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## Federal Class Actions in *Shady Grove v. Allstate*

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# The Supreme Court Invalidates State Restriction on Federal Class Actions in *Shady Grove v. Allstate*

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## I. INTRODUCTION

The United States Supreme Court recently held that Federal Rule of Civil Procedure 23 trumps a state rule that forbids all class action relief based on a state statutory penalty.<sup>2</sup> With the Court splitting along ideologically diverse lines,<sup>3</sup> three separate opinions vigorously debated matters of state policy prerogative and legislative interpretation. The Justices appeared to agree, however, that the decision will surely result in increased forum shopping for class action plaintiffs under the Class Action Fairness Act, 28 U.S.C. § 1332(d) (2006) (“CAFA”). The irony, not lost on the dissent,<sup>4</sup> was that CAFA was enacted to protect class action defendants from state judges overeager to certify large classes. It now acts to submit the same defendants to federal class action liability where state class action liability does not exist.

The ripples from *Shady Grove* likewise reach antitrust law. For instance, the same state rule at issue in *Shady Grove* also restricts class action relief under New York’s antitrust provision, the Donnelly Act.<sup>5</sup> Coupled with CAFA, *Shady Grove* may lead to more antitrust class actions in federal court based on state law provisions like the Donnelly Act.

## II. SHADY GROVE IN THE LOWER COURTS

This is the story, in Justice Ginsburg’s words, of an “attempt to transform a \$500 case into a \$5,000,000 award.”<sup>6</sup> Plaintiff treated a woman injured in an automobile accident and received her rights to collect insurance benefits from defendant Allstate.<sup>7</sup> Allstate allegedly paid plaintiff’s claim tardily,<sup>8</sup> and it refused to pay the approximately \$500 in statutory interest that accrued on the overdue benefits.<sup>9</sup> Plaintiff brought a diversity suit in federal court to collect benefits for itself and for a class of others to whom Allstate allegedly had not paid the required statutory interest.<sup>10</sup>

On a motion to dismiss, the district court recognized that New York law prohibits the use

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<sup>2</sup> *Shady Grove Orthopedic Assocs., P.A. v. Allstate Insurance Co.* (“*Shady Grove*”), 130 S. Ct. 1431 (2010).

<sup>3</sup> The Court split 4-1-4. The plurality consisted of Chief Justice Roberts and Justices Scalia, Sotomayor, and Thomas. Justice Stevens concurred, and Justices Ginsburg, Kennedy, Breyer, and Alito joined in dissent.

<sup>4</sup> *Shady Grove*, 130 S. Ct. at 1473.

<sup>5</sup> See N.Y. GEN. BUS. LAW §§ 340-347 (McKinney 2004). The Donnelly Act was enacted in 1899 and was modeled after the federal Sherman Antitrust Act.

<sup>6</sup> *Id.* at 1460 (Ginsburg, J., dissenting).

<sup>7</sup> *Id.* at 1436.

<sup>8</sup> See N.Y. INS. LAW ANN. § 5106(a) (West 2009).

<sup>9</sup> *Id.*

<sup>10</sup> *Id.*

of a class action to recover state statutory penalties, unless specifically permitted by the underlying statute.<sup>11</sup> The court concluded that CPLR § 901(b) restricts class actions based on New York law both in state court and in federal court.<sup>12</sup> Because statutory interest is a “penalty,” the court held that CPLR § 901(b) bars a federal class action. The court thus dismissed for lack of jurisdiction.<sup>13</sup>

The Second Circuit affirmed.<sup>14</sup> First, the court decided that Federal Rule of Civil Procedure 23 (“Rule 23”)<sup>15</sup> does not conflict with CPLR § 901(b). According to the court, Rule 23 deals only with procedural issues relating to the certification of a class.<sup>16</sup> CPLR § 901(b) deals similarly with procedural issues of certification. But the court held that it also forbids a substantive cause of action, by reflecting a state policy judgment that a class action is an undesirable mechanism of enforcing a statutory penalty scheme.<sup>17</sup> Because CPLR § 901(b) deals with an issue Rule 23 does not, the two provisions are not in conflict.<sup>18</sup> Finally, the court held that, under *Erie*,<sup>19</sup> CPLR § 901(b) is a “substantive” provision that requires application by federal courts sitting in diversity jurisdiction.<sup>20</sup> CPLR § 901(b) thus forbids a plaintiff from “maintaining” a class action on a state statutory penalty in federal court.<sup>21</sup>

