The Pot of Gold at the End of the Class Action Lawsuit: Can States Claim It as Unclaimed Property?

Ethan Millar
John Coalson
THE POT OF GOLD AT THE END OF THE CLASS ACTION LAWSUIT: CAN STATES CLAIM IT AS UNCLAIMED PROPERTY?

John L. Coalson, Jr.\textsuperscript{1}  
Ethan D. Millar\textsuperscript{2}

TABLE OF CONTENTS

I. INTRODUCTION

II. BACKGROUND ON STATE UNCLAIMED PROPERTY LAWS  
A. Introduction and the “Derivative Rights Doctrine”  
B. Purposes of State Unclaimed Property Laws

III. STATE COURT CLASS ACTIONS  
A. States’ Rights to Take Custody of Unclaimed Property  
B. Whether Unclaimed Class Action Settlement Proceeds Are Subject to Escheat Under State Unclaimed Property Laws  
C. Other Reasons Why State Unclaimed Property Laws May Not Apply to Unclaimed Class Action Proceeds  
D. Class Action Settlements That Do Not Involve Cash Payments  
E. Potential Claims by Defendant’s State of Domicile to Class Action Proceeds Exempted by Class Member’s State of Residence

IV. FEDERAL COURT CLASS ACTIONS  
A. Introduction to Federal Preemption  
B. Federal Rule of Civil Procedure 23  
C. The \textit{Erie} Doctrine  
D. Other Authorities Supporting the Proposition that Federal Law Applies to the Disposition of Unclaimed Class Action Settlement Proceeds  
E. Initial Settlement Agreement Does Not Provide for the Disposition of Unclaimed Proceeds  
1. Settlement Agreement Regarding the Disposition of Unclaimed Class Action Proceeds Is Entered Into Subsequent To the Initial Settlement of the Case  
2. Settlement Agreement Does Not Specifically Provide for the Treatment of Unclaimed Class Action Proceeds

V. CONCLUSION

\textsuperscript{1} Mr. Coalson is a partner at Alston & Bird LLP, where he specializes in state tax and unclaimed property law. B.B.A. 1974, Emory University (highest distinction); J.D. 1977, University of Georgia School of Law (\textit{summa cum laude}; Order of the Coif).

\textsuperscript{2} Mr. Millar is an attorney at Alston & Bird LLP, where he specializes in state tax and unclaimed property law. Mr. Millar also serves as an adjunct professor at Emory University School of Law, and as Chair of the Unclaimed Property Subcommittee of the Business Law Section of the American Bar Association. B.S. 1995, University of California at Los Angeles (\textit{summa cum laude}; Phi Beta Kappa); J.D. 1998, UCLA School of Law (Order of the Coif).
ABSTRACT:

This article analyzes the potential application of state unclaimed property laws to unclaimed settlement proceeds in a state or federal court class action. This article concludes that, in a federal court class action, federal law rather than state law should apply to the disposition of unclaimed settlement proceeds under Federal Rule of Civil Procedure 23, the Erie doctrine, and other authorities. Thus, since federal law grants the district court broad discretion to approve settlements and determine the manner of disposing of unclaimed settlement proceeds, the court is not bound by state unclaimed property laws which may otherwise require those proceeds to be remitted to the state.

However, even in the state court context, we point out that state unclaimed property laws vary widely, and many states exempt from escheat obligations, such as unclaimed class action proceeds, that are not incurred in the ordinary course of business. We also argue that no state should be entitled to claim amounts represented by uncashed settlement checks, when the parties to the settlement have expressly agreed that the defendant may retain those amounts. We recognize that under so-called state “anti-limitations provisions,” most states appear to have the right to claim these amounts, but we suggest that those provisions should be interpreted narrowly to further the policies and purposes that underlie state unclaimed property laws. Finally, we suggest that in some cases, the parties can mitigate the risks imposed by state unclaimed property laws by structuring the settlement to require the distribution to class members of vouchers, coupons or gift cards redeemable for merchandise or services, rather than checks.
I. INTRODUCTION

It is not uncommon in class action settlements for a significant amount of the settlement checks to never be cashed.\(^3\) Sometimes, the settlement agreement provides that these unclaimed amounts belong to the defendant; often, however, the settlement agreement is silent on this issue. Regardless of the provisions of the settlement agreement, however, many states have recently begun asserting that these unclaimed amounts must be turned over to the state as unclaimed property. So far, there has been little litigation specifically on point, and thus the issue remains largely unsettled. Several commentators have concluded that, at least in the federal context, the court has the discretion to determine the disposition of unclaimed funds without regard to state unclaimed property laws.\(^4\) However, the authorities on which they rely do not directly discuss the potential application of state unclaimed property laws, but rather assume that these laws are inapplicable. This article examines in detail whether, in either state or federal court class actions,\(^5\) the states may validly claim unclaimed settlement proceeds under their unclaimed property laws.

Part II of this article provides a general overview of state unclaimed property laws, including a discussion of the “derivative rights doctrine”, which is the core principle underlying these laws. Parts III and IV examine whether a state may take custody of unclaimed settlement proceeds in a state court class action and a federal court class action, respectively. We conclude that, in either a state or federal court class action, states should not be able to claim unclaimed settlement proceeds where the settlement specifically provides that the defendant is entitled to these proceeds. In the federal context, our conclusion is driven by our belief that the unclaimed property laws are procedural rules that should be preempted by the Federal Rules of Civil Procedure, the *Erie* doctrine, and federal decisions granting the courts broad discretion to approve (and disapprove) class action settlement agreements. In the state context, the potential application of state unclaimed property laws will need to be made on a state-by-state basis. In some states, unclaimed class action proceeds may be exempt from escheat because they are not obligations held or owed in the ordinary course of business. In states that have broader unclaimed property statutes, the unclaimed proceeds may be subject to escheat under state “anti-limitations provisions”, which permit states to claim property where the owner is restricted from claiming the property after a specified period of time. Although these anti-limitations provisions would on their face appear to apply to

---

3 See, e.g., *West Virginia v. Chas. Pfizer & Co.*, 314 F. Supp. 710 (S.D.N.Y. 1970), aff’d, 440 F.2d 1079 (2d Cir.), cert. denied, 404 U.S. 871 (1971) ($32 million unclaimed out of a $100 million settlement); *Van Gemert v. Boeing*, 739 F.2d 730 (2d Cir. 1984) (over $2.5 million unclaimed). Often, this is because the check mailed to each individual class member is for a very small amount.

4 See, e.g., Alan S. Kaplinsky and Burt Rublin, “Class Action Developments: Gary B. Hall v. Midland Group et al” (Practising Law Institute, 2000) (The law is clear that “the parties to the settlement may stipulate that any unclaimed portion shall be returned to the defendant.”); Newberg on Class Actions §§ 10.15, 12.11 (3d ed. 1992).

5 Most class action lawsuits do not meet the jurisdictional prerequisites necessary to be heard in federal court; accordingly, state law will apply in most cases. However, the Class Action Fairness Act of 2005, which created new substantive and procedural rules for class actions in federal court, has made it easier to meet these jurisdictional hurdles.
most class action settlement agreements, we argue that these provisions should be narrowly construed to apply only where the primary intent is to avoid state unclaimed property laws. We also suggest ways in which the settlement agreement may be structured to reduce the risk posed by these provisions, if they are not so narrowly construed.

II. BACKGROUND ON STATE UNCLAIMED PROPERTY LAWS

A. Introduction and the “Derivative Rights Doctrine”

Every state (as well as the District of Columbia) has now enacted unclaimed property laws that require “holders” of various types of intangible property to report and remit such property to the state after it has remained unclaimed by its owner for a specified period of time (usually three to five years). In general, the “holder” of unclaimed property is the person or entity that owes the property to another, and thus is the “debtor” under state law (the unclaimed property is the “debt” that is owed). Hence, in the context of a class action settlement, the defendant is the holder because it has agreed to pay the class members a specified amount under the settlement.

Most state unclaimed property laws are based on one of four model unclaimed property acts prepared by the National Conference of Commissioners on Uniform State Laws (“NCCUSL”). These model acts were promulgated in 1954, 1966, 1981 and 1995. Few states still follow either the 1954 or 1966 model acts. Most states currently base their unclaimed property laws on the Uniform Unclaimed Property Act of 1981 (the “1981 Act”), but at least ten states have also adopted, at least in part, the Uniform Unclaimed Property Act of 1995 (the “1995 Act”). A number of states, including California, Delaware and New York, have not adopted any of the model acts. Nevertheless, all states follow the same basic framework for reporting and remitting unclaimed property. However, as discussed in more detail in Part III, they sometimes differ in their scope and the specific mechanics that are followed.

All state unclaimed property laws are now “custodial escheat”, rather than “true escheat”, laws. This means that, when unclaimed property is remitted to the state by the holder of the property, title to the property does not pass to the state. Instead, title remains with the owner of the abandoned property, and the owner may reclaim the property from the state at any time. The state thus acts as a mere custodian or conservator for the owner.

The fundamental principle underlying all state unclaimed property laws is known as the “derivative rights doctrine”. This doctrine provides that the right of a state to take

---

7 The 1995 Act differs from the 1981 Act in several ways. For example, the 1995 Act shortened the period of presumed abandonment of many types of property from five years to three years, and redefined the term “holder” to be consistent with the Supreme Court’s decision in Delaware v. New York, 507 U.S. 490 (1993).
8 For simplicity, however, in this article, we will refer to property that a state may take custody of under its unclaimed property laws as property “subject to escheat”.
custody of unclaimed property is derived from the rights of the owner of the property. Accordingly, the state “stands in the shoes” of the missing owner and acts on the owner’s behalf. Under this doctrine, the state can have no greater rights to the unclaimed property than the owner of the property. However, as we shall see, many states have attempted to carve out exceptions to this rule.

B. Purposes of State Unclaimed Property Laws

The principal objective of state unclaimed property laws is to assist owners in reclaiming their missing property. The state thus acts as an intermediary between the holder, which is in possession of the unclaimed property, and the owner. After the holder reports and remits the property to the state, the state is obligated to attempt to contact the owner and return the property to him. If the state is unsuccessful in finding the owner, the state must hold the property on the owner’s behalf until the owner comes to collect it. Accordingly, state unclaimed property laws are primarily designed as procedural mechanisms that facilitate the return of unclaimed property to its owner.

A number of courts have also held that these laws have a secondary objective as well – to give the state, rather than the holder of the unclaimed property, the benefit of the use of the property until the owner reclaims it (or if the owner never reclaims it). However, at least one recent decision has held that, because the primary purpose of the laws is to reunite owners with their missing property, the ultimate goal of such laws should be to generate little or no revenue at all for the state.

C. States’ Rights to Take Custody of Unclaimed Property

The U.S. Supreme Court has held that the state that has the primary right to take custody of unclaimed property is the state in which the last known address of the owner of the property is located, as set forth on the books and records of the holder of the property.

