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The United States Supreme Court Holds Federal Class Action Rules Trump State Class Action Statutes in Diversity Cases

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On March 31, the United States Supreme Court issued a splintered 5-4 opinion governing the application of state laws in class actions brought in federal court based on diversity jurisdiction, *Shady Grove Orthopedic Associates, P.A. v. Allstate Insurance Co.*, No. 08-1008 (Slip Opinion). *Shady Grove* could significantly curtail the application of state laws in federal diversity cases and could prompt more class action filings in federal court.

BACKGROUND. *Shady Grove* was a putative class action filed in New York federal district court for recovery of unpaid statutory interest on overdue insurance benefits from Allstate. The district court dismissed the case for lack of jurisdiction because plaintiff's individual claim (worth roughly $500) was insufficient to satisfy the amount in controversy requirement for diversity cases and the suit could not proceed as a class action due to a New York statute prohibiting classwide imposition of statutory penalties, such as statutory interest. The Second Circuit affirmed, holding that New York's ban on classwide statutory penalties defeated the amount-in-controversy requirement.

THE MAJORITY HOLDINGS. The Supreme Court reversed in a fractured[1] 5-4 opinion, holding that Federal Rule of Civil Procedure Rule 23 governs class actions in federal court and trumps conflicting state statutes. The Court answered two questions: (1) does the federal rule control the issue and directly conflict with state law? and (2) if so, does application of the federal rule violate the Rules Enabling Act, 28 U.S.C. § 2072? On the first question, Justice Scalia, writing for the majority, held the New York statute was in "an unavoidable collision" with the "one-size-fits-all formula for deciding the class action question" under Federal Rule 23, because "Rule 23 unambiguously authorizes *any* plaintiff, in *any* federal civil proceeding, to maintain a class action if the Rule's prerequisites are met." Slip op. at 4, 11, 12 n.8 (Scalia, J.). On the second question, five justices voted for the same result – application of Federal Rule 23 over the conflicting New York statute – but with a 4-1 split in reasoning.

THE CRITICAL SPLIT. The four-justice plurality and the single-justice concurrence took different paths to the same result. The plurality opinion held that Rule 23 is procedural, at least insofar as it allows willing plaintiffs to join their separate claims against the same defendants, and "it is not the substantive or procedural nature or purpose of the affected state law that matters, but the substantive or procedural nature of the *Federal Rule*." Slip op. at 16 (emphasis

[1] MAJORITY OPINION (PARTS I, II-A): Scalia, J., joined by Roberts, C.J., Thomas, J., Sotomayor, J., Stevens, J.

PLURALITY OPINION (PARTS II-B, II-C, II-D): Scalia, J., joined by Roberts, C.J., Thomas, J., Sotomayor, J. (Parts II-B, II-D only)

CONCURRING: Stevens, J.

DISSENTING: Ginsberg, J., joined by Kennedy, J., Breyer, J., and Alito, J.

added). That practical approach was based on the "real concern that Federal Rules which vary from State to State would be chaos." *Id.* at 19.

Supplying the fifth vote in a concurring opinion, Justice Stevens inquired whether the *state rule* was procedural. Straddling narrow ground between the plurality and the dissent, Justice Stevens wrote that a federal rule cannot "displace a state law that is procedural in the ordinary use of the term but is so intertwined with a state right or remedy that it functions to define the scope of the state-created right." Slip op. at 8 (Stevens, J., concurring). Justice Stevens nevertheless concluded that the New York statute was "classically procedural" but confined that result to "*this* case." *Id*. at 20-21. The majority thus agreed that state class action procedural rules cannot alter federal class action procedures where the two conflict.

THE DISSENT. Four justices dissented. The dissent, written by Justice Ginsberg, accepted the same basic two-question analytic framework but answered the first question differently. Concluding that New York's statute served an "entirely different concern" than Rule 23, the dissent found no "inevitable collision" between them. Slip op. at 12, 14 (Ginsberg, J., dissenting). The dissent distinguished Rule 23's provisions governing "[t]he fair and efficient *conduct* of class litigation" from the New York statute's "*remedy* for an infraction of state law." *Id.* at 12. The dissent cautioned that the plurality's finding of a direct conflict was based on a "wooden[]" interpretation of Rule 23 and "unwisely and unnecessarily retreat[ed] from the federalism principles undergirding *Erie* [*R. Co. v. Tompkins*, 304 U.S. 64 (1938)]." *Id.* at 16. As noted by the dissent, the majority's holding would potentially preempt numerous state statutes designed to curb the recovery of statutory damages by class actions. *Id.* at 16 n.11.

OPEN QUESTIONS. Several open questions remain after *Shady Grove*. First, the extent to which other state statutes are preempted by the federal rules is up for debate. Justice Stevens' narrow approach focusing on the nature of the specific state law would permit statute-by-statute arguments. In contrast, Justice Scalia's categorical approach would foreclose such statute-by-statute arguments, preempting any state law "colliding" with federal class action rules. It remains to be seen how the lower courts will reconcile the critical split between the concurring and plurality opinions. Second, whether state statutes capping individual damages are preempted is still an open question. *Shady Grove* declined to decide whether "state laws that set a ceiling on damages recoverable in a single suit . . . are pre-empted." Slip op. at 7 n.4 (Scalia, J.). Third, *Shady Grove* does not resolve "murky" questions under *Erie* that arise if the federal and state laws do not conflict. *Id.* at 4.

PRACTICAL EFFECT. An important practical effect of *Shady Grove* is predicted by the Court itself: forum shopping. If the federal rules preempt certain state statutes (as in this case), litigants may seek to file in federal court. The plurality recognized this risk, acknowledging "the reality that keeping the federal-court door open to class actions that cannot proceed in state court will produce forum shopping." Slip op. at 22 (Scalia, J.). The dissent, moreover, however, pointed out the "large irony" that the Class Action Fairness Act ("CAFA"), designed to curb class actions, would potentially make federal courts a "mecca" for "class actions seeking state-created penalties for claims arising under state law" that would be otherwise barred in state court. *Id*. at 24 (Ginsberg, J., dissenting). *Shady Grove* may thus increase the number of class actions initially brought by plaintiffs in federal court and may raise strategic considerations about removal for defendants sued in state courts.

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