule. Under a Rules Enabling Act analysis, it is likely a federal court would apply federal cy pres law, honor the settlement agreement, and disregard a state’s cy pres law or unclaimed property act.

A. *The Argument that Federal Rule of Civil Procedure 23(e) Governs Cy Pres Awards*

When adversarial parties agree to a cy pres award, the plaintiff class and defendants must agree to the arrangement by a formal settlement agreement. Thus, before a court permits such a settlement, including a cy pres award, they must ensure that all requirements of Rule 23(e) are met. Most notably, the court must determine whether the settlement is “fair, reasonable, and adequate” in accordance with Rule 23(e)(2).¹⁶⁹ Therefore, under the principle that the greater includes the lesser, where a settlement includes a cy pres remedy, Rule 23(e)(2) governs a court’s decision in

¹⁶⁶ *Id.* It is relevant to note that this part of the Fifth Circuit’s analysis considers the “inequitable administration of justice” prong of the *Hanna* test with respect to a nonparty, the state of Texas. While acknowledging that “some aspects of the ‘twin aims’ analysis—in particular, the focus on forum shopping—seem better suited to disputes between plaintiffs and defendants, rather than those involving post-judgment intervenors,” the Court was nevertheless willing to consider Texas’s interest as part of its analysis. *Id.*

¹⁶⁷ *Id.*

¹⁶⁸ See *supra* note 116 and accompanying text.

¹⁶⁹ FED R. CIV. P. 23(e)(2).

judging the validity of the cy pres award. A cy pres award must also be “fair, reasonable, and adequate.”¹⁷⁰

As the Court held in *Shady Grove*, “Rule 23 provides a one size-fits-all formula for deciding the class-action question.”¹⁷¹ In *Shady Grove*, the Court used a Rules Enabling Act analysis despite the vagueness of Rule 23(b)(3)’s predominance and superiority requirements and despite the fact that federal common law governs their interpretation.¹⁷² Likewise, a federal court should use a Rules Enabling Act analysis despite the vagueness in Rule 23(e)(2)’s requirement that settlements and cy pres awards are “fair, reasonable and adequate” and despite the fact that federal common law governs the validity of cy pres awards. Thus, where federal cy pres law conflicts with state law, a court need not “wade into *Erie*’s murky waters.”¹⁷³ Instead, it must simply determine whether Rule 23(e) is consistent with the Rules Enabling Act.¹⁷⁴

Moreover, Rule 23(e) clearly conflicts with both state cy pres statutes and state unclaimed property acts. Rule 23(e) sets the requirements for all class action settlements, including distribution of leftover funds as cy pres awards. The conflict with state cy pres statutes, which also set out the requirements for the distribution of leftover funds as cy pres awards, is clear. The conflict with state unclaimed property acts is less obvious, but still present. Both Rule 23(e) and state unclaimed property laws “attempt[] to answer the same question”¹⁷⁵: what to do with unclaimed funds after a class action settlement agreement.

B. Rules Enabling Act Analysis

As discussed in Part II, courts are extremely hesitant to declare that a Federal Rule violates the Rules Enabling Act. The Supreme Court has never invalidated a Federal Rule and largely defers to the judgment of the Rules Advisory Committee.¹⁷⁶ Thus, if a court were to glean cy pres awards

¹⁷⁰ See Millar & Coalson, *supra* note 73, at 538 (“If a court has the discretion to approve (or disapprove) a settlement based on its fairness and reasonableness, then the court necessarily has the power to approve each of the provisions in the settlement agreement—including those involving the treatment of unclaimed settlement proceeds.”).

¹⁷¹ 559 U.S. 393, 399 (2010) (plurality opinion).

¹⁷² See *supra* notes 106–09 and accompanying text.

¹⁷³ *Shady Grove Orthopedic Assocs.*, 559 U.S. at 398 (plurality opinion).

¹⁷⁴ If at some point in the future, a specific cy pres provision is added to Rule 23(e) similar to the Rule 23 Subcommittee April 2015 proposal, see *infra* note 182 and accompanying text, a federal court would definitely conduct a Rules Enabling Act analysis. The Subcommittee’s subsequent withdrawal of the proposed amendment has interesting implications. See *infra* Part V.

¹⁷⁵ *Shady Grove Orthopedic Assocs.*, 559 U.S. at 399 (plurality opinion).