---


10 See, e.g., Douglas Aircraft Co. v. Cranston, 374 P.2d 819, 821 (Cal. 1962) (“The objectives of the [Unclaimed Property Act] are to protect unknown owners by locating them and restoring their property to them and to give the state rather than the holders of unclaimed property the benefit of the use of it . . . .”); Smyth v. Carter, 845 N.E.2d 219, 222 (Ill. App. Ct. 2006) (“Unclaimed property acts are designed to serve the dual purposes of reuniting owners with the value of unclaimed property and giving the state, rather than the holder, the benefit of the use of the unclaimed property pending reclamation by the owner.”); Travelers Express Co. v. Minn., 506 F. Supp. 1379 (D. Minn.), aff’d, 664 F.2d 691 (8th Cir. 1981), cert. dismissed, 456 U.S. 920 (1982). At least two theories have been advanced in support of this latter objective. First, the state may be more able or willing to preserve the property for its owner than the holder, who may lose or otherwise dissipate the property either intentionally or through negligence. See, e.g., State v. Liquidating Trs. of Republic Petroleum Co., 510 S.W. 2d 311 (Tex. 1974). Second, if the owner never reclaims the property, then perhaps it is more “fair” for the state to use the property for the benefit of all its citizens, rather than permit the holder to retain the property and thereby receive an undeserved “windfall.” See, e.g., TXO Prod. Corp. v. Okla. Corp. Comm’n, 829 P.2d 964 (Okla. 1992).

property. We will refer to this rule as the “first-priority rule” and the state in which the last known address of the owner of the property is located as the “first-priority state”. If the last known address of the owner is unknown, or if the first-priority state does not provide for escheat of the property, then the Supreme Court has held that the state of domicile of the holder has the secondary right to claim the property. We will refer to this rule as the “second-priority rule” and the state of domicile as the “second-priority state”.

In a class action settlement, the defendant will generally have a record of the last known address of each of the class members that are sent checks. Accordingly, in most cases, the first-priority rule, rather than the second-priority rule, should apply, in which case the states that could potentially claim the unclaimed class action settlement proceeds would be the states in which the class members reside.

III. STATE COURT CLASS ACTIONS

A. Whether Unclaimed Class Action Settlement Proceeds Are Subject to Escheat Under State Unclaimed Property Laws

In determining whether a state may take custody of unclaimed class action proceeds in a state court class action, the threshold question is whether such proceeds constitute the type of property that is subject to escheat.

The 1981 Act generally provides that “all intangible property ... that is held, issued, or owing in the ordinary course of a holder’s business and has remained unclaimed by the owner for more than 5 years after it became payable or distributable is presumed abandoned.” The 1995 Act similarly applies to any “fixed and certain interest in intangible property that is held, issued, or owed in the course of a holder’s business.”

The 1995 Act and the unclaimed property statutes of various states (including Alabama, Arizona, Arkansas, Kansas, Louisiana, Maine, Montana, Nevada, New Jersey,

---

13 The Court has held that the state of domicile of a corporation is its state of incorporation.
14 Although the Court only announced these two bases under which a state has the jurisdiction or right to claim unclaimed property, 36 states (including the District of Columbia) have adopted a so-called “third-priority” rule under which the state where the transaction giving rise to the unclaimed property occurred may claim the property if the holder has no record of the owner’s last known address and the holder’s state of domicile does not provide for escheat of the property. Such a rule has been widely criticized as unconstitutional (since the Supreme Court specifically considered and rejected such a rule in Texas v. New Jersey), but an analysis of that issue is well beyond the scope of this article.
15 If the settlement is administered by the court or a third party rather than by the defendant, the defendant may not have records of the addresses of class members who are issued, but do not cash, settlement checks. In this case, unless the records of the court or third party can somehow be imputed to the defendant (perhaps under an agency theory), the second-priority rule should apply. In that case, only the defendant’s state of domicile would potentially be entitled to claim the unclaimed settlement proceeds.
New Mexico, North Carolina, Vermont and West Virginia) expressly include “property received by a court as proceeds of a class action, and not distributed pursuant to the judgment” as a type of property subject to abandonment.\(^{18}\) Utah has adopted an even broader provision, which states that “[i]ntangible property payable or distributable to a member of or participant in a class action that remains unclaimed for more than one year after the time for the final payment or distribution is considered abandoned, unless the apparent owner has communicated in writing with the holder concerning the property within the preceding six months.”\(^{19}\) Rhode Island and Wyoming have also adopted provisions very similar to Utah’s.\(^{20}\)

However, it is not clear that the 1995 Act’s provision would apply here, as the uncashed settlement checks would in most cases not be “received by a court”. In addition, in *Wilson v. Mass. Mut. Life Ins. Co.*,\(^{21}\) the New Mexico Court of Appeals held that unclaimed class action proceeds were not subject to abandonment despite the express provision, because the proceeds were not held, issued or owing in the “course of business,” as required by the unclaimed property statute. Notably, the court interpreted the phrase “course of business” in the New Mexico statute (which is based on the same provision in the 1995 Act) to mean the same as “ordinary course of business” (which was the phrase used in an earlier version of the New Mexico statute based on the 1981 Act).\(^{22}\)

Accordingly, uncashed settlement checks may not be considered unclaimed property in many states because they are not held, issued or owing in the (ordinary) course of business.

Furthermore, in order for property to constitute abandoned “intangible property” subject to escheat under a state’s unclaimed property laws, the holder of the property must have an “unqualified” and “liquidated” obligation to pay the property to its alleged owner. In other words, the holder’s obligation must be fixed and certain. This requirement, while not expressly stated in most state statutes, is compelled by the derivative rights doctrine. Otherwise, the state would be entitled to claim property that the owners themselves have no right to claim (and never had a right to claim).\(^{23}\) Thus, if a check is merely a conditional offer of settlement, it may not be treated as unclaimed property, but if the check is paid pursuant to an unconditional obligation, the amounts represented by the check may be treated as unclaimed property subject to abandonment and escheat.\(^{24}\) When a class action settlement is entered into, a fixed and certain liability

---


\(^{19}\) Utah Code Ann. § 67-4a-207(3).


\(^{21}\) 135 N.M. 506 (Ct. App. 2004).

\(^{22}\) A comment to Section 1(13) of the 1995 Act provides that this revision was not intended to be a substantive change from the 1981 Act.

\(^{23}\) The state generally has the burden of proving that the holder of property has an unqualified obligation to pay such property to another person See, e.g., Insurance Co. of N. Am. V. Knight, 8 Ill. App. 3d 871 (1973).

of the defendant is created with respect to the class members who satisfy the conditions of the settlement agreement and are issued checks.

Once the checks are issued, the only condition that will generally apply to the payment of such checks is that the checks must be presented within a specified period of time; otherwise, under the terms of the settlement agreement, they will become null and void and the defendant will be entitled to retain any amounts represented by the uncashed checks. This condition can be broken down into two sub-conditions. The first is that of “presentment” – the requirement that, in order for a check to be paid, it must first be presented for payment. A few older cases have held that a holder’s obligation does not become “unqualified” until demand for the payment has actually been made by the owner. However, most states have now adopted statutory provisions similar to Section 2(b) of the 1981 Act, which provides that, for purposes of the unclaimed property act, property is deemed to be payable or distributable notwithstanding the owner’s failure to make demand or to present any instrument or document required to receive payment. These provisions were intended to obviate the results reached in these cases. In addition, even where a state has not explicitly adopted a provision similar to Section 2(b), we would expect that most courts would take the view that a holder’s obligation becomes unqualified regardless of whether demand has actually been made.

The second sub-condition is that the check must be presented for payment within a specified period of time. However, thirty-six states (plus the District of Columbia) have adopted statutes that provide that the expiration of a period of limitation on the owner’s right to receive or recover property, whether specified by contract, statute or court order, does not prevent the property from being presumed abandoned or affect a duty to file a report or to pay or deliver the property to the state.
adopted statutes that provide that expiration periods imposed by statute or court order do not prevent property from being presumed abandoned. Only three states – Kentucky, Massachusetts and Mississippi – have not adopted any form of such an “anti-limitations provision”. It is likely that the sub-condition that the checks be cashed within a specified period of time would be considered an expiration period imposed pursuant to a court order (rather than an expiration date imposed by contract) because a court order would be necessary to approve the settlement agreement. Thus, if the amount represented by the check was otherwise required to be reported and remitted to the state, then the existence of the sub-condition would not change this result.

Even those few states that have not specifically adopted such an “anti-limitation provision” may attempt to take custody of an “expired” check on the basis that the expiration date is a “private escheat” mechanism that is unenforceable as against the state because it violates public policy. Similar arguments have been successful in several cases, including State v. Jefferson Lake Sulphur Co., Screen Actors Guild, Inc. v. Cory and People v. Marshall Field & Co. However, arguably this type of “public policy”


30 178 A.2d 329 (N.J. 1962). This case involved the potential application of New Jersey’s unclaimed property law to dividends issued by Jefferson Lake Sulphur Company, a New Jersey corporation (“Jefferson Lake”). A few months after New Jersey enacted its unclaimed property law, generally permitting New Jersey to take custody of any dividends that remained unclaimed after five years from the date of payment, the Board of Directors of Jefferson Lake voted to amend the company’s certificate of incorporation to provide that any dividends that remained unclaimed for a period of three years would revert back to Jefferson Lake. The Board of Directors mailed a notice to each of the stockholders of the company (and its predecessor) to explain the change. In the notice, the Board admitted that the change was being made to circumvent the New Jersey unclaimed property statute. The Supreme Court of New Jersey stated that “[e]scheat of unclaimed dividends serves the important public need of providing revenue to be utilized for the common good.” Id. at 336. The court also concluded that a company that incorporates in New Jersey becomes subject to this public policy, and thus the “[a]lteration of a charter for the avowed purpose of defeating a relevant aspect of the sovereign's declared public policy cannot achieve judicial approval.” Id. In reaching this conclusion, the court relied on a number of cases holding that a corporation’s charter or bylaws that conflicts with the state’s public policy is void. Thus, because Jefferson Lake’s charter was amended for the express purpose of avoiding the escheat laws, the court held that the amendment was invalid.

31 154 Cal. Rptr. 77 (Cal. App. 1979). In that case, the Screen Actors Guild (“SAG”) received residuals on behalf of its members – actors, stuntmen and other performers – and forwarded the residuals to the persons entitled to them. SAG’s bylaws provided that if a residual is unclaimed for at least six years, then it reverts to SAG for the benefit of all of its members. However, in practice, SAG did not enforce this provision. The court held that SAG’s bylaw was contrary to public policy because it “would deny to the state the benefit of the use of most of the unclaimed residuals” and was “obviously designed to frustrate operation of the [unclaimed property laws].” 154 Cal. Rptr. at 80. The court also held that the bylaws, as a mere private agreement, could not be used to circumvent a public law. However, the court acknowledged that, due to SAG’s relationship with its members and its extensive process for distributing residuals, SAG may be better able than the state to actually serve the goal of the unclaimed property laws to locate missing owners of abandoned property. The court thus suggested that the “Legislature may wish to make this circumstance the basis for a special exemption of the unclaimed residuals at issue.” id.

32 404 N.E.2d 368 (Ill. App. 1980). In this case, an Illinois Appellate Court was faced with the issue of whether Illinois had the right under its unclaimed property laws to take custody of unredeemed, expired gift certificates issued by Marshall Field & Co. (“Marshall Field”). Until 1975, Illinois' period of presumed
exception should apply only where it is clearly established that the sole (or at least the primary) motive of the holder was the avoidance of state unclaimed property laws.\textsuperscript{33} In most class action settlements, this would not be the case.\textsuperscript{34}

Both the anti-limitations provisions and Section 2(b) of the 1981 Act violate the derivative rights doctrine by giving the state a greater right to claim the property than the actual owner of the property. However, Section 2(b) can probably be justified on the basis that the presentment requirement is a mere formality, and not a material condition. Indeed, in \textit{Connecticut Mutual Life Ins. Co. v. Moore},\textsuperscript{35} the U.S. Supreme Court did not require the state to satisfy an insurance policy condition requiring proof of death and surrender of the policy in order to escheat the unclaimed insurance proceeds. In that case, the insurance companies argued that these contract conditions served a substantive purpose – that is, they were intended to provide information from which the companies could establish defenses to their obligation to pay. In rejecting this argument, the Court stated that the “enforced variations from the policy provisions” were not unconstitutional because otherwise “the insurance companies would retain moneys contracted to be paid on condition and which normally they would have been required to pay.”\textsuperscript{36} In explaining its holding, the Court stated:

When the state undertakes the protection of abandoned property claims, it would be beyond a reasonable requirement to compel the state to comply with conditions that may be proper as between the contracting parties. The state is acting as a conservator, not as a party to a contract.\textsuperscript{37}

Thus, it would appear that before a state will be relieved of complying with “proper” conditions precedent applicable to the owner’s right to the property, the obligation must be such that (1) “normally” it would have been paid, and (2) it would not be “reasonable” to require the state, acting as a conservator, to satisfy the condition. One court in distinguishing the \textit{Connecticut Mutual} decision stated that the decision excused compliance with contract conditions “which only go to formalism of interest, such as

---

\textsuperscript{33} Indeed, such a limitation would be consistent with each of these cases.