### III. THE SHADY GROVE DECISION

Plaintiff Shady Grove petitioned the Supreme Court for a writ of certiorari. Apparently thinking a cert grant was unlikely, Allstate declined to respond to Shady Grove’s petition until asked to by the Court.<sup>22</sup> The Court granted cert on May 4, 2009 and, some eleven months later, it reversed the Second Circuit. Examining the plurality and dissenting opinions first will provide a helpful context for analyzing Justice Stevens’ concurring (and controlling)<sup>23</sup> opinion.

#### A. Justice Scalia’s Plurality Opinion

Many have expressed surprise that Justice Scalia delivered a plaintiff friendly—much less a class-action friendly opinion in *Shady Grove*.<sup>24</sup> As one commentator asked, “Is Justice Scalia getting soft on plaintiffs?”<sup>25</sup> In reality, the opinion shows nothing more than Scalia’s typical strict textualism and preference for bright-line rules.

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<sup>11</sup> *Shady Grove Orthopedic Assocs., P.A. v. Allstate Insurance Co.*, 466 F. Supp. 2d 467 (E.D.N.Y. 2006); *see also* N.Y. CIV. PRAC. LAW ANN. (CPLR) § 901(b) (West 2006).

<sup>12</sup> *Id.* at 472.

<sup>13</sup> *Id.* at 469.

<sup>14</sup> *Shady Grove Orthopedic Assocs., P.A. v. Allstate Insurance Co.*, 549 F.3d 137 (3d Cir. 2008).

<sup>15</sup> FED. R. CIV. P. 23.

<sup>16</sup> 549 F.3d at 143.

<sup>17</sup> *Id.* at 143, 144-45.

<sup>18</sup> *Id.*

<sup>19</sup> *See Erie R. Co. v. Tompkins*, 304 U.S. 64 (1938).

<sup>20</sup> 549 F.3d at 145.

<sup>21</sup> *Id.*

<sup>22</sup> Posting of Lyle Denniston to SCOTUSblog, <http://www.scotusblog.com/2009/10/a-new-look-at-the-erie-doctrine/> (Oct. 30, 2009, 18:53 EST).

<sup>23</sup> Justice Stevens’ concurrence attracted no other votes. Because it is the narrowest opinion, however, it will control in future cases.

<sup>24</sup> *See, e.g.*, Posting of Daniel Fisher to Forbes’ On the Docket Blog, <http://blogs.forbes.com/docket/2010/03/31/stop-the-presses-scalia-defends-class-actions/>, (Mar. 31, 2010, 11:55 EST).

<sup>25</sup> Posting of Ashby Jones to The Wall Street Journal Law Blog, <http://blogs.wsj.com/law/2010/04/01/the-shady-grove-case-is-scalia-getting-soft-on-plaintiffs/> (Apr. 1, 2010, 18:45 EST).

Writing for different Justices in different Parts of his opinion,<sup>26</sup> Justice Scalia laid out the framework for his analysis: First, does the Federal Rule squarely conflict with the state rule?<sup>27</sup> If yes, does the Federal Rule “exceed[] statutory authorization or Congress’s rulemaking power?”<sup>28</sup> If not, the Federal Rule will always prevail.

Justice Scalia held that Rule 23 applied in this case and was unavoidable. First, Rule 23 states that a “class action may be maintained” if it meets certain criteria.<sup>29</sup> CPLR 901(b) states that a suit “may not be maintained as a class action” if it seeks to recover a statutory penalty.<sup>30</sup> To Justice Scalia, therefore, the two Rules attempt to answer the same question.<sup>31</sup> He likewise rejected the Second Circuit’s eligibility-certifiability distinction. Congress could simply relabel Rule 23’s requirements as “eligibility criteria” and thus remove the “artificial,” “made-to-order” distinction.<sup>32</sup> Justice Scalia relied on many of his standard arguments against focusing on legislative intent to discern the meaning of a statute or rule, as the dissent sought to do.<sup>33</sup> Further, even “artificial narrowing” of the scope of CPLR § 901(b) scope was insufficient. Justice Scalia stressed that “Rule 23 unambiguously authorizes *any* plaintiff, in *any* federal civil proceeding, to maintain a class action if the Rule’s prerequisites are met.”<sup>34</sup> Because CPLR § 901(b) purports to limit this categorical affirmative, the two rules are in conflict.