¹⁷⁶ See *supra* Section II.A.2.

from Rule 23(e), it is likely that a federal court sitting in diversity jurisdiction would apply the federal law. As the Court held in *Shady Grove*, Rule 23 does not violate the Rules Enabling Act because “[a] class action . . . merely enables a federal court to adjudicate claims of multiple parties.”¹⁷⁷ Therefore, Rule 23 regulates procedure such that any impact on substantive law would be incidental. Likewise, a court specifically examining the validity of Rule 23(e) would likely, almost by default, determine that Rule 23(e) is a procedural tool to permit class action settlement agreements. It would likely find that any impact Rule 23(e) has on substantive law would be incidental to that purpose, and therefore, comply with the Rules Enabling Act under the *Burlington Northern* test.¹⁷⁸

Under this analysis, a federal court would approve any settlement agreement between class action plaintiffs and defendants consistent with Rule 23(e), including any cy pres agreement that it determines is “fair, reasonable, and adequate.” State law would not bind a federal court sitting in diversity jurisdiction. Thus, a federal court would not be obligated to follow a state cy pres statute’s specific guidelines—for example, the mandate that funds go to legal aid charities.¹⁷⁹ Similarly, a federal court sitting in diversity jurisdiction would not be obligated to adhere to the terms of a state’s unclaimed property statute and would not be obligated to escheat unclaimed settlement funds to the state.¹⁸⁰ The court would not concern itself with the substantive or procedural purposes behind the state laws. Instead, the court would just need to ensure that the settlement—including the cy pres award that is a part of the settlement—complies with the broad guidelines of Rule 23(e). Any substantive impact that a particular settlement and its terms would have on state cy pres or unclaimed property law is irrelevant under this analysis because a court would likely determine that it is incidental to the procedural purpose of Rule 23(e).

V. THE IMPACT OF THE RULE 23 SUBCOMMITTEE’S PROPOSAL— AND ITS SUBSEQUENT WITHDRAWAL

In April 2015, the Rule 23 Subcommittee proposed an amendment to Rule 23(e) to explicitly codify cy pres remedies; the proposed Rule

¹⁷⁷ *Shady Grove Orthopedic Assocs.*, 559 U.S. at 408 (plurality opinion).

¹⁷⁸ See, e.g., *In re Baby Prods. Antitrust Litig.*, 708 F.3d 163, 173 n.8 (3d Cir. 2013) (noting, in dicta, that a cy pres award as a part of a settlement does not violate the Rules Enabling Act because the “certification of a settlement simply recognizes the parties’ deliberate decision to bind themselves according to mutually agreed-upon terms without engaging in any substantive adjudication of the underlying causes of action” (quoting *Sullivan v. DB Invs., Inc.*, 667 F.3d 273, 312 (3d Cir. 2011))).

¹⁷⁹ For state-specific cy pres statutes, see *supra* notes 67–71.

¹⁸⁰ Every state has an unclaimed property statute. See *supra* note 74 and accompanying text.

23(e)(3) would have allowed federal courts to “approve a [settlement] proposal that includes a cy pres remedy.”¹⁸¹ The proposal provided specific guidelines as to when a cy pres award would, and would not, be appropriate:

(A) If individual class members can be identified through reasonable effort, 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) The proposal may provide that, 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.¹⁸²

Ultimately, the Rule 23 Subcommittee opted to remove the cy pres amendment from its agenda.¹⁸³ Nevertheless, the proposal—and its withdrawal—provide two key insights into the way in which a federal court sitting in diversity jurisdiction should analyze a conflict between federal and state law involving a cy pres award as part of a class action settlement: (1) Rule 23(e) governs cy pres awards and (2) courts should more closely examine whether cy pres awards violate the Rules Enabling Act.

First, the Rule 23 Subcommittee’s proposal demonstrates that Rule 23(e) in fact governs cy pres awards, notwithstanding the Subcommittee’s subsequent failure to enact the proposal. There is a reason that the Subcommittee went straight to Rule 23(e) to codify class action cy pres remedies. It recognized that the modern class action cy pres award is an aspect of a class action settlement that the court must approve based on Rule 23(e)’s requirements. The Subcommittee’s initial desire to amend Rule 23(e) leaves little doubt that cy pres remedies are “covered by one of the Federal Rules.”¹⁸⁴ Therefore, “the question facing the court [sitting in diversity jurisdiction] is a far cry from the typical . . . *Erie* choice,”¹⁸⁵ but instead is an examination of whether Rule 23(e) violates the Rules

¹⁸¹ APRIL 2015 RULE 23 SUBCOMMITTEE REPORT, *supra* note 9, at 23.

¹⁸² *Id.* at 23–24.

¹⁸³ NOVEMBER 2015 RULE 23 SUBCOMMITTEE REPORT, *supra* note 12, at 46.

¹⁸⁴ See *Hanna v. Plumer*, 380 U.S. 460, 471 (1965).

¹⁸⁵ *Id.*

Enabling Act. A Rules Enabling Act analysis—and not a Rules of Decision Act analysis—is appropriate.