\textsuperscript{34} \textit{But see Texas v. Snell}, 950 S.W.2d 108 (Tex. App. 1997), discussed \textit{infra}.

\textsuperscript{35} 333 U.S. 541 (1948).

\textsuperscript{36} \textit{Id.} at 546.

\textsuperscript{37} \textit{Id.} at 547.
proof of death … but it is nevertheless held to compliance with matters that deal with substantive determination of ownership.”

Under this standard, a different result should be reached for the anti-limitation provisions. The requirement that the check be negotiated within a specified period of time is a material condition that is often specifically negotiated as part of the class action settlement. Indeed, a defendant may agree to a higher settlement amount if the defendant is assured that it will receive any unclaimed proceeds. To disregard this requirement is to ignore the terms of the settlement, and grant the state a significantly greater interest than the class members have themselves. In addition, the anti-limitations provisions also indirectly give additional substantive rights to the owner of the property. For instance, let’s assume that a class action settlement check has not been cashed within the specified period of time in the settlement agreement. The class member no longer has the right to claim that property, as per the terms of the settlement agreement. However, if the anti-limitations provision is respected, then the defendant may have to turn the property over to the state after it has been “presumed abandoned” under the state’s unclaimed property law. The class member could then reclaim the property from the state, thus doing indirectly what he had no right to claim directly from the defendant.

This expansion of rights created by the anti-limitations provisions was almost certainly not intended by the state legislatures when they adopted these provisions, as again, state unclaimed property laws are not designed to affect the substantive rights of taxpayers, but are merely intended as procedural mechanisms to return unclaimed property to the missing owners. Indeed, in State v. Standard Oil Co. the New Jersey Supreme Court held as follows:

[W]here all remedy upon the intangibles has been barred by the statute of limitations, there is no property to escheat under the act now before us. The State’s right is purely derivative: it takes only the interest of the unknown or absentee owner. If the remedy has been extinguished by the statute of limitations, the State is under like incapacity. The State takes only the creditor’s right; it cannot create or revive an obligation that had no existence or had become extinct. [Citation omitted.] Here, defendant invokes the bar of the statute of limitations; and where the defense is sufficient in law, there is no property subject to escheat.

Accordingly, the state anti-limitations provisions are primarily the result of a lack of understanding of how state unclaimed property laws are supposed to work. As the

---

39 In addition, the comments to the 1981 Act make it clear that the anti-limitations provisions were intended to codify the decisions in the Jefferson Lake, Screen Actors Guild and Marshall Field cases cited above. Cmts. to Unif. Unclaimed Prop. Act of 1981, § 29, 8C U.L.A. 151. Yet those cases involved holders of unclaimed property that were intentionally trying to circumvent the state unclaimed property laws. The anti-limitations provisions potentially have a much broader scope, and one that is not consistent with general unclaimed property principles.
U.S. Supreme Court stated in *Delaware v. New York*, 507 U.S. 490 (1993), “[f]unds held by a debtor become subject to escheat because the debtor has no interest in the funds....” Thus, where a debtor has specifically contracted for an interest in property if a certain condition is satisfied – including the expiration of a time of limitation – then, once that condition is satisfied, the person is no longer the debtor, but is the new owner. The anti-limitation provisions ignore this basic truth, and thus should be narrowly construed to apply – if at all – only where the primary purpose of the provision is to avoid state unclaimed property laws. In short, since the state’s claim to the settlement proceeds is derived entirely from the settlement agreement itself, it seems somewhat perverse to say that state can enforce its claim where the settlement agreement expressly limits the class member’s rights to the proceeds.

One may counter that the anti-limitation provision should apply where the expiration of the owner’s rights is included as part of an adhesion contract. In that situation, there may be a consumer protection motive for these provisions. But even if such an argument is defensible in the abstract (which we are not certain it is), it would not typically apply in the class action settlement context, because the terms of such settlements are almost always negotiated at arm’s length by parties with relatively equal bargaining power (and if they are not, the court should not approve the settlement agreement without determining itself that the settlement terms are fair and reasonable). Nevertheless, until it is clear that courts will interpret and apply these anti-limitations provisions narrowly, they create a substantial risk, at least in some states, that unclaimed class action proceeds may be subject to escheat.

---

42 Such a narrow construction would be consistent with the *Marshall Field*, *Screen Actors Guild*, and *Jefferson Lake Sulphur* cases, all of which involved situations where the holder’s primary intent was to avoid its unclaimed property obligations. In addition, as discussed in Part III.B, such a construction may be required where a broader construction would render meaningless other state statutes.
43 It should be noted that the anti-limitations provision would, at least on its face, seem to apply regardless of whether the settlement agreement simply provides that the checks must be cashed within a certain period of time or whether the agreement expressly states that amounts represented by uncashed checks remain the sole property of the defendant. However, these two scenarios are somewhat distinguishable. In the latter scenario, it is clear that the parties specifically considered the possibility that some checks may not be cashed, and agreed that the defendant could keep the amounts represented by those checks. This is the clearest example where the anti-limitations provision should not apply, as it is exactly contrary to the intent of the parties when they negotiated the settlement agreement. Thus, any claim by the state fails to recognize the substantive rights of the parties in the property at issue. By contrast, in the first scenario, it may be that the parties did not actually contemplate what should happen to the expired checks. This is probably quite unusual, though, as there is a high likelihood of expired checks in any given case, particularly if the individual checks are for relatively small amounts. Thus, unless there is other evidence that suggests that the parties in fact did not consider who should receive the amounts represented by the uncashed checks, it should probably be presumed that the parties intended those amounts to remain the property of the defendant.
44 Notwithstanding Section 2(b) of the 1981 Act and the anti-limitations provisions, however, it is important to understand that, under the derivative rights doctrine, potential class members that do not submit valid claims under the settlement agreement will not give rise to unclaimed property. Under the terms of most class action settlement agreements, the defendant has the right to review claims submitted by potential class members and to contest any claims it does not consider to be valid. Among the requirements for payment to a potential claimant under a typical settlement agreement is that the claimant must provide information to support his or her claim under penalty of perjury. This is not a mere formality – as in the
Finally, a few states have adopted other provisions in their unclaimed property laws that may be broad enough to apply to situations not covered by the anti-limitations provision (*e.g.*, because they are not limited to the situation where the owner’s right to claim the property expires after a specified period of time). For example, Tex. Prop. Code § 74.309 provides:

An individual, corporation, business association, or other organization may not act through amendment of articles of incorporation, amendment of bylaws, private agreement, or any other means to take or divert funds or personal property into income, divide funds or personal property among locatable patrons or stockholders, or divert funds or personal property by any other method for the purpose of circumventing the unclaimed property process.

Notably, this statute’s scope is limited to agreements or actions that are entered into for the “purpose” of circumventing the unclaimed property process, and thus should not apply to agreements or actions that merely have the *effect* of avoiding the unclaimed property process.\(^{45}\) Thus, this statute appears to be a codification of the “private escheat” cases noted above.\(^{46}\) The scope of Tex. Prop. Code § 74.309 was examined by the Texas Court of Appeals in *State of Texas v. Snell*.\(^{47}\) In *Snell*, the court held that a court order violated Texas unclaimed property laws where the order provided that unclaimed class action settlement distributions would be paid to a charity designated by the trial judge rather than escheat to the State of Texas. The court stated:

The disposition of unclaimed property in the State of Texas is not left to the whim of the private citizens or the courts, and rightfully so. The Texas Legislature has imposed a specific and detailed procedure for identifying, reporting, and tendering, and has further

---

\(^{45}\) In other contexts, courts have generally held such “purpose” requirements to require a fairly strong showing of intent. *See, e.g., Personnel Adm’r v. Feeney*, 442 U.S. 256, 279 (1979) (“‘Discriminatory purpose[]’ implied more than intent as volition or intent as awareness of consequences. It implies that the decision maker…selected or reaffirmed a particular course of action at least in part ‘because of,’ not merely ‘in spite of,’ its adverse effects upon an identifiable group.”)

\(^{46}\) *See also* Del. Code Ann. § 1210.

\(^{47}\) 950 S.W.2d 108 (Tex. App. 1997).
provided for governmental custody and distribution of unclaimed property.48

However, in Snell, the settlement agreement strongly suggested that its purpose was to circumvent the unclaimed property process.49 Accordingly, Snell represents a highly unusual situation, as most class action settlement agreements do not mention state unclaimed property laws, or suggest that the settlement is being devised to avoid the application of these laws.

B. **Other Reasons Why State Unclaimed Property Laws May Not Apply to Unclaimed Class Action Proceeds**

There are other reasons – both legal and policy-based – why states should not be entitled to take custody of unclaimed class action proceeds in a state court class action.

First, because the class action concept has its origin in equity, the courts retain traditional equity powers over the disposition of unclaimed class action proceeds. Thus, if the settlement agreement is silent regarding such disposition, the court may still have the discretionary authority to choose whether the proceeds should be paid to the state as unclaimed property.50 On the other hand, where the court has already approved a settlement agreement that explicitly permits the defendant to retain the unclaimed funds, the court cannot subsequently “rewrite” the settlement agreement by exercising its equity powers and transferring the money to the state.

State unclaimed property laws should also not apply to unclaimed class action settlement proceeds where the application of such laws would be inconsistent with other state laws. For example, Cal. Civ. Proc. Code § 384(b) generally provides that unclaimed class action proceeds may be paid:

> 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. The court shall ensure that the distribution of any unpaid

---

48 Id. at 112. The court also noted that, although Tex. Prop. Code § 74.309 does not specifically proscribe a court from circumventing the unclaimed property process, an “individual” is specifically prevented from circumventing such process. Thus, the court order violated Tex. Prop. Code § 74.309 “by ordering an individual, the escrow agent, to transfer the funds upon the decision of the trial court of his or her appropriate charity.” Id.

49 Id. at 110 (“The plan, in the last sentence of paragraph 5.2.3, provided that settlement distribution checks or amount[s] which might be unclaimed by Appellees/plaintiff class members and which would ‘otherwise escheat to the State of Texas’ would instead be paid to the charity designated by the trial judge.”)

50 See Friar v. Vanguard Holding Corp., 509 N.Y.S.2d 374, 376 (1986) (although the court ultimately upheld the disposition of unclaimed funds to the state comptroller as abandoned property, the court noted that “the application of abandoned property statutes to unclaimed class action funds is not required….’”); Garrett v. Coast Federal Savings and Loan Association, 136 Cal. App. 3d 266 (1982) (holding that there was “no authority” for the escheat of unclaimed class action funds to the State of California).
residual derived from multistate or national cases brought under California law shall provide substantial or commensurate benefit to California consumers.