The only question remaining, then, was whether Rule 23 violated the Rules Enabling Act, 28 U.S.C. § 2072(b) (2006).<sup>35</sup> Justice Scalia found that such an inquiry asks whether the challenged Rule “really regulat[es] procedure.”<sup>36</sup> To the plurality, Rule 23 clearly met this standard; it does not alter substantive rights but instead “regulate[s] only the process for enforcing those rights.”<sup>37</sup> Although Allstate argued that Rule 23 “abridges” a substantive right of a defendant to avoid “aggregated class action liability,”<sup>38</sup> as created by CPLR § 901(b), Justice Scalia disagreed. He stated that the substantive purpose of the state rule is immaterial, because a Federal Rule of Procedure cannot be valid in some states but invalid in others.<sup>39</sup> Thus, a court should look only to the “substantive or procedural nature of the Federal Rule” in a § 2072(b) inquiry.

In closing, Justice Scalia “acknowledge[d] the reality” that this outcome would lead to forum shopping by class-action plaintiffs.<sup>40</sup> To him, however, forum shopping is the inevitable, if

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<sup>26</sup> Justice Scalia wrote for Chief Justice Roberts and Justices Stevens, Thomas, and Sotomayor in Parts I and II-B; Chief Justice Roberts and Justices Thomas and Sotomayor in Parts II-B and II-D; and Chief Justice Roberts and Justice Thomas in Part II-C.

<sup>27</sup> *Shady Grove*, 130 S. Ct. at 1437.

<sup>28</sup> *Id.* (citing *Hanna v. Plumer*, 380 U.S. 460, 463-64 (1965)).

<sup>29</sup> FED. R. CIV. P. 23(b).

<sup>30</sup> N.Y. INS. LAW ANN. § 5106(a) (West 2009).

<sup>31</sup> *Shady Grove*, 130 S. Ct. at 1437.

<sup>32</sup> *Id.* at 1438.

<sup>33</sup> *See id.* at 1440-41 (noting that, among other things, the evidence of intent was sparse; courts must interpret the law the legislature *did* enact rather than the law they *thought* they enacted; and courts are ill-equipped to search for legislative intent).

<sup>34</sup> *Id.* at 1442 (emphasis in original).

<sup>35</sup> 28 U.S.C. § 2072(b) provides that a Federal Rule of Procedure “shall not abridge, enlarge or modify any substantive right.”

<sup>36</sup> *Shady Grove*, 130 S. Ct. at 1442 (quoting *Sibbach v. Wilson & Co.*, 312 U.S. 1, 14 (1941)).

<sup>37</sup> *Id.* at 1443.

<sup>38</sup> *Id.* (quoting Brief for Respondent 31).

<sup>39</sup> *Id.* at 1444.

<sup>40</sup> *Id.* at 1447.

not intended, consequence of uniform Federal Rules of Procedure.<sup>41</sup> As Justice Scalia concluded, “[A] Federal Rule governing procedure is valid whether or not it alters the outcome of the case in a way that induces forum shopping.”<sup>42</sup>

### **B. Justice Ginsburg’s Dissenting Opinion**

Justice Ginsburg, writing for Justices Breyer, Kennedy, and Alito, asked “Is this conflict really necessary?”<sup>43</sup> This question served as the cornerstone of her dissenting opinion. To Justice Ginsburg, the plurality relentlessly sought a conflict between Rule 23 and CPLR § 901(b) instead of “interpret[ing] Federal Rules with awareness of, and sensitivity to, important state regulatory policies.”<sup>44</sup> If the Court had given “respectful consideration”<sup>45</sup> to those policies, as laid out in CPLR § 901(b)’s legislative history, the plurality would not have found conflict between the two provisions.<sup>46</sup>