Although it is true that Federal Rules have a strong presumption of validity,¹⁸⁶ the decision to analyze an issue under the Rules Enabling Act rather than the Rules of Decision Act “is by no means to concede the validity of all Federal Rules, for the Enabling Act contains significant limiting language of its own.”¹⁸⁷ The Rules Enabling Act limits the Rules by providing that they “shall not abridge, enlarge or modify any substantive right.”¹⁸⁸ Professor Ely has suggested that the Court in *Hanna* recognized that the “Enabling Act constitutes the only check on the Rules—that ‘Erie’ does not stand there as a backstop,” and therefore, that courts should “take the Act’s limiting language more seriously than it has in the past.”¹⁸⁹

Professor Martin Redish has argued that cy pres awards violate the Rules Enabling Act.¹⁹⁰ According to Professor Redish, “[s]ubstantive laws necessarily contain two elements: a behavioral proscription and an enforcement mechanism.”¹⁹¹ The behavioral proscription is the aspect of a law that regulates behavior.¹⁹² The enforcement mechanism, on the other hand, compensates injured parties and provides punitive remedies to wrongdoers.¹⁹³ Professor Redish contends that a Rule 23(e) settlement that includes a cy pres award transforms a substantive right: it modifies the enforcement mechanism of the underlying substantive law from one of compensating plaintiffs to one imposing of civil fines on defendants.¹⁹⁴ Several lower federal courts have recognized Professor Redish’s concerns.¹⁹⁵

The Rule 23 Subcommittee, in deciding to withdraw its proposal to codify cy pres as part of Rule 23(e), explicitly identified the Rules Enabling

¹⁸⁶ See *supra* notes 130–33 and accompanying text.

¹⁸⁷ Ely, *supra* note 82, at 698.

¹⁸⁸ 28 U.S.C. § 2072 (2012).

¹⁸⁹ Ely, *supra* note 82, at 698.

¹⁹⁰ See Redish et. al., *supra* note 4, at 644–48.

¹⁹¹ *Id.* at 644.

¹⁹² *Id.* at 644–45.

¹⁹³ *Id.* at 645.

¹⁹⁴ *Id.* at 647 (“[I]nvocation of cy pres in the class action context alters substantially the DNA of the underlying substantive law . . .”).

¹⁹⁵ See, e.g., *Klier v. Elf Atochem North America, Inc.*, 658 F.3d 468, 481 (5th Cir. 2011) (Jones, J., concurring) (“*Cy pres* distributions arguably violate the Rules Enabling Act by using a wholly procedural device—the class-action mechanism as prescribed in Rule 23—to transform substantive law ‘from a compensatory remedial structure to the equivalent of a civil fine.’” (quoting Redish et al., *supra* note 4, at 623)); *In re Thornburg Mortg., Inc. Sec. Litig.*, 885 F. Supp. 2d 1097, 1110–11 (D.N.M. 2012) (holding that “cy pres awards are a bad idea and inappropriate,” and citing favorably Professor Redish’s critique of cy pres awards—including the Rules Enabling Act concerns).

Act concern. In explaining its decision, the Subcommittee noted that “adopting such a provision would raise genuine [Rules] Enabling Act concerns,” and thus concluded that “uneasiness about the proper limits of the rulemaking authority cautioned against adopting a freestanding provision on cy pres provisions.”¹⁹⁶ In other words, the Subcommittee withdrew its proposal in order to maintain the status quo and allow federal courts to continue to enforce cy pres remedies as part of settlement agreements without the risk of Rules Enabling Act scrutiny. The Subcommittee likely realized that explicitly codifying cy pres awards in Rule 23 would eliminate any doubt that cy pres remedies must be examined under the Rules Enabling Act, and would make Rule 23(e)’s potential violation of the Enabling Act too obvious to ignore.¹⁹⁷

Courts should not ignore Rules Enabling Act concerns merely because the Subcommittee withdrew the proposal. Instead, a federal court sitting in diversity jurisdiction, presented with a conflict between federal cy pres law and a state cy pres or unclaimed property statute, should still recognize that federal cy pres law derives from Rule 23(e). Thus, it should use a Rules Enabling Act rather than a Rules of Decision Act analysis. And despite the withdrawal, the court should examine the validity of cy pres remedies with a keen eye and seriously consider the Rules Enabling Act concerns identified by Professor Redish, several lower federal courts, and the Subcommittee itself.

CONCLUSION

A federal court sitting in diversity jurisdiction may confront a situation in which it must determine the validity of a settlement containing a cy pres award. If the state in which the court sits has its own cy pres or unclaimed property statute, the court must first determine whether federal or state law applies. There is a lack of clarity as to whether cy pres awards should be derived from Rule 23(e) or federal judge-made common law, and therefore, it is unclear whether courts should use a Rules Enabling Act or Rules of Decision Act analysis in determining whether to apply federal or state law. But following the Rule 23 Subcommittee’s suggestion in April 2015 to explicitly add a cy pres award provision to Rule 23(e), there is no longer a question. Courts should interpret cy pres awards as derived from and controlled by the Federal Rules of Civil Procedure. Finally, because the Subcommittee rescinded their suggestion in November 2015 due to Rules

¹⁹⁶ NOVEMBER 2015 RULE 23 SUBCOMMITTEE REPORT, *supra* note 12, at 46–47.

¹⁹⁷ For an in-depth discussion of the Rules Enabling Act concerns, see Redish et al., *supra* note 4, at 644–48.

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Enabling Act concerns, courts should recognize that Rules Enabling Act concerns are legitimate.