If state unclaimed property laws are allowed to “trump” such laws, then that would render these types of laws essentially meaningless. That contradicts general principles of statutory construction, which presume that the legislature intends each statute that it enacts to have some meaning and effect.\textsuperscript{51}

Similarly, state unclaimed property laws may conflict with general procedures under state law for enforcing settlements or judgments. For instance, in Texas, a plaintiff can enforce a judgment only by obtaining a writ of execution. Tex. Civ. Prac. & Rem. Code § 34.001(a) provides that “[i]f a writ of execution is not issued within 10 years after the rendition of a judgment of a court of record or a justice court, the judgment is dormant and execution may not be issued on the judgment unless it is revived.” Tex. Civ. Prac. & Rem. Code § 31.006 further provides that “[a] dormant judgment may be revived by scire facias or by an action of debt brought not later than the second anniversary of the date that the judgment becomes dormant.” Accordingly, if a prevailing plaintiff does not act to collect on a judgment within 12 years after the judgment is rendered, the plaintiffs’ rights to collect are extinguished.\textsuperscript{52} Many states have statutory provisions that are similar to Tex. Civ. Prac. & Rem. Code §§ 31.006 and 34.001. To permit the state to claim the proceeds under these circumstances (i.e., under its anti-limitations provision) would not only violate the derivative rights doctrine by giving the state rights that are greater than those of the owner of the unclaimed property, but would also render these statutes essentially null and void. Again, such a result is inconsistent with fundamental principles of statutory interpretation, and no policy or other justification exists for expanding the states’ rights in this manner.

Finally, the application of state unclaimed property laws to the disposition of unclaimed settlement funds in a class action may raise a number of practical problems, including (1) the court would be required to review the unclaimed property laws of potentially all 50 states and the District of Columbia to determine whether, and to what extent, those state laws may limit the court’s discretion to dispose of any unclaimed class action settlement funds;\textsuperscript{53} (2) settlements may be hindered because the parties would be unable to agree on a binding disposition of unclaimed settlement funds (which is often an issue during settlement negotiations); and (3) numerous past settlements or court orders would need to be revisited to determine whether such settlements violated state unclaimed property laws.


\textsuperscript{53} However, it is not clear whether such a requirement would impose an unusual burden on a court. Presumably, the court could simply provide notice to the various states of the lawsuit and let the states submit claims, as appropriate. This is a fairly common procedure in federal bankruptcy courts, where the debtor holds unclaimed property.
A court that is considering the potential application of state unclaimed property laws to unclaimed class action settlement proceeds should take into account these practical problems in rendering its decision.

C. Class Action Settlements That Do Not Involve Cash Payments

Some class action settlements do not require the defendant to issue checks to settling class members, but instead require the defendants to issue “vouchers” or “coupons” that are redeemable for merchandise or services provided by the defendant, but not for cash. Under the derivative rights doctrine, the defendant would not be required to pay the amount of any such unused vouchers or coupons to a state as unclaimed property because the owner himself could not redeem the vouchers or coupons for cash.54

Although there is little direct authority in the states’ unclaimed property statutes that codifies this rule,55 a number of judicial authorities support such a rule (in addition to those authorities generally upholding the derivative rights doctrine). For example, in New Jersey v. Sperry & Hutchinson Co.,56 New Jersey had instituted suit against Sperry & Hutchinson Company (“S&H”) to require escheat of the cash value of unredeemed trading stamps issued by S&H that had remained unredeemed for longer than New Jersey’s period of presumed abandonment. The trial court rendered judgment for S&H, and the State appealed. The Superior Court, Appellate Division, held that, under the derivative rights doctrine, any right of the State to escheat the cash value of unredeemed stamps would be no greater than that of individual stampholders to demand payment from the company and that, where the trading stamp company was under no legal obligation to redeem stamps in less than completed books, the State had no right to escheat the value of the stamps in the absence of proof that they were in fact held in redeemable quantities by individual stampholders. The Supreme Court affirmed the Appellate Division’s decision, stating that it did not find in the record sufficient evidence of specifically identifiable property subject to escheat or custody under the statutes to justify liability against S&H.

54 At most, the defendant would be required to issue substitute vouchers or coupons to the state, and permit the state to redeem them for merchandise or services, or possibly sell them to third parties who could then redeem them. However, such resale of vouchers and coupons would appear to present a “cascading” unclaimed property problem, insofar as the purchasers of these vouchers and coupons may themselves not use them, thereby triggering the defendant’s obligations to re-escheat them back to the state, which could then resell them to yet another third party. For this reason, if a defendant were required to transfer duplicate copies of the vouchers or coupons to the state, the state should not be entitled to resell the vouchers or coupons, but could only hold them on behalf of the true owners.

55 But see In the Matter of the November 8, 1996 Determination of the State of N.J. Dep’t of Treasury, 706 A.2d 1177, 1179 (N.J. Super. 1998) (concluding that gift certificates that were not redeemable for cash are not subject to escheat based in part on the fact that the state’s unclaimed property statute defined intangible property to include items that either must be satisfied by the payment of cash (e.g., wages, dividends, interest, royalties, deposits, customer credits) or are readily convertible to cash (such as stock); thus, even though the list was not intended to be exhaustive, the court viewed the list as limiting the definition of intangible property to “cash equivalents” for unclaimed property purposes; the court also relied on evidence suggesting that the legislature intended to exclude gift certificates from the definition of “intangible property” subject to escheat).

Similarly, in *North Carolina v. City of Asheville et al.*, North Carolina sought to claim amounts representing the unrefunded purchase price of tickets for Elvis Presley concerts canceled due to the performer’s death. The North Carolina Court of Appeals concluded that, because the owners of the unused tickets were not unqualifiedly entitled to a refund of the purchase price, the state could not claim such amounts as abandoned property.

The Tennessee Chancery Court reached a similar result (but without expressly relying on the derivative rights doctrine) in *Service Merchandise Co. v. Adams*. In that case, Tennessee sought to take custody of unredeemed gift certificates that were redeemable only for merchandise. Tennessee had recently amended its unclaimed property laws to specifically provide for the escheat of gift certificates, but was attempting to take custody of the unredeemed gift certificates under the statute as it existed both prior to and after this amendment. The court first held that unredeemed gift certificates – or rather, the promise of the gift certificate issuer to deliver merchandise to the owner of the gift certificate – was intangible property covered by Tennessee’s unclaimed property laws (the pre-amendment statute also applied to gift certificates because that statute contained a “catch-all” provision that included all intangible property). However, the court then held that, because the property at issue was the obligation to deliver merchandise, and not the cash equivalent of the purchase price of the gift certificates, the issuer must “deliver to the custody of the State of Tennessee copies of the gift certificates or other memoranda which account for and memorialize the intangible promise of the Plaintiff (Holder) to deliver merchandise to the Owner.” The court specifically held that “the statute does not require the Plaintiff to deliver to the State cash for the unredeemed gift certificates under either the pre-1993 Miscellaneous Provision of the Act or under the 1993 amendment.”

Notably, the court reached this conclusion despite the fact that (i) Tennessee’s unclaimed property law specifically stated that the “amount presumed abandoned is the purchase price of the gift certificate” (the court held that this provision provided merely a valuation of the intangible property embodied in the gift certificate and was not a directive for the holder to turn over to the state the purchase price of gift certificates in cash); and (ii) if the value of merchandise for which a gift certificate was redeemed was no more than $10 less than the face amount of the redeemed gift certificate, the difference would be paid to the gift certificate owner in cash (thus, the court did not consider this exception to the prohibition on cash redemptions to be sufficient to require the gift certificate issuer to pay any cash to the state).

---

59 Id. at *5.
60 Id.
61 The court also held that, if the Tennessee statute were construed to require the gift certificate issuer to pay to the state cash equal to the face amount of the unredeemed gift certificates, the statute would violate the Takings Clause of the U.S. Constitution. Citing *Lucas v. S.C. Coastal Council*, 505 U.S. 1003 (1992), the court held that the Tennessee statute would “result in a complete denial of the Plaintiff’s beneficial use of its property (i.e., capital) by denying the Plaintiff its anticipated gross profit and a return on the
However, a number of states with unclaimed property laws almost identical to those in Tennessee take the position, at least administratively, that cash equal to the unredeemed balance on a gift card is subject to escheat. On the other hand, over half the states contain explicit exemptions for gift cards in their unclaimed property statutes. Some of these states presumably enacted these exemptions precisely because gift cards are not (generally) redeemable for cash, and thus are not the type of property that should ordinarily be subject to escheat.

Accordingly, class action defendants in settlement negotiations that have the option of issuing vouchers, coupons, gift cards or other instruments that are not redeemable in cash, rather than checks, may find it beneficial to do so to minimize potential liabilities under state unclaimed property laws.

D. Potential Claims by Defendant’s State of Domicile to Class Action Proceeds Exempted by Class Member’s State of Residence

As discussed above, in most class action settlements, the first-priority rule will apply, and thus the applicable unclaimed property laws will be those of the states in which the missing class members reside. However, it is likely that at least some of those states will exempt class action proceeds from escheat – either because they are not incurred in the “ordinary” course of business or for some other reason. In such case, the question arises whether the state of domicile of the defendant may claim the unclaimed proceeds under the second-priority rule.

This is a more complicated issue than may immediately be apparent, as it raises questions regarding both the scope of the U.S. Supreme Court’s rules first announced in Texas v. New Jersey, as well as the circumstances under which those rules may preempt state unclaimed property statutes. Accordingly, a complete discussion of this issue is beyond the scope of this article. Nevertheless, it is worth pointing out that, when the Court created the rules for determining which state has the right to claim unclaimed intangible property, it stated that it intended to “adopt a rule which will settle the question of which State will be allowed to escheat this intangible property.” Thus, the Court seemed to contemplate that, in any given situation, only one state will have the right to...
claim unclaimed property, and if it does not (or cannot) exercise that right, then another state may not step in and claim the property.\textsuperscript{64}

On the other hand, one may argue that, by permitting the domiciliary state to take custody of unclaimed property where the first-priority state does not “provide for” the escheat of the property, the Supreme Court intended to allow the domiciliary state to claim the property if the first-priority state specifically exempts the property from escheat. But in both Pennsylvania v. New York and Delaware v. New York, the Court apparently suggested that the domiciliary state may claim the property only if (a) the holder did not have a last known address of the owner or (b) the first-priority state does not have any unclaimed property law at all – or at least an unclaimed property law that does not apply to the specific type of property at issue. This view comports with common sense. If the domiciliary state could claim the property where the first-priority state exempted the property, that would effectively allow the state with the lesser right to the property to override the policy decision made by the state with the greater right to the property. If that were the rule, then no state would ever exempt property from escheat because the property would simply be claimed by another state.\textsuperscript{65}

IV. FEDERAL COURT CLASS ACTIONS

In a federal court class action, the paramount issue is whether state or federal law applies to the disposition of unclaimed settlement proceeds. If state law applies, then all of the considerations discussed above in determining whether a state may take custody of unclaimed class action settlement proceeds in a state court class action will also apply in a federal court class action. Thus, a state may not be able to take custody of these unclaimed proceeds if (a) the state’s unclaimed property statutes apply only to intangible property held, issued or owing in the (ordinary) course of business, (b) the “proceeds” consist of obligations, such as vouchers or coupons, that are not redeemable for cash, or (c) the class members have failed to satisfy a condition (other than a mere formality) that is required in order for the proceeds to be due and payable.

\textsuperscript{64} See, e.g., State of New Jersey v. Amsted Industries, 226 A.2d 715, 717 (N.J. 1967) (“[t]here was no question that some state should have the right to escheat unclaimed property but there was equally no question that only one state should have that right.”).

\textsuperscript{65} See also, e.g., State of New Jersey v. Amsted Industries, 226 A.2d 715, 718 (N.J. 1967) (“Under Texas the creditor’s state now has the paramount interest and other states should do what they can to honor it.”).