Justice Ginsburg would read Rule 23 to “govern[] the procedural aspects of class litigation.”<sup>47</sup> She believed that, unlike CPLR § 901(b), it did not regulate “the size of a monetary award a class plaintiff may pursue.”<sup>48</sup> Justice Ginsburg emphasized this point with a hypothetical. If a state statute provided that “a suit to recover more than \$1,000,000 may not be maintained as a class action,” the plurality would likely find it invalid, with its unwavering focus on the words “may not be maintained.”<sup>49</sup> A state statute providing that “no more than \$1,000,000 may be recovered in a class action” would stand under the plurality’s analysis,<sup>50</sup> even though the two statutes intend precisely the same effect.<sup>51</sup>

Having found no conflict between the two Rules, the dissent analyzed whether applying the Federal Rule “would invite forum-shopping and yield markedly disparate litigation outcomes.”<sup>52</sup> Justice Ginsburg found it “difficult to imagine a scenario that would promote more forum shopping” than that in *Shady Grove*.<sup>53</sup> A class action defendant also now faced a “substantial variation[]” in liability between the relief available in federal and state court.<sup>54</sup> Given the “impropriety of displacing . . . state-law limitations on state-created remedies” in diversity actions,<sup>55</sup> Justice Ginsburg would have upheld New York’s restriction on class action relief for state statutory penalties.<sup>56</sup>

### **C. Justice Stevens’ Concurring Opinion**

Justice Stevens found the middle ground. He agreed with the plurality that Rule 23

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<sup>41</sup> *Id.* at 1448.

<sup>42</sup> *Id.*

<sup>43</sup> *Id.* at 1460.

<sup>44</sup> *Id.*

<sup>45</sup> *Id.* at 1464.

<sup>46</sup> *Id.* at 1465.

<sup>47</sup> *Id.* at 1466.

<sup>48</sup> *Id.*

<sup>49</sup> *Id.*

<sup>50</sup> *See id.* at 1472 (citing *Gasparini v. Center for Humanities, Inc.*, 518 U.S. 415, 428 (1996) (“[A] statutory cap on damages would supply substantive law for *Erie* purposes.”)).

<sup>51</sup> *Id.* at 1467.

<sup>52</sup> *Id.* at 1461.

<sup>53</sup> *Id.* at 1472, n.13.

<sup>54</sup> *Id.* at 1471 (quoting *Gasparini*, 518 U.S. at 430).

<sup>55</sup> *Id.* at 1472.

<sup>56</sup> *Id.* at 1472.

conflicted with CPLR § 901(b) and thus controlled the outcome.<sup>57</sup> But he also agreed with the dissent that federal courts must apply some state procedural rules in diversity actions.<sup>58</sup> To identify these rules, courts should look not to the “form” of the rules as being substantive or procedural, but rather to “whether the state law actually is part of a State’s framework of substantive rights or remedies.”<sup>59</sup>

Like Justice Scalia, Justice Stevens applied a two-step framework that asked first whether the two rules conflicted and, if so, whether the Federal Rule was invalid.<sup>60</sup> However, Justice Stevens analyzed the second step differently from Justice Scalia. Justice Scalia asked whether a rule “really regulate[s] procedure.”<sup>61</sup> Justice Stevens instead held that the proper test is whether the challenged federal rule “would displace a state law that is procedural in the ordinary sense 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.”<sup>62</sup> Justice Stevens reasoned that CPLR § 901(b) could possibly be a substantive limit on damages, based on its legislative history.<sup>63</sup> But because this argument rested on “extensive speculation,” Justice Stevens would “respect Congress’ decision that Rule 23 governs class certification in federal courts.”<sup>64</sup>

#### IV. ANALYSIS

*Shady Grove* is difficult to analyze as being either “correct” or “incorrect.” The Court’s three opinions rest on fundamentally opposing philosophies of statutory interpretation and federal-state interaction that are arguably separate from the precise points of law at issue. But this analysis notes at least three broad themes regarding *Shady Grove* and its likely aftermath.

