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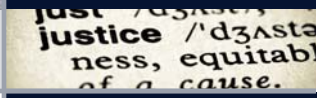
Class Action Alert



Companies Face Increased Exposure to Class Actions in the Wake of *Shady Grove v. Allstate*

BY TURNER A. BROUGHTON AND JOSEPH R. POPE

As a response to the burgeoning abuses of class action lawsuits, several states enacted legislation specifying that certain claims were categorically ineligible for class action treatment. New York was one of these states. In 1975, New York enacted N.Y. C.P.L.R. § 901(b), which reads that unless otherwise authorized under statute "an action to recover a penalty, forfeiture or minimum measure of recovery created or imposed by statute may not be maintained as a class action." The purpose of the provision was to prevent the "excessively harsh results" that may obtain if statutory penalties, which had been calibrated to individual lawsuits, were made recoverable in a class action.

The Supreme Court in *Shady Grove Orthopedic Assoc.'s v. Allstate Ins. Co.* (No. 08-1008) recently found that New York's policy choice in enacting § 901(b) was overridden under the aegis of Federal Rule of Civil Procedure 23; thus, New York state law claims ineligible for class action treatment in state court could proceed in a class action brought in federal court. The 5-4 decision rests on the premise that § 901(b) is a procedural rule in conflict with Rule 23. Whether similar state law bans on class actions will be interpreted likewise in federal courts is a question whose answer depends on how lower courts ultimately construe and apply *Shady Grove*.

The Background of the Case

Physicians at Shady Grove Orthopedic Associates, located in Maryland, provided medical care to a woman injured in an automobile accident. As partial payment for her treatment, the woman assigned to Shady Grove her rights to insurance benefits under a policy issued in New York by Allstate Insurance. Under New York law, after an insured, or the assignee of an insured, submits a claim, the insurer has 30 days to either pay or deny the claim. Allstate eventually paid the claim but not on time. Shady Grove then demanded that Allstate pay the statutory interest that had accrued on the claim, which was approximately $500. Allstate refused.

Claiming that Allstate routinely flouted its responsibility to pay statutory interest on late payments, Shady Grove brought a class action, based on diversity, in the Eastern District of New York on behalf of itself and a proposed class of Allstate insureds who similarly had been denied interest payments. Notwithstanding the class action provision set out in Federal Rule of Civil Procedure 23, the District Court found itself deprived of jurisdiction by § 901(b). It reasoned that § 901(b) applied to the case as statutory interest was a "penalty." The Second Circuit affirmed, finding that Rule 23 and § 901(b) did not conflict

Editorial inquiries should be directed to Turner A. Broughton, 804.783.6926 or tbroughton@williamsmullen.com.

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and that § 901(b) was "substantive" for purposes of *Erie Railroad Co. v. Tompkins*, 304 U.S. 64 (1938).

The Supreme Court reversed in a fractured decision. Justice Scalia wrote the majority opinion as to Parts I and I.A., and marshaled a plurality of four Justices for Parts II.B and II.D, but managed only three Justices to concur in Part II.C. Justice Stevens wrote a concurrence, while Justice Ginsburg and three other Justices dissented.

The Majority Opinion

In a somewhat disjointed opinion, Scalia found that Rule 23 applied in federal court in all cases, including those brought under state law. With little consideration of the purposes underlying *Erie* and its progeny, Justice Scalia cast aside any suggestion that § 901(b) was a substantive provision; instead finding it a procedural statute that conflicted with the plain language of Rule 23, as both provisions sought to govern whether a class action lawsuit could proceed in federal court. Thus, in Scalia's view, so long as Rule 23(a)'s requirements of numerosity, commonality, typicality, and adequacy of representation are met, and the suit fits into one of Rule 23(b)'s three categories, the suit can go forward as a class action.

Scalia found unpersuasive Allstate's arguments that its holding frustrated New York's substantive policy or that the decision abridged a state substantive right to be free from an oppressive, and possibly devastating, class action proceeding. According to Scalia, any state interests subsumed within § 901(b) must yield to the federal rule. Scalia reasoned that the plain text of the rule mandated this result, writing, "Rule 23 unambiguously authorizes any plaintiff, in any federal civil proceeding, to maintain a class action if the Rule's prerequisites are met. We cannot contort its text, even to avert a collision with state law that might render it invalid."

He also found it of little consequence that the majority opinion would encourage forum shopping, even though *Erie* expressly sought to end, or at least limit, the practice. Scalia concluded that forum shopping "is the inevitable (indeed, one might say the intended) result of a uniform system of federal procedure."

Justice Stevens' Concurrence

Stevens joined the majority in finding that § 901(b) was a state rule of procedure in direct conflict with Rule 23, but he rejected Scalia's broad pronouncement that Rule 23 would govern in all federal civil proceedings. While Rule 23 preempted § 901(b), "[t]hat does not mean, however, that the federal rule always governs." Instead, Stevens reasoned, based on, *Hanna v. Plumer*, 380 U.S. 460 (1965), and *Gasperini v. Center for Humanities, Inc.*, 518 U.S. 415 (1996), that federal rules "must be interpreted with some degree of sensitivity to important state interests and regulatory policies." Thus, in certain instances, the federal rule should be read in a way that gives the state procedural rule room to operate; for those purposes, the state rule becomes "substantive." Stevens explained that these are instances where a "[s]tate chooses to use a traditionally procedural vehicle as a means of defining the scope of substantive rights or remedies." As such, a federal court cannot "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."