The second-priority state’s failure to recognize the exemption created by the first-priority state would also run afoul of the Full Faith and Credit Clause of the U.S. Constitution. That Clause provides that “full faith and credit shall be given in each state to the public acts, records, and judicial proceedings of every other state.” U.S. Const. art. IV, § 1. The purpose of this Clause is to “preserve rights acquired or confirmed under the public acts and judicial proceedings of one state by requiring recognition of their validity in others.” Pink v. A.A.A. Highway Exp., Inc., 314 U.S. 201, 246 (1941). The Full Faith and Credit Clause also expresses “a unifying principle...looking toward maximum enforcement in each state of the obligations or rights created or recognized by the statutes of sister states.” Hughes v. Fetter, 341 U.S. 609, 612 (1951) (emphasis added). Although this Clause generally does not “require a State to apply another State’s law in violation of its own legitimate public policy” (Nevada v. Hall, 440 U.S. 410, 422 (1979)), where one state has a greater claim to the property than another, that state’s policy should control. Otherwise, the policy of the state with the lesser claim (here, the second-priority state) will effectively trump the policy of the state with the greater claim (the first-priority state).
But if federal law applies, and such law is inconsistent with state unclaimed property laws, then the state laws should be preempted.

A. **Introduction to Federal Preemption**

The preemption of state law by federal law has its origins in the Supremacy Clause (Article VI, Clause 2) of the United States Constitution, which provides:

> This Constitution, and the Laws of the United States which shall be made in Pursuance thereof...shall be the supreme Law of the Land; and the Judges in every State shall be bound thereby, any Thing in the Constitution or Laws of any State to the Contrary notwithstanding.

In general, in determining whether a federal statute preempts state law, the critical inquiry is whether Congress intended to preempt state law.\(^{66}\)

Intent is easily demonstrated where the federal law expressly provides that state law is preempted.\(^{67}\) However, intent may also be implied. For example, if compliance with both the federal and state laws is impossible, then the state law is preempted.\(^{68}\) Intent can also be implied where the federal law is so comprehensive that it leaves no room for the states to supplement such law or where “the state law stands as an obstacle to the accomplishment and execution of the full purposes of Congress.”\(^{69}\) The nature of the subject matter and the need for exclusive federal law to achieve “uniformity vital to national interests” is also an important factor in determining intent.\(^{70}\)

In ascertaining whether Congress intended to preempt state law, there is a presumption against preemption, at least in fields of traditional state regulation.\(^{71}\) State unclaimed property laws are generally viewed as covering a field of traditional state

---

\(^{66}\) Calif. Fed. Sav. & Loan Ass'n v. Guerra, 479 U.S. 272 (1978) (to determine whether state law is preempted by federal law, the court’s “sole task is to ascertain the intent of Congress”); Cipollone v. Liggett Group, Inc., 505 U.S. 504 (1992). Similarly, where federal common law (rather than a federal statute) is at issue, then the inquiry should be whether the Supreme Court intended to preempt state law. Federal common law may preempt state law to the same extent as a federal statute. See Wilburn Boat Co. v. Fireman’s Fund Ins. Co., 348 U.S. 310, 314 (1955) (“States can no more override . . . [federal] judicial rules validly fashioned than they can override Acts of Congress.”). Federal common law is typically defined as case law that is judicially fashioned by federal courts, rather than interpretive of existing state or federal rules.


\(^{69}\) Id. See also Fla. Lime & Avocado Growers v. Paul, 373 U.S. 132, 176 (1963) (intent to preempt found where federal law is “comprehensive, pervasive, and without a hiatus which the state regulations could fill”).

\(^{70}\) Fla. Lime & Avocado Growers, 373 U.S. at 144.

\(^{71}\) Id. See also Penn Dairies v. Milk Control Comm’n, 318 U.S. 261 (1943); N.Y. State Conference of Blue Cross & Blue Shield Plans v. Travelers Ins. Co., 514 U.S. 645, 655 (1995) (“the historic police powers of the State were not to be superseded by the Federal Act unless that was the clear and manifest purpose of Congress.”).
regulation. Hence, the presumption against preemption probably applies here. Nevertheless, this presumption may be rebutted by a finding that Congress clearly intended to preempt such laws.

Accordingly, in a federal court class action, we must first ask whether federal law applies to the disposition of unclaimed class action funds and, if so, whether that federal law expressly or impliedly preempts state unclaimed property laws. In determining whether federal law applies to the disposition of unclaimed class action proceeds, the first question is whether jurisdiction is based on a federal question or on diversity of citizenship. Where jurisdiction is based on a federal question, federal law generally applies to any matter to be resolved in the action, including the disposition of unclaimed proceeds (whether such disposition is viewed as a substantive or procedural matter). If, however, jurisdiction is based upon diversity of citizenship, federal law will apply to a particular matter rather than state law if either (1) a valid Federal Rule of Civil Procedure is applicable to such matter or (2) the matter is properly viewed as “procedural” rather than “substantive” under the doctrine set forth by the U.S. Supreme Court in *Erie R. Co. v. Tompkins* (the “*Erie* doctrine”).

---


74 304 U.S. 64 (1938).

75 *Hanna v. Plumer*, 380 U.S. 460 (1965). Federal law may also preempt state law where the state law conflicts with the U.S. Constitution or a federal statute. In this case, however, there is no constitutional provision applicable to the disposition of unclaimed class action funds pursuant to the settlement agreement, and the only potentially relevant federal statutes are 28 U.S.C. § 2041 and 12 U.S.C. § 2503. 28 U.S.C. § 2041 provides that “[a]ll moneys paid into any court of the United States, or received by the officers thereof, in any case pending or adjudicated in such court, shall be forthwith deposited with the Treasurer of the United States or a designated depository, in the name and to the credit of such court.” 28 U.S.C. § 2041 would not apply here because unclaimed settlement proceeds will generally not be “paid into any court of the United States, or received by the officers thereof.” In addition, even if this statute were otherwise applicable, courts have interpreted it as a permissive, rather than mandatory, option. *See Van Gemert v. Boeing Co.*, 739 F.2d 730, 735 (9th Cir. 1984) (holding that 28 U.S.C. § 2041 “does not limit the discretion of the district court to control the unclaimed portion of a class action judgment fund,” but simply “will control when a court so orders or when the court fails to make any disposition of this type of fund.”); *Jones v. National Distillers*, 56 F. Supp. 2d 355, 358 (S.D.N.Y. 1999). 12 U.S.C. § 2503 is also not applicable to this case. 12 U.S.C. § 2503 generally provides that the state in which a traveler’s check is purchased has priority to take custody of any unclaimed funds represented by such check. This statute was enacted in response to the U.S. Supreme Court’s decision in *Pennsylvania v. New York*, 407 U.S. 206 (1972), which generally held that the state in which the last known address of the owner of unclaimed
In addition, a federal court may be able to apply federal equitable principles or federal common law in a diversity jurisdiction case, even if the application of such equitable principles or common law is contrary to state law and relates to a “substantive” matter under the *Erie* doctrine.76

**B. Federal Rule of Civil Procedure 23**

The only Federal Rule of Civil Procedure that may potentially apply to the disposition of unclaimed class action funds is Rule 23, which generally governs practice and procedure in federal court class actions.

Rule 23(d) provides as follows:

In the conduct of actions to which this rule applies, the court may make appropriate orders: (1) determining the course of proceedings or prescribing measures to prevent undue repetition or complication in the presentation of evidence or argument; (2) requiring, for the protection of the members of the class or otherwise for the fair conduct of the action, that notice be given in such manner as the court may direct to some or all of the members of any step in the action, or of the proposed extent of the judgment, or of the opportunity of members to signify whether they consider the representation fair and adequate, to intervene and present claims or defenses, or otherwise to come into the action; (3) imposing conditions on the representative parties or on intervenors; (4) requiring that the pleadings be amended to eliminate therefrom allegations as to representation of absent persons, and that the action proceed accordingly; (5) *dealing with similar procedural matters*. The orders may be combined with an order under Rule 16, and may be altered or amended as may be desirable from time to time. (emphasis added)

Accordingly, if the disposition of unclaimed settlement proceeds is a “procedural” matter and is similar to the other enumerated matters in Rule 23(d)(1) through (4), then the federal court may make “appropriate” orders regarding such dispositions. There are a few possible objections to the potential applicability of Rule 23(d). First and most importantly, the question arises whether the disposition of unclaimed class action proceeds is, in fact, a procedural matter. Second, is such a disposition “similar” to the other matters identified in Rule 23(d)? And third, is the court’s order “appropriate” if it is contrary to state unclaimed property laws?

There is little authority interpreting the scope of Rule 23(d). The only court that has directly applied this rule to dispositions of unclaimed class action settlement proceeds

---

76 See, e.g., *Robinson v. Campbell*, 16 U.S. 212 (1818), discussed infra.
found that Rule 23(d) does apply to such dispositions.\textsuperscript{77} In reaching this conclusion, the court did not analyze any of these questions, but simply concluded that the disposition of unclaimed settlement proceeds is a procedural matter and courts have broad discretion under Rule 23(d) to resolve procedural matters. We agree with the court’s conclusion that such dispositions are procedural matters,\textsuperscript{78} but do not further address the potential issues under Rule 23(d) raised above, because we believe the applicability of Rule 23 is more clearly required by Rule 23(e).

Rule 23(e) provides that “[t]he claims, issues, or defenses of a certified class may be settled, voluntarily dismissed, or compromised only with the court’s approval.” Rule 23(e)(2) further provides that the court may only approve a proposed settlement after finding that it is “fair, reasonable and adequate.”\textsuperscript{79} 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. One may argue that the court’s approval is not “fair” and “reasonable” if the settlement violates state unclaimed property laws, and therefore the court is constrained by those laws in approving the settlement. However, at least two cases have rejected such an argument, apparently on the basis that “the disposition of unclaimed funds in a class action settlement in federal court is a procedural matter committed to the discretion of the district court under Federal Rule of Civil Procedure 23, and thus is unconstrained by state unclaimed property laws.”\textsuperscript{80}

As discussed below, the Rules Enabling Act essentially requires that, to be valid, Rule 23(e) (like any Federal Rule of Civil Procedure) must be a procedural rule. However, unlike Rule 23(d), we need not determine that the disposition of unclaimed settlement proceeds is a procedural matter in order to conclude that Rule 23(e) is applicable and thus supersedes contrary state unclaimed property laws. Rather, we can conclude that Rule 23(e) is procedural simply because the court’s act of approving or disapproving a settlement is a procedural act. It is thus irrelevant whether the settlement

\textsuperscript{77} In re Lease Oil Antitrust Litigation, 2007 U.S. Dist. LEXIS 91467.

\textsuperscript{78} The issue of whether the disposition of unclaimed settlement proceeds is a procedural matter is also raised by the Rules Enabling Act of 1934 and the 
\textit{Erie} doctrine, discussed below. We conclude that such a disposition is a procedural matter under these rules for various reasons, including (i) state unclaimed property laws are not intended to modify any substantive rights of the parties; (ii) a determination that federal law applies to the disposition of unclaimed class action settlement proceeds is unlikely to encourage forum shopping; and (iii) the application of federal law to dispositions of unclaimed funds would not result in inequitable administration of the laws. We believe that these same reasons generally support characterizing such a disposition as a procedural matter for purposes of Rule 23(d).

\textsuperscript{79} See also, e.g., Cotton v. Hinton, 559 F.2d 1326, 1330 (5th Cir. 1977); Parker v. Anderson, 667 F.2d 1204, 1208-1209 (5th Cir. 1982); In re General Motors Corp. Pick-Up Truck Fuel Tank Products Liability Litigation, 55 F.3d 768 (3rd Cir. 1995).

