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Speeches

Cy Pres Symposium Keynote Address, October 30, 2010

The Cy Pres Remedy: Procedure or Substance?

By GEOFFREY C. HAZARD, JR.*

CY PRES RECOVERY IS usually considered from a procedural viewpoint. The issue arises most commonly in class actions on behalf of a large number of prospective claimants whose number and identity are difficult to determine. Rule 23 of the Federal Rules of Civil Procedure¹ and state law counterparts govern class action lawsuits.² Under Rule 23, courts have broad authority to determine the size and shape of the class, review and approve any settlement, and review and approve procedures for distribution of any award.³ Hence, the problem is considered a matter of procedure. And so it is.

However, courts may also consider the matter of *cy pres* in terms of the substantive law basis of the claim against the defendant and related concepts in the law of remedies. I wish to suggest that some clarification of the doctrine can result from looking at it in this way.

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1. FED. R. CIV. P. 23.

2. See, e.g., *Larner v. L.A. Doctors Hosp. Assocs., LP*, 86 Cal. Rptr. 3d 324, 332 (Ct. App. 2008) (providing that California law controls class actions to the extent the law exists, and if California law does not exist, the Federal Rules may provide persuasive authority).

3. FED. R. CIV. P. 23(e) (“The claims . . . of a certified class . . . may be settled . . . only with the court’s approval.” “[T]he court may approve [a settlement, dismissal, or compromise] . . . after . . . finding that it is fair, reasonable, and adequate.”); see also *Horton v. Goose Creek Indep. Sch. Dist.*, 690 F.2d 470, 483 (5th Cir. 1982) (“The decision to grant or to deny certification is . . . initially committed to the sound discretion of the district judge, and the decision will not be overturned except for abuse of discretion.”); *Madison Cnty. Jail Inmates v. Thompson*, 773 F.2d 834, 845 (7th Cir. 1985) (“The district court has considerable discretion in determining whether settlement is fair and reasonable.”).

To begin with, the observer should remember that the concept of *cy pres* as applied in class suits is borrowed from the law of trusts, particularly charitable trusts.⁴ In the administration of charitable trusts the specific charitable purpose specified in the trust instrument may be difficult or impossible to carry out. For example, a specific charitable purpose can become obsolete or even illegal. Consider the *Girard College* case that arose some decades ago in Philadelphia.⁵ The trust in that case was established early in the 19th century for the purpose of furthering the education of young men; the beneficiaries were young *white* men.⁶ A court later found the racial limitation to be illegal because the trustee was a public entity governed by the Equal Protection Clause of the Fourteenth Amendment.⁷

Upon such an eventuality, the choice is to invalidate the trust or to administer it in different terms but in the same general direction as specified in the terms of the trust. The law has considered—correctly in my view—that the latter choice is better. In other words, courts should identify a “second best” fulfillment of the trust purpose.

Adaptation of this concept to class suits is not direct but rather is by analogy. The analogy of course is that, given a defendant’s obligation to pay, and given that the identity of the payees is difficult or impossible to determine, the “second best” approach is to disburse the payment to some set of people or cause that is situated more or less like the injured group. However, such a decision must be based on an initial determination that the defendant should indeed be made to pay.

It is at this point that some courts have hesitated or stopped.⁸ The theory could be that there is no justiciable obligation if the supposed

4. See *Brooks v. Duckworth*, 67 S.E.2d 752, 754 (N.C. 1951) (“Where changes in conditions not contemplated by the trustor have rendered impossible the accomplishment of the charitable purposes intended by the devise of property in trust, the equitable jurisdiction of the court may be invoked to modify the terms of the trust in order to give effect to the general intent expressed in the will.”); *Estate of Gatlin v. Yates*, 94 Cal. Rptr. 295 (Ct. App. 1971) (stating that *cy pres* allows courts to carry out testamentary trusts established for charitable purposes).

5. *In re Girard Coll. Trusteeship*, 138 A.2d 844 (Pa. 1958).

6. *Id.* at 845.

7. *Id.* at 846.

8. See *Eisen v. Carlisle & Jacquelin*, 479 F.2d 1005, 1010–12 (2d Cir. 1973) (stating that fluid recovery is not possible and class action is not manageable because there is no reliable or rational way to determine class members), *vacated on other grounds*, 417 U.S. 156 (1974); *Collins v. Safeway Stores, Inc.*, 231 Cal. Rptr. 638, 646 (Ct. App. 1986) (“Where, as here, the occurrence is of an accidental nature, the defendants are shown to have responded immediately to protect the public, where steps were taken at considerable economic cost to prevent recurrence, and where all but a relatively small portion of the ‘ill-

victims could not be identified, and the courts could raise this issue themselves. A plausible case can be made that no liability may properly be imposed if there are no specific persons to whom the liability can run. But, as others argue, it is wrong that a wrongdoer may escape merely because its victims cannot be specifically identified. This proposition has special force when the wrongdoing was widespread and carried out in such a way that the victims did not notice or had no practical opportunity to protest.

At this point it is useful to refer to another part of the law of trusts—the general duties imposed on a fiduciary. There is good law that a person acting in a fiduciary capacity, and taking possession of money in that capacity, has a duty to account.⁹ Once it is established that a person took possession of money properly belonging to someone else, that person is a trustee—sometimes called a “constructive trustee.”¹⁰ The amount of the constructive trust can be determined in various ways, depending on the pathway by which the money was accrued. Once the amount is determined, the law requires that the trustee account for it.¹¹ More specifically, the law does not require the wronged person to prove how the accused has misused the money but does require proof of the amount at issue and legal misuse.¹² The accused must show either that no misuse was involved or that the amount is less than has been alleged.¹³ If the accused fails in that effort, he must disgorge the money.¹⁴ The law does not permit a trustee to keep the proceeds of the breach of trust.