State procedural rules that serve to define substantive rights or remedies, according to Stevens, include laws that "make it significantly more difficult to bring or to prove a claim, thus serving to limit the scope of that claim." In *Cohen v. Beneficial Industrial Loan Corp.*, 337 U.S. 541 (1949), for example, New Jersey had enacted a rule requiring a stockholder bringing a derivative suit to post a bond before bringing the action. The Supreme Court found this rule substantive for purposes of *Erie* because the rule was merely a condition precedent for bringing a claim. A state statute of limitations was likewise deemed substantive in *Guaranty Trust Co. v. York*, 326 U.S. 99 (1945). And, in *Gasperini v. Center of Humanities, Inc.*, 518 U.S. 415 (1996), a state appellate rule that required state appellate courts to scrutinize the quantum of damages awarded by a jury under a more rigorous standard than that employed in federal court was deemed substantive.

In Part II.C of his opinion, Scalia criticized Steven's approach as being too amorphous and complicated for district courts to employ. Thus, "[i]nstead of a single hard question of whether a Federal Rule regulates substance or procedure, that approach will present hundreds of hard questions, forcing federal courts to assess the substantive or procedural character of countless state rules that may conflict with a single Federal Rule." Stevens retorted, saying that while Scalia "may generally prefer easily administrable, bright-line rules," broader interests of public policy demand a less wooden approach.

The Dissent

Justice Ginsburg, joined by Justices Breyer, Kennedy, and Alito, wrote that in view of *Erie*'s twin aims of avoiding forum shopping and an inequitable administration of the law, the Court should continue to interpret "Federal Rules with awareness of, and sensitivity to, important state regulatory policies." The dissent invoked Justice Harlan who aptly conveyed the federalist dimensions of Erie in Hanna by describing Erie as "one of the modern cornerstones of our federalism, expressing policies that profoundly touch the allocation of judicial power between the state and federal systems." In the dissent's view, the majority's reading of the Federal Rules was inconsistent with Erie's pro-federalist policy and "would

trench on state prerogatives without serving any countervailing federal interest."

The dissent agreed with Stevens' observation that Federal Rules should be interpreted with some degree of sensitivity to important state interests and regulatory policies, and such rules should not be applied if they would alter substantive rights. The dissent, however, departed with Stevens and his reading of Rule 23 vis-à-vis § 901(b). In its view, § 901(b) was a substantive provision that defined the scope of the remedies available to a litigant under state law. While Rule 23 prescribes the considerations relevant to class certification and post certification procedures, § 901(b) restricts the remedy available to litigants. "In other words, Rule 23 describes a method of enforcing a claim for relief, while § 901(b) defines the dimensions of the claim itself."

Shady Grove's Impact on Future Class Actions

Because *Shady Grove* has no clear majority opinion providing a test under which to measure future cases in which a defendant invokes a state law restriction to class actions, the case may prove difficult to apply in many cases. Yet, building from the proposition that the federal rules preempt state procedural laws when the two unavoidably collide, we know that the *Shady Grove* majority necessarily found that Rule 23 occupies a broad expanse, and state laws that attempt to limit collective actions will accordingly be inapplicable in most diversity actions. To be sure, state laws closely analogous to § 901(b) must yield to Rule 23. In its brief, Allstate identified 96 such laws.

Numerous states, for example, have enacted legislation restricting the availability of class actions in cases arising under their consumer protection laws. These states include Alabama, Alaska, Georgia, Kentucky, Louisiana, Mississippi, and Montana. Only a few years ago, Plaintiffs' attorneys attempted to bring a nationwide class action in Massachusetts based, in part, on the consumer protection laws of some of these states. The district court, however, dismissed the claims of consumers from those states because of the state bar on such class actions. *See In re Pharm. Indus. Average Wholesale Price Litig., 230 F.R.D. 61 (D. Mass. 2005)*. *Shady Grove* opens the door for a different result in future cases with similar facts and claims.

Recall, however, that Justice Stevens departed from the majority's bright-line rule that Rule 23 preempts any state law barring class actions in federal court, and espoused instead a standard for interpreting the federal rules that is sensitive to state policy interests. Thus, a state curb on class actions may apply if the restriction is so intertwined with an underlying "state right or remedy that it functions to define the scope of the state-created right." Some lower courts may consider this standard to be part of the rule in future cases. This is because of an obscure interpretive canon called the "narrowest grounds doctrine." As espoused by the Supreme Court in *Marks v. United States*, 430 U.S. 188 (1977), the rule provides that when the members of the Supreme Court are deeply divided on an issue, the narrowest opinion supporting the outcome is viewed as the controlling interpretation. Because Stevens would provide some deference to state rules that regulate class actions based on state law, his is the narrower view. How this standard, if adopted, will affect future cases is quite unclear, as we know § 901(b) did not satisfy its criteria. What is clear is Shady Grove provides plaintiffs an incentive to bring class actions based on state law in federal court as a means of avoiding state law restrictions.

For more information pertaining to this matter, please contact Turner A. Broughton at 804.783.6926 or tbroughton@williamsmullen.com and Jospeh R. Pope at 804.783.6550 or jpope@williamsmullen.com.

Class Action Litigation Team

A. Peter Brodell
Co-Chair, Class Action Litigation Team
804.783.6433
pbrodell@williamsmullen.com

Turner A. Broughton
Co-Chair, Class Action Litigation Team
804.783.6926
tbroughton@williamsmullen.com

Calvin "Woody" W. Fowler, Jr.
Co-Chair, Class Action Litigation Team
804.783.6442
cfowler@williamsmullen.com

Kevin W. Benedict
919.981.4044
kbenedict@williamsmullen.com

Beth Hirsch Berman
757.629.0604
bberman@williamsmullen.com

James M. Burns
202.327.5087
jmburns@williamsmullen.com

M. Keith Kapp
919.981.4024
kkapp@williamsmullen.com

James V. Meath
804.783.6412
jmeath@williamsmullen.com
804.783.6435

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