\textsuperscript{80} In re Lease Oil Antitrust Litigation, 2007 U.S. Dist. LEXIS 91467, at *54. See also Paterson et al. v. Western Union Financial Services, Inc., No. 2-01-CV016DF (E.D. Tex., Mar. 14, 2002), aff’d, 308 F.3d 448 (5th Cir. 2002). The U.S. Court of Appeals for the Fifth Circuit affirmed the holding in Paterson on the basis that the unclaimed class action proceeds were not yet presumed abandoned under state law, and thus the state had no standing to claim the funds in any event. Thus, the Court of Appeals did not decide the substantive issue of whether the state’s claim, once ripened, would be preempted.
may involve substantive or procedural matters, as Rule 23(e) applies in either case. Indeed, if it did not, then the Rule would be essentially meaningless, as all settlements necessarily involve substantive matters, including the resolution of the case itself.

Thus, the only remaining question under Rule 23(e) is what is meant by “fair” and “reasonable”. In determining whether a settlement meets this standard, the U.S. Supreme Court has held that the court must “judge the fairness of a proposed compromise by weighing the plaintiff’s likelihood of success on the merits against the amount and form of the relief offered in the settlement.”\textsuperscript{81} We have found no authorities that suggest that a settlement would be fair and reasonable only if it complies with state unclaimed property laws.\textsuperscript{82} To the contrary, the few relevant authorities have held that the court has broad discretion under Rule 23(e) to approve settlements, including disposing of unclaimed class action settlement proceeds.\textsuperscript{83}

Once it is determined that Rule 23 governs the disposition of unclaimed class action funds, the Rule must be applied rather than a conflicting state law, unless the Rule violates either the U.S. Constitution or the Rules Enabling Act of 1934, codified at 28 U.S.C. § 2072.\textsuperscript{84} In this regard, the courts have held that Federal Rules of Civil

\textsuperscript{81} Carson v. American Brands, Inc., 450 U.S. 79, 88, n. 14 (1981). See also Protective Committee for Independent Stockholders of TMT Trailer Ferry, Inc. v. Anderson, 390 U.S. 414, 424-425 (1968). Courts should consider all of the facts and circumstances in determining the fairness of a settlement agreement, including: (1) the likelihood that the plaintiffs will ultimately prevail in litigation; (2) the estimated cost and duration of further litigation; (3) the estimated complexity of the litigation; (4) the settlement offer (relative to the amounts sought); (5) the extent to which class members oppose the settlement; (6) the parties’ plan for distributing the settlement proceeds; and (7) the experience of counsel. Linney v. Cellular Alaska Pshp., 151 F.3d 1234, 1242 (9th Cir. 1998); Torrisi v. Tucson Elec. Power Co., 8 F.3d 1370, 1376 (9th Cir. 1993); Montgomery County Real Estate, 83 F.R.D 305, 316 (Md. 1979). In addition, where the payment of attorneys’ fees is also part of the negotiated settlement, the fee must be evaluated for fairness in the context of the overall settlement. Kinsely v. Network Assocs., 312 F.3d 1123, 1126 (9th Cir. 2002). A proposed settlement will generally be entitled to an initial presumption of fairness if it is established that (1) the settlement was arrived at by arm’s length bargaining, (2) sufficient discovery has been taken or investigation made to enable counsel and the court to act intelligently, (3) the proponents of the settlement are counsel experienced in similar litigation, and (4) the number of objectors to the settlement is small compared to the class as a whole. Newburg on Class Actions (4th ed.) § 11:41. See also, e.g., McNary v. American Sav. And Loan Ass’n, 76 F.R.D. 644, 649 (N.D. Tex. 1977) (“Courts have consistently refused to substitute their business judgment for that of counsel, absent evidence of fraud or overreaching.”).

\textsuperscript{82} Indeed, as discussed in note 80, supra, the potential application of state unclaimed property laws was not even a factor considered by courts in determining whether a settlement is fair and reasonable.

\textsuperscript{83} See, e.g., Wilson v. Southwest Airlines, Inc., 880 F.2d 807 (5th Cir. 1989), discussed infra.

\textsuperscript{84} Hanna, 380 U.S. at 471. See also Burlington N. R. Co. v. Woods, 480 U.S. 1, 5 (1987). It may be argued that, since Rule 23(b) does not expressly prohibit the court from applying state unclaimed property laws, it is not inconsistent with the application of such laws and thus there can be no preemption. Indeed, a similar argument was successful in Cohen v. Beneficial Industrial Loan Corporation, 337 U.S. 541 (1949). In that case, the Court held that former Rule 23(b), which was silent as to whether plaintiff shareholders in a shareholders’ derivative action were required to post a bond covering the defendant corporation’s expenses in the event that it prevailed on the merits, was not sufficiently broad to conflict with a state law imposing such a security-bond requirement. The facts in Cohen are arguably similar to those involving a class action defendant in that, in both cases, a Federal Rule of Civil Procedure generally governed the manner of litigating a particular type of lawsuit (class action or shareholder derivative suit), but was silent as to a specific matter for which a state law purported to be applicable. Thus, the argument would be that the court retains general discretion to approve or disapprove settlements, but with respect to the disposition
Procedure are entitled to a strong presumption of validity.\textsuperscript{85} In fact, no Federal Rule of Civil Procedure has ever been declared invalid under either the U.S. Constitution or the Rules Enabling Act.\textsuperscript{86}

Indeed, we see no reasonable basis for invalidating Rule 23 under the U.S. Constitution, if the Rule is interpreted to apply to dispositions of unclaimed class action settlement proceeds or the approval of settlements involving such dispositions. By virtue of Articles I (the Necessary and Proper Clause) and III (providing for a federal court system), Congress has the power to make rules governing the practice in the federal courts, which in turn “includes a power to regulate matters which, though falling within the uncertain area between substance and procedure, are rationally capable of classification as either.”\textsuperscript{87} Thus, as long as it is “rational” to treat a matter as procedural, Congress constitutionally may provide for the regulation of that particular subject in the federal courts, even though the matter also may have “substantive” aspects. For the reasons discussed below with respect to the Enabling Act, the disposition of unclaimed class action funds may be rationally be viewed as a procedural matter, and thus Rule 23 should meet the constitutional standard.

Rule 23 should also be valid under the Enabling Act. The Federal Rules of Civil Procedure were promulgated pursuant to the authority delegated to the U.S. Supreme Court by the Enabling Act, which provides (in pertinent part):

\begin{itemize}
  \item[(a)] The Supreme Court shall have the power to prescribe general rules of practice and procedure and rules of evidence for cases in the United States district courts (including proceedings before magistrates thereof) and courts of appeal.
  \item[(b)] Such rules shall not abridge, enlarge or modify any substantive right. All laws in conflict with such rules shall be of no further force or effect after such rules have taken effect.
\end{itemize}

Thus, Rule 23 is valid under the Enabling Act as long as it is a rule of procedure and does not “abridge, enlarge or modify any substantive right.”\textsuperscript{88} A procedural right is one that relates to “the judicial process for enforcing rights and duties recognized by substantive law and for justly administering remedy and redress for disregard or

---

\textsuperscript{85} See, e.g., Burlington N. R.R. Co. v. Woods, 480 U.S. 1, 6 (1987); Exxon Corp. v. Burglin, 42 F.3d 948, 950 (5th Cir. 1995) (“[A]ll federal rules of court enjoy presumptive validity. Indeed, to date the Supreme Court has never squarely held a provision of the civil rules to be invalid on its face or as applied.”)

\textsuperscript{86} Id. See also Exxon Corp. v. Burglin, 42 F.3d 948, 950 (5th Cir. 1995) (quoting Bator, Hart & Wechsler’s The Federal Courts and the Federal System 769 (1988)).

\textsuperscript{87} Hanna, 380 U.S. at 472.

\textsuperscript{88} See Sibbach v. Wilson & Company, 312 U.S. 1, 14 (1941) (the test for determining the validity of a Federal Rule of Civil Procedure is “whether a rule really regulates procedure”).
infraction of them.” In other words, a procedural rule “affects only the process of enforcing litigants’ rights and not the rights themselves.” A substantive right, by contrast, is generally one that forms part of a claim for relief, the remedy available for a claim, or a defense to a claim.

One may argue that a court order approving a class action settlement agreement should be regarded as modifying a “substantive right” created by the unclaimed property laws. The argument would be that, under the unclaimed property laws, the state acquires the right to receive unclaimed class action proceeds if the class member that is owed this property does not claim it within a certain period of time. Thus viewed, if the settlement agreement provides that the unclaimed proceeds are the property of the defendant, rather than the state, then the settlement is extinguishing the state’s substantive rights to the proceeds in favor of the defendant. But such an argument is premised on the faulty assumption that unclaimed property laws are intended to create substantive rights in the first place. As discussed above, unclaimed property laws are designed to provide a procedure to return missing property to its rightful owner, and the derivative rights doctrine – under which the state succeeds to the rights of the owner, but holds no greater rights than the owner – is a recognition of this purpose. Thus, it is only through the state anti-limitations provisions, which ignore this doctrine and grant states the rights to claim certain property that the owner himself can no longer claim, that unclaimed property statutes could potentially result in a different allocation of rights than as specified in the class action settlement agreement.

But as discussed in Part III.A above, it is questionable whether anti-limitations provisions should even be applicable where parties with equal (or approximately equal) bargaining power negotiate at arm’s length regarding their rights to a particular item of property. Unclaimed property laws were not designed to intrude on the contractual freedoms of such parties, and there is therefore no reason to broadly interpret the anti-limitations provisions to apply to class action settlements. Simply put, if the parties to the settlement agreement have agreed amongst themselves that the defendant should be entitled to retain its property if certain conditions are met, and those conditions are met, then the defendant is thereafter the sole owner of the property, and it – rather than the class action plaintiffs – should be entitled to the protections of state unclaimed property laws. No state should be entitled to step in and rewrite the settlement agreement based on laws that are designed merely to return property to its missing owner.

In addition, if the settlement agreement is viewed as modifying a substantive right because of the anti-limitations provision, then it is also modifying substantive rights by settling the case. Clearly, that cannot be the test under the Enabling Act, or Rule 23

---

89 Sibbach, 312 U.S. at 14. See also Miss Publishing Corp. v. Murphree, 326 U.S. 438, 446 (1946) (a procedural rule “relates merely to the manner and the means by which a right to recover…is enforced”).
90 Burlington N. R.R., 480 U.S. at 8.
91 See Sibbach, 312 U.S. at 13 (stating that substantive rights include “the right not to be injured in one’s person by another’s negligence” and to obtain “redress” for “infraction” of that right); Affholder, Inc. v. S. Rock, 746 F.2d 305, 310 (5th Cir. 1984) (holding that a state law that imposes a mandatory penalty for an unsuccessful appeal does not create substantive rights because the statute “conferred no right that might have been asserted in the complaint or for which judgment might have been rendered in the trial court.”).
would have been stricken down long ago before the impact of state unclaimed property laws was ever a concern. Indeed, the U.S. Supreme Court has long recognized that even procedural matters may affect the rights of the parties. Hence, the test under the Enabling Act should really be whether the court’s act in approving the settlement agreement under Rule 23 is a procedural or substantive act, and not whether the underlying settlement agreement affects the substantive rights of parties. Of course the settlement agreement affects those rights – that is its entire purpose. But Rule 23 merely addresses the court’s right to approve the settlement agreement, which is a procedural rather than substantive act. Thus, Rule 23 should be valid under the Enabling Act.