Moreover, if I am right about the concept, the trustee is liable not merely for loss to the fund but also must disgorge any profit realized from his misuse of the fund for his own benefit.¹⁵

This branch of the law of trusts is both procedural and substantive. It is procedural in allocating to claimants the burden of proving the existence of a trust relationship while allocating to the defendant the burden of exculpation of wrongdoing. It is substantive in that it requires the wrongdoer to disgorge. The duty to disgorge is enforced

gotten gain’ was in fact consumed in the production, sorting, packaging, shipping and marketing of the contaminated product, we do not believe fluid recovery is useful in fulfilling the purpose of the underlying action.”).

9. See RESTATEMENT (THIRD) OF TRUSTS § 37 cmt. e (2003).

10. See *Anderson v. Bellino*, 658 N.W.2d 645, 658 (Neb. 2003).

11. *Id.* at 658–59.

12. See *United States v. Herbawi*, 972 F. Supp. 171, 174 (W.D.N.Y. 1997).

13. See *Rollins v. Metro. Life Ins. Co.*, 912 F.2d 911, 915 (7th Cir. 1990).

14. GEORGE GLEASON BOGERT ET AL., *THE LAW OF TRUSTS AND TRUSTEES* § 471 (rev. 3d ed. 2010).

15. See *Snepp v. United States*, 444 U.S. 507, 515 (1980).

quite apart from the question of to whom the money should be paid. This is because the law disfavors allowing the wrongdoing trustee to keep the proceeds of the wrong.

Cy pres in class actions could be approached in this light. I call to mind the situations involved in three well-known cases: *Daar v. Yellow Cab Co.*,¹⁶ *Eisen v. Carlisle & Jacquelin*,¹⁷ and *Phillips Petroleum Co. v. Shutts*.¹⁸ I refer to the "situations" in these cases, not the specific issues or holdings but rather to the relationships involved. I want to focus on the characteristics of the defendants' alleged conduct under substantive law.

Daar was a suit against the Yellow Cab Company in which the plaintiff contended that the company had manipulated the meters on its taxicabs to record higher fares than permitted under a governing ordinance.¹⁹ The alleged misconduct was therefore a regulatory one. *Eisen* involved a claim that securities brokers on the New York Stock Exchange had conspired to fix their charges in violation of the Sherman Act.²⁰ The alleged misconduct was both a criminal and civil violation.²¹ *Phillips Petroleum* involved a claim by gas company investors who sought recovery of interest on royalties owed by a gas company.²² The gas company had suspended payments while awaiting a Federal Power Commission ("FPC") ruling on gas prices.²³ The alleged misconduct, in substantive law terms, was a classic constructive trust case: a party (the Phillips company) holding money to which others (the royalty payees) were entitled.²⁴

I submit that the nature of these wrongs would justify the remedy of disgorgement. The misconduct in each case was not merely negligent or even grossly negligent; it was intentional and indeed systematic.²⁵ The alleged misconduct in *Daar* and *Eisen* was also criminal.²⁶ The *Phillips* case is much more problematic because there was a substantial legal question about the proper handling of the royalties

16. *Daar v. Yellow Cab Co.*, 433 P.2d 732 (Cal. 1967).

17. *Eisen v. Carlisle & Jacquelin*, 417 U.S. 156 (1974).

18. *Phillips Petroleum Co. v. Shutts*, 472 U.S. 797 (1985).

19. *Daar*, 433 P.2d at 736-38.

20. *Eisen*, 417 U.S. at 160-61.

21. *Id.*

22. *Phillips Petroleum Co.*, 472 U.S. at 799.

23. *Id.* at 800.

24. *Id.* See generally *Great-W. Life & Annuity Ins. Co. v. Knudson*, 534 U.S. 204, 213-14 (2002) (defining constructive trust).

25. See *Daar v. Yellow Cab Co.*, 433 P.2d 732, 736-38 (Cal. 1967); *Eisen*, 417 U.S. at 160-61; *Phillips Petroleum Co.*, 472 U.S. at 799-801.

26. *Daar*, 433 P.2d at 736; *Eisen*, 417 U.S. at 160-61.

pending the FPC ruling on gas prices.²⁷ However, one could imagine a different scenario in which holding back the royalties would be clearly unjustified. On that basis, it would be a classic breach of the fiduciary duty to account.

A recognized remedy for such a wrong is the duty of a constructive trustee to account. The rule governing the duty to account compels the wrongdoer to surrender the illegally appropriated fund, including any profit realized during the period of wrongful possession, together with legal interest.²⁸

Conclusion

In considering application of *cy pres* in class actions, I suggest that the character of the wrong involved is highly relevant to the nature of the remedy. The *cy pres* concept in its class suit application facilitates the remedy of disgorgement. It is disgorgement of lucre that was ill-gotten by means that were studiedly and systematically wrong, not merely accidental, negligent, or under a good-faith claim of legitimate possession. In such situations, it is reasonable to suggest that concern over the sanctioning of a wrongdoer outweighs the concern that there are no specific, identifiable victims.

The search for appropriate distribution of the disgorgement is not very difficult. In *Daar*, the fund could have been used to pay cab fares for poor people going to and from hospitals. In *Eisen*, the fund could have gone to business schools to establish courses in securities law or business ethics. In *Phillips*, it could have gone to environmental preservation or some such purpose.

27. *Phillips Petroleum Co.*, 472 U.S. at 799–800.

28. *Women's Fed. Sav. & Loan Ass'n v. Nev. Nat'l Bank*, 673 F. Supp. 401, 404 (D. Nev. 1987).