##### A. CAFA, Forum Shopping, and a Dose of Irony

Due to the alarming prevalence with which some state judges approved class actions, Congress enacted CAFA in 2005. CAFA provides that a party may remove class actions on state law claims to federal court when, among other requirements, at least \$5,000,000 is in controversy.<sup>65</sup> This restricts forum shopping by preventing plaintiffs’ lawyers from keeping large class actions in class action-friendly state courts. It also serves as a check to the class action device itself. As Justice Ginsburg noted, “Congress envisioned fewer—not more—class actions overall” as a result of CAFA.<sup>66</sup>

*Shady Grove* provides an ironic twist to Congress’s enactment of CAFA. CAFA once protected class action defendants by allowing them to remove jurisdiction from an unsympathetic state judge. It may, under some circumstances,<sup>67</sup> now submit the same defendants to “class

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<sup>57</sup> *Id.* at 1448.

<sup>58</sup> *Id.*

<sup>59</sup> *Id.* at 1449.

<sup>60</sup> *Id.* at 1451.

<sup>61</sup> *See id.* at 1442.

<sup>62</sup> *Id.* at 1452 (emphasis added).

<sup>63</sup> *Id.* at 1459.

<sup>64</sup> *Id.* at 1460.

<sup>65</sup> 28 U.S.C. § 1332(d).

<sup>66</sup> *Shady Grove*, 130 S. Ct. at 1473.

<sup>67</sup> Although it is a powerful tool for litigants, CAFA also limits the removal of class actions to federal court in important ways. For example, § 1332(d)(4)(A)(i)(I) forbids federal jurisdiction where more than two-thirds of the class are citizens of the state in which the action was originally filed. And under § 1332(d)(3), district courts may decline to exercise jurisdiction based on consideration of certain factors.

actions seeking state-created penalties for claims arising under state-law claims that would be barred from class treatment in the State's own courts."<sup>68</sup>

New York's Donnelly Act,<sup>69</sup> modeled after the federal Sherman Antitrust Act, may be a good example. New York state courts have held that the treble damages provision of the Donnelly Act is a "penalty" under CPLR § 901(b).<sup>70</sup> Class action plaintiffs under the Act were once barred, therefore, from recovering treble damages both in state and federal court. *Shady Grove* means that treble damages under the Donnelly Act may now be available in federal court, but not in the courts of the very state in which the claim arises.<sup>71</sup> Antitrust litigators should take note of other state antitrust provisions that might similarly be affected by the combination of CAFA and *Shady Grove*.

## **B. The Importance of Legislative Drafting**

For state legislatures, *Shady Grove* provides a compelling reminder that strategic statutory drafting is often outcome-determinative. Justice Scalia made much of the fact that Rule 23 said that a class action "may be maintained" while CPLR § 901(b) said that a class action "may not be maintained." He reasoned that, because a litigant "maintains" litigation, the text of the rules placed discretion in the litigant, not in the court.<sup>72</sup> Justice Ginsburg criticized the plurality for its rigid textualism. She noted that a statute drafted as a class action damages cap would pass muster where a statute drafted as a class action restriction would not—even though the "intended effect" of the statutes would be the same.<sup>73</sup> Whatever the outcome of the analysis, the import was clear: This Court cares deeply about the precision of the statutory text it examines.

The Court's first opportunity to apply *Shady Grove* resulted in more of the same textual focus. Soon after it decided *Shady Grove*, the Court granted cert in *Holster v. Gatco, Inc.*,<sup>74</sup> ("Holster"), summarily vacated the judgment of the Second Circuit, and remanded for reconsideration. *Holster* dealt with a plaintiff who brought a class action based on alleged violations of the Telephone Consumer Protection Act ("TCPA").<sup>75</sup> Although the TCPA provides a private cause of action, it states that an individual may only "bring" the claim "if otherwise permitted by the laws or rules of court of a State."<sup>76</sup> When the plaintiff sought to bring a class action under the TCPA in federal court, the district court dismissed. It held that the *Erie* rule applied to the TCPA and that CPLR § 901(b) was substantive, thus barring the class action

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<sup>68</sup> *Shady Grove*, 130 S. Ct. at 1473.

<sup>69</sup> N.Y. GEN. BUS. LAW §§ 340-347 (McKinney 2004).