Accordingly, where a federal court has properly exercised its discretion under Rule 23 and approved a class action settlement that provides for the disposition of unclaimed settlement proceeds, any state unclaimed property law that would require such proceeds to be reported and remitted to the state rather than disposed of according to the settlement agreement would undermine the federal court’s discretion under Rule 23 and thus would impermissibly conflict with federal law. For this reason, the state unclaimed property laws should be preempted.

C. The Erie Doctrine

Federal law also applies to the disposition of unclaimed class action settlement proceeds if the disposition is properly viewed as a procedural matter rather than a substantive matter, based on the “twin aims” of the *Erie* doctrine: (i) discouragement of forum shopping and (ii) avoidance of inequitable administration of the laws.

Although a determination that federal law applies to dispositions of unclaimed class action settlement proceeds could theoretically encourage forum shopping if the

---

92 See, e.g., *Miss Publishing Corp. v. Murphree*, 326 U.S. 438, 445-46 (1946) (rejecting a challenge to provisions of Rule 4 relating to service of process, and observing that “[u]ndoubtedly most alterations of the rules of practice and procedure may and often do affect the rights of litigants.”); *Hanna*, 380 U.S. at 473 (“To hold that a Federal Rule of Civil Procedure must cease to function whenever it alters a mode of enforcing state-created rights would be to disembowel either the Constitution’s grant of power over federal procedure or Congress’ attempt to exercise that power in the Enabling Act.”).

93 See, e.g., *Brinn v. Tidewater Transp. Dist. Comm’n*, 242 F.3d 227, 233-34 (4th Cir. 2001) (stating that “[a] state statute that thwarts a federal court order enforcing federal rights ‘cannot survive the command of the Supremacy Clause’” and holding that a state statute that limited a court’s discretion to award attorney’s fees would “stand as an obstacle” to Congress’s intent in the Americans with Disabilities Act and the Rehabilitation Act to give federal courts such discretion); *In re Xpedior Incorporated*, 354 B.R. 210 (2006) (state unclaimed property law was superseded by the provisions of a plan of reorganization approved by a federal bankruptcy court); *Washington v. Wash. State Commercial Passenger Fishing Vessel Ass’n*, 443 U.S. 658, 695 (1979) (“State-law prohibition against compliance with the District Court’s decree cannot survive the command of the Supremacy Clause of the United States Constitution.”).

94 *Hanna*, 380 U.S. at 468. See also *Gasperini v. Center for Humanities, Inc.*, 518 U.S. 415, 428 (quoting *Hanna*, 380 U.S. at 468 n. 9) (stating that a particular matter is substantive only if application of the 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.”). Thus, a matter may be considered procedural for purposes of determining its validity under the U.S. Constitution or the Rules Enabling Act, but may not be considered procedural under the *Erie* doctrine.
parties opt to litigate in federal courts to avoid having to take into account state unclaimed property laws during settlement negotiations,\(^95\) such a prospect is dubious at best. Indeed, the court in *In re Lease Oil Antitrust Litigation* considered this exact issue and concluded:

> There is no reason to believe that entrusting the disposition of unclaimed funds in a class action to the discretion of the district courts would encourage forum shopping. At the outset of litigation, neither the named plaintiffs nor their counsel are likely to be concerned with the rules that will apply (a) if the litigation is ultimately successful, and then, (b) if and when some class members fail to submit claims or cash checks to share in the recovery.\(^96\)

Similarly, in *Herbert v. Wal-Mart Stores*,\(^97\) the U.S. Court of Appeals for the Fifth Circuit noted that there is little risk that variations in regard to the uncalled-witness rule will lead to forum shopping because the application of the rule will only arise during, or at the end of, trial.\(^98\) The disposition of unclaimed class action funds, if it becomes an issue at all, will only become an issue after the end of litigation. Hence, under the *Herbert* rationale, this issue should not have a significant (if any) impact on forum decisions.

The application of federal law to dispositions of unclaimed funds in a federal court class action would also not result in inequitable administration of the laws. With regard to this issue, the Supreme Court has stated that “[t]he *Erie* rule is rooted in part in a realization that it would be unfair for the character or result of a litigation materially to differ” merely due to the differing citizenship of the parties (and the resulting availability or unavailability of federal court diversity jurisdiction).\(^99\) But this is exactly what would happen in many class actions if state unclaimed property laws were applicable to unclaimed settlement proceeds. As discussed in Part III, in a nationwide class action, the unclaimed property laws of many states would likely apply.\(^100\) And because some states clearly exempt class action settlement proceeds, whereas other states would claim these

---

95 Compare Paterson et al. v. Western Union Financial Services, Inc., No. 2-01-CV016DF (E.D. Tx., 3/14/02), aff’d, 308 F.3d 448 (5th Cir. 2002), with State of Texas v. Snell, 950 S.W. 2d 108 (Tex. App. 1997).
97 911 F.2d 1044, 1047 (5th Cir. 1990).
98 See also Nissho-Iwai Co. v. Occidental Crude Sales, 848 F.2d 613, 624 (5th Cir. 1988) (similar reasoning with regard to post-judgment interest rules, where the interest rate is not set until the time of the judgment).
99 Hanna, 380 U.S. at 467.
100 As noted above, this is a consequence of the “first-priority rule” created by the U.S. Supreme Court in *Texas v. New Jersey* that provides that, if the holder of unclaimed property (i.e., the defendant in a class action) has a record of the last known address of the owner of the property (i.e., a class member), then the laws of the state in which that address is located generally apply.
proceeds, the treatment of class members will vary considerably. A federal rule, by contrast, would promote uniform treatment to all class members.\footnote{In re Lease Oil Antitrust Litigation, 2007 U.S. Dist. LEXIS 91467, at *59. See also In re Drexel Burnham Lambert Groups, Inc., 151 B.R. 684, 692 (Bankr. S.D.N.Y. 1993).}

One may point out, however, that the U.S. Supreme Court has determined that a state statute of limitations is a substantive matter for purposes of the \textit{Erie} doctrine.\footnote{See West v. Conrail, 481 U.S. 35 (1987); Guaranty Trust Co. v. York, 326 U.S. 99 (1945).} A state anti-limitations provision is analogous to a statute of limitations provision in that both provisions relate to the time during which a claim may be made. Thus, one may argue that state anti-limitations provisions should be viewed as “substantive” provisions on the same basis as the statute of limitations provisions. While such an argument may appear at first blush to have merit as a technical matter, it ignores a key distinction between statutes of limitation and state anti-limitation provisions. A statute of limitations provides a complete defense against the plaintiff’s claim of liability in the case. Thus, it goes straight to the core of the controversy. By contrast, the anti-limitations provisions come into play only at the termination of the case, when the defendant’s liability has already been fixed pursuant to the settlement, and there are unclaimed proceeds remaining from the settlement. Thus, “the conflict between state unclaimed property statutes and the federal rule granting district courts discretion to dispose of unclaimed funds does not involve the core rules of decision, such as the elements of the claims, the elements of the defenses, or the measure of relief available to class members.”\footnote{In re Lease Oil Antitrust Litigation, 2007 U.S. Dist. LEXIS 91467, at *59. See also Herbert, 911 F.2d at 1047-48 (stating that the uncalled witness rule does not implicate inequity concerns under \textit{Erie}, in part because it is not "bound up with the definition of the rights and obligations of the parties under state law" or "related to the elements of a state law claim or defense").}

Hence, the disposition of unclaimed settlement proceeds should be considered a procedural matter rather than a substantive one under the \textit{Erie} doctrine.

\textbf{D. Other Authorities Supporting the Proposition that Federal Law Applies to the Disposition of Unclaimed Class Action Settlement Proceeds}

In addition to Rule 23 and the \textit{Erie} doctrine, a number of other authorities generally support the proposition that federal law, rather than state law, applies to the disposition of unclaimed class action settlement proceeds in a federal court.\footnote{Although these cases are not based on an application of Rule 23 or the \textit{Erie} doctrine, their conclusions may nevertheless be consistent with such rules if it can be assumed that the courts in those cases believed that the disposition of unclaimed class action settlement proceeds was a procedural matter. Alternatively, the conclusions in these cases may be rationalized under either the “equitable-remedial-rights” doctrine or as an application of federal common law. See, e.g., Robinson v. Campbell, 16 U.S. 212, 222-223 (1818) (holding that “the remedies in the courts of the United States are to be, at common law or in equity, not according to the practice of state courts, but according to the principles of common law and equity….”).}
The most significant of these authorities is *Klein v. United States*.\(^{105}\) In that case, a defendant in a federal court class action owed funds to certain bondholders who could not be located. The district court required that such funds be paid into its registry. After the funds had remained unclaimed for more than five years, they were deposited in the U.S. Treasury pursuant to federal Revised Statutes § 996. Under that section, the funds remained subject to the order of the district court to be paid to persons entitled to it upon full proof of their rights to receive them. A Pennsylvania state court subsequently decreed escheat of the deposited funds and directed the Escheator of Pennsylvania to apply to the district court for an order that the funds be paid to him. The United States claimed that the state court decree was an unconstitutional interference with the federal court.

The U.S. Supreme Court held that the state court decree was not unconstitutional because the “decree for escheat of the fund is not founded on possession and does not disturb or purport to affect the Treasury’s possession of the fund or the district court’s authority over it. Nor could it do so.”\(^{106}\) Rather, “[a]t most the decree of the state court purports to be an adjudication upon the title of the unknown claimants in the fund by a proceeding in the nature of an inquest of office as in the case of escheated lands.”\(^{107}\) The Court concluded that the decree “is subordinate to every right asserted and decreed in the federal suit and effective only so far as it establishes rights derived from them.”\(^{108}\) The Court further noted that Revised Statutes § 996 contemplated changes in ownership of funds deposited in the Treasury by providing that such funds shall be paid over to any person entitled to it, upon full proof of his right to receive it. Accordingly, to the extent that the state’s rights in the unclaimed funds were derived from the bondholders’ rights to such funds, the state escheator was entitled to claim the funds on behalf of the missing owners.

Significantly, the language in the Court’s decision that a state court could not “disturb or purport to affect the Treasury’s possession of the fund or the district court’s authority over it” and that the state court’s decree was “subordinate” to the federal court decree regarding the disposition of the unclaimed settlement proceeds suggests that the Court viewed the federal court as having primary authority over the disposition of unclaimed class action settlement funds. The state was entitled to take custody of such funds under its unclaimed property laws only to the extent that the state’s action was consistent with the federal court’s decree. Accordingly, state unclaimed property laws could be applied to unclaimed class action settlement proceeds only if the funds were first escheated to the federal government, and were held by the federal government on behalf of their rightful owners.

---

\(^{105}\) 303 U.S. 276 (1938). Notably, *Klein* was decided on February 28, 1938, approximately 2 months prior to the Court’s decision in *Erie* (on April 25, 1938), but was argued on February 11, 1938, approximately 2 weeks after the *Erie* case was argued (on January 31, 1938). Accordingly, it is probably reasonable to infer that the Court’s decision in *Klein* was reflective of (and took into account) the Court’s position in *Erie*, even though *Klein* was decided prior to *Erie*.

\(^{106}\) *Id.* at 282 (emphasis added).

\(^{107}\) *Id.*

\(^{108}\) *Id.*
The Eighth Circuit reached a similar conclusion in *Panhandle Eastern Pipe Line Co. v. Federal Power Commission.* In *Panhandle,* the court determined that the defendant was equitably entitled to be reimbursed, out of the undistributed residue of an impounded fund, for the expenses which the defendant had paid, at the direction of the court, in connection with the distribution of the fund to the ultimate consumers of natural gas sold during the impoundment period. The State of Michigan, in its resistance to the defendant’s motion for reimbursement, argued that a portion of the unclaimed funds was subject to escheat in Michigan. In rejecting Michigan’s claim, the court stated:

> While [Michigan’s suggestion] might be convenient, we think it cannot be done. The fund in the hands of this Court is a trust fund. *Its control and disposition are governed by federal law.* It has not yet been fully administered by this Court. The State of Michigan will, no doubt, ultimately receive the residual portion of the undistributed funds to which it may be entitled, but only after it has been held by this Court for five years and then deposited in the United States Treasury, pursuant to Sec. 2042, Title 28 U.S.C.A. 

Accordingly, the court in *Panhandle* held that the disposition of unclaimed funds in a federal court was a matter of federal law and, consistent with *Klein,* suggested that a state may only claim rights to escheat such funds if the funds were first paid over to the U.S. Treasury and were held by the Treasury as unclaimed property on behalf of the true owners until the state period of presumed abandonment had run and the state acquired a present right to claim possession of the funds. Conversely, where the federal court instead opts to pay the unclaimed funds over to a private party (such as the plaintiff, defendant, or a charitable organization), such private party does not hold the funds as unclaimed property on behalf of another, but rather holds the funds for itself. Thus, in such a situation, the state would not be able to assert a claim that such funds constitute unclaimed or abandoned property subject to the state’s custody.

Finally, there is also a line of cases in the federal bankruptcy context that generally supports the conclusion that a federal court order directing the payment of unclaimed settlement funds effectively preempts the application of state unclaimed property laws to such funds.

---

109 179 F.2d 896 (8th Cir. 1949).

110 *Id.* at 903 (emphasis added).

111 *See also Van Gemert v. Boeing Co.*, 739 F.2d 730, 735 (2nd Cir. 1984), in which the Second Circuit stated: "The State of New York argues that the court incorrectly applied equitable principles in returning a judgment fund to a defendant who had been adjudicated liable for improper conduct. While it does not explicitly say so, the State apparently contends that the court should have applied §§ 2041-2042 in equity. *Presumably New York and other claiming states eventually then could assert claims under state abandoned property laws.*" (emphasis added) *Van Gemert* thus provides additional support for the proposition that federal law governs the disposition of unclaimed class action funds.

112 These cases held that, because (a) a state’s right to take custody of unclaimed property is conditioned on the expiration of a period of presumed abandonment and (b) a party’s status as a creditor in bankruptcy is determined by whether the party had a claim against the debtor which arose at or before the petition for
E. Initial Settlement Agreement Does Not Provide for the Disposition of Unclaimed Proceeds

The prior discussion on federal preemption has generally assumed that the class action settlement agreement specifically provides for the disposition of unclaimed class action proceeds. Thus, the question may arise whether the same conclusion would be reached where either (1) the settlement agreement regarding the disposition of unclaimed class action proceeds is entered into subsequent to (rather than concurrently with) the initial settlement of the case, or (2) the settlement agreement does not specifically discuss the treatment of unclaimed class action proceeds. We briefly discuss these possibilities below.

1. Settlement Agreement Regarding the Disposition of Unclaimed Class Action Proceeds Is Entered Into Subsequent To the Initial Settlement of the Case

In Wilson v. Southwest Airlines, Inc., the plaintiffs had filed a class action lawsuit against Southwest Airlines alleging that Southwest’s policy of hiring only female flight attendants violated Title VII of the Civil Rights Act of 1964. After the liability trial in which the district court found for the class, the court approved the parties’ consent decree pursuant to which, among other things, Southwest established a $1 million back-pay fund to compensate victims of the hiring policy. However, by March 1983, all back-pay claims had been satisfied and the fund still had a remaining balance of over $500,000. Southwest requested that the balance be refunded to it, but the district court applied the *cy pres* doctrine to donate the balance of the fund to a local charity. Both Southwest and the plaintiffs appealed the district court decision and announced at oral argument that they had reached a settlement disposing of the unclaimed funds between themselves.

The Fifth Circuit first determined that none of the parties had a legal right to any of the unclaimed funds. However, the court found that both Southwest and the plaintiffs had an equitable claim to such funds. Southwest had an equitable claim in the

bankruptcy was filed, the state cannot be a creditor for property whose abandonment period expired after the petition for bankruptcy was filed. See *Arkansas v. Federated Dep’t Stores, Inc.*, 175 B.R. 924, 933 (S.D. Ohio 1992) (“[t]he States are not creditors with respect to property presumed abandoned post-petition because the debtors do not have a legal obligation to turn the property over under the States’ unclaimed property statutes until the dormancy period expires.”); *In re Cont’l Airlines, Inc.*, 161 B.R. 101 (Bankr. D. Del. 1993); *In re Drexel Burnham Lambert Groups, Inc.*, 151 B.R. 684 (Bankr. S.D.N.Y. 1993). Accordingly, the final order of the bankruptcy court approving a plan of reorganization that had the effect of terminating and extinguishing any claims of creditors who did not file required proofs of claim in the bankruptcy proceedings essentially terminated a state’s right to make a claim under the state’s unclaimed property statute where the property -- the claims of the absent creditors who did not file proofs of claim -- was not presumed abandoned as of the petition date, and hence the state had no present right under its unclaimed property laws to step into the shoes of the absent creditors and claim payment from the bankruptcy estate on their behalf.

113 880 F.2d 807 (5th Cir. 1989).
114 In particular, Southwest did not have a legal claim because it had renounced its legal claim to the unclaimed funds as part of the consent decree.
funds because (i) all of the funds originally belonged to it; (ii) the policy of Title VII is compensatory rather than punitive; (iii) Southwest had not acted out of invidious discrimination, but in the good faith belief that its hiring practices were legal; (iv) during the litigation, Southwest acted in a straightforward manner and without deception; and (v) Southwest moved quickly and in good faith to correct its hiring practices after the verdict was rendered. The court also noted that, unlike in other class action settlements, the unclaimed funds in this case represented an overestimate of liability by the plaintiffs and Southwest because fewer potential class members submitted valid claims than expected. The purpose of the back-pay fund was therefore substantially achieved. Finally, the court concluded that the settlement was fair, reasonable and adequate “because it provides for transfer of the balance of the fund to the only parties with equitable rights in it and in proportion to the relative equitable interests of those parties.”

Thus, the Fifth Circuit reversed the district court’s orders and approved the parties’ settlement allocating the unclaimed funds between themselves.

State unclaimed property laws should be preempted to the same extent in this situation – where the settlement agreement disposing of the unclaimed proceeds is entered into after the initial settlement of the case – as where the initial settlement agreement provides for the disposition of the unclaimed proceeds. In both cases, Rule 23 grants the court the discretion to approve the settlement, and the same standard of fairness, reasonableness and adequacy applies. The only gloss added by the Wilson case is that a settlement should meet this standard where it disposes of unclaimed funds in accordance with the parties’ equitable rights in the funds, if any. But clearly that should also be true where the initial settlement agreement provides for the disposition of the unclaimed proceeds. Thus, in all cases, a court may need to consider the parties’ equitable rights in the funds in approving the settlement, but once the court has properly approved the settlement, the state may not require a different result.

2. Settlement Agreement Does Not Specifically Provide for the Treatment of Unclaimed Class Action Proceeds

Where the class action settlement agreement does not specify the manner of distributing any unclaimed settlement funds, Rule 23(e) may not be applicable. However, Rule 23(d), the Erie doctrine and the Klein, Panhandle and other decisions discussed above would still apply, and would seem to permit a federal district court to apply equitable principles in determining the manner of disposing of such funds, rather than forcing it to comply with state unclaimed property laws.

---

115 Id. at 816.
116 Notably, in Wilson, the Fifth Circuit assumed that federal law applied to the disposition of the unclaimed funds. The court did not analyze whether state law should have applied to such disposition.
117 As discussed above, in some settlement agreements, it may be implicit that the defendant is entitled to retain these funds. If so, then Rule 23(e) should govern, and the same analysis as set forth above should apply.
Indeed, federal courts typically consider four options in disposing of such funds: (a) reverting the funds to the defendant; (b) distributing the funds pro rata to class members who have already made claims; (c) invoking the “cy pres” doctrine to distribute the funds to a charitable organization; or (d) escheating the funds to the government.\textsuperscript{119} In each of these cases, escheat was simply an option for the court to consider, and not a requirement for the court to follow.

An example of a case approving the reversion of unclaimed class action funds to the defendant is \textit{Van Gemert v. Boeing Co.}\textsuperscript{120} In this case, the Second Circuit upheld the district court’s order that unclaimed settlement funds should revert to the defendant because (i) in a private action, a defendant should not be obligated to pay more than the amount claimed; and (ii) the defendant had acted without malice, without bad faith and had relied on the advice of others before taking each step. In reaching this holding, the court stated:

\begin{quote}
The critical determining factor here … is that trial courts are given broad discretionary powers in shaping equitable decrees …. [T]his principle should apply to equitable decrees involving the distribution of any unclaimed class action fund.\textsuperscript{121}
\end{quote}

Similarly, in \textit{Mangone v. First USA Bank},\textsuperscript{122} the court approved a reversion of unclaimed funds to defendants pursuant to a settlement agreement where (i) the plaintiffs received nearly 100\% recoveries pursuant to the settlement; (ii) the settlement likely overstated the amount of benefits that could be claimed by class members because the defendants had previously provided credits to many customers independently; and (iii) the defendants expended millions of dollars in providing notice of the class action and settlement, paying class counsel’s fees and expenses, investigating the issues giving rise to the lawsuit and in administering the settlement.

Other cases have considered and rejected a reversion of unclaimed class action settlement funds to the defendant under certain circumstances. In particular, courts typically decline to allow a reversion to the defendant where the defendant has been sued under a law intended to deter or punish the conduct complained of (such as an anti-trust law).\textsuperscript{123} However, none of these cases overruled the court’s discretion to dispose of such funds and none of these cases rejected the reversion on the basis that it conflicted with state unclaimed property laws.

\begin{footnotes}
\item[120] 739 F.2d 730 (2nd Cir. 1984).
\item[121] \textit{Id.} at 737.
\item[122] 206 F.R.D. 222 (S.D. Ill. 2001).
\end{footnotes}
Accordingly, even where the settlement agreement is silent regarding the disposition of unclaimed class action funds, a federal court should still have the discretion to dispose of such funds (including permitting the defendant to retain such funds under circumstances where such retention is fair and equitable) and should not be forced to comply with any otherwise applicable state unclaimed property laws.

V. CONCLUSION

State unclaimed property laws are intended to operate as procedural mechanisms to help the owners of missing property reclaim their property. As such, these laws should be preempted in a federal court class action settlement where the district court has approved under Federal Rule of Civil Procedure 23 a settlement that includes a provision disposing of unclaimed settlement proceeds. Any other result would impermissibly limit the district court’s discretion in determining the proper disposition of unclaimed settlement funds. In addition, even where the settlement agreement is silent regarding the disposition of such proceeds, the federal court’s powers to determine the manner of disposing of these funds should supersede any contrary state unclaimed property laws based on federal common law principles.

It is more difficult to conclude whether unclaimed property laws may apply to a state court class action, as such a determination would necessarily need to be made on a state-by-state basis. Many states only escheat property that is held and owed in the ordinary course of business, which should exclude unclaimed class action settlement proceeds. Those that do not may attempt to claim such proceeds under their “anti-limitations provisions,” even if the settlement agreement provides a limit on the time during which class members may make claims. Although we believe that courts should narrowly construe such anti-limitations provisions to apply only where the primary motive is to avoid state unclaimed property laws (or possibly where a contract of adhesion is involved), until such decisions are rendered, these provisions pose a potential risk that the settlement may not be respected. To mitigate this risk, the parties may want to consider (where feasible) the use of vouchers, coupons, gift cards or other non-cash options (rather than settlement checks) that are more clearly not subject to state unclaimed property laws.