<sup>70</sup> See, e.g., *Sperry v. Crompton Corp.*, 863 N.E.2d 1012 (N.Y. 2007).

<sup>71</sup> A recent article argues that the Court has inadvertently "accomplished what the New York state Legislature tried but failed to do," and in the process "resuscitat[ed] the legislative intent and indeed any vitality at all of the Donnelly Act." Barbara J. Hart & Kesav M. Wable, *Donnelly Act Class Claimants Given New Lease on Life: Plaintiffs Get Around the Restriction of CPLR*, N.Y. L.J., May 17, 2010, <http://www.law.com/jsp/nylj/PubArticleNY.jsp?id=1202458149011>.

<sup>72</sup> *Shady Grove*, 130 S. Ct. at 1438. Likewise, Justice Scalia wrote for a majority of the Court when he derided the dissent's reliance on legislative intent as a supplement to a strict textual analysis. See *id.* at 1440-41.

<sup>73</sup> *Id.* at 1466.

<sup>74</sup> *Holster v. Gatco, Inc.*, 130 S. Ct. 1575 (2010).

<sup>75</sup> Telephone Consumer Protection Act ("TCPA"), 47 U.S.C. § 227(b)(1)(C) (2006). The TCPA forbids the sending of "unsolicited advertisement[s]" to a fax machine unless specific conditions are met. See *Holster v. Gatco, Inc.*, 485 F. Supp. 2d 179, 181 (E.D.N.Y. 2007) (citing 47 U.S.C. § 227(b)(1)(C)).

<sup>76</sup> 47 U.S.C. § 227(b)(3).



claim.<sup>77</sup> The Second Circuit summarily affirmed.<sup>78</sup>

Justice Scalia concurred in the Court's order, countering a spirited dissent by Justice Ginsburg.<sup>79</sup> As he had done in *Shady Grove*, he carefully parsed the phrasing of the TCPA and of CPLR § 901(b). He noted that CPLR § 901(b) does not forbid a plaintiff from "bringing"—as stated by the TCPA—an action to recover a statutory penalty, it only prevents a plaintiff from "maintaining" the suit "as a class action."<sup>80</sup> Because the two renderings thus did not inherently conflict, according to Justice Scalia, the TCPA did not necessarily supersede Rule 23 and the class action might not be barred.<sup>81</sup>

The Court's unbending textual focus has considerable practical significance for future cases. Hanging in the balance are the fates of sixty state statutes that Allstate identified in its merits brief as restricting class actions on specific claims.<sup>82</sup> Allstate also listed thirty-six other state and federal provisions that place a damages cap on the relief that may be awarded in class actions.<sup>83</sup> The Court may soon be forced to decide two issues. First, is there any legal significance between a state class action damages cap and a state class action proscription, as foreseen by Justice Ginsburg? And to what extent do differences in statutory phrasing matter, if at all, in determining whether a state class action proscription and Rule 23 conflict? State legislatures would be well advised to take note of the answers.

### **C. The Tenuous Future of *Shady Grove***

*Shady Grove's* future relevance is difficult to predict. Under Supreme Court practice, Justice Stevens' concurrence is the controlling opinion. Justice Stevens is retiring, however, and his concurrence in *Shady Grove* attracted no other votes. The vigorous debate in *Holster* suggests that Justices Scalia and Ginsburg have only refortified their previous positions in *Shady Grove*.

The next case arising under *Shady Grove* will present intriguing possibilities for the Court. The new Justice will have the opportunity to make a majority of the *Shady Grove* plurality or dissent. He or she could also capture members of the plurality or dissent in solidifying Justice Stevens' "intertwinement" test. These possibilities bear close attention as the new Justice is confirmed, and as the next challenge to a state restriction on federal class actions based on state law claims arises.

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<sup>77</sup> See 485 F. Supp. 2d at 184-86.

<sup>78</sup> See *Holster*, 130 S. Ct. at 1575.

<sup>79</sup> *Id.* at 1575-76.

<sup>80</sup> *Holster*, 130 S. Ct. at 1576.

<sup>81</sup> *Id.*

<sup>82</sup> See Brief for Respondent App. B.

<sup>83</sup> See *id.* App. A.