Civil Procedure: Choice of Law in Federal Courts

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1 The Rules of Decision Act

28 U.S. Code § 1652

> *The laws of the several states, except where the Constitution or treaties of the United States or Acts of Congress otherwise require or provide, shall be regarded as rules of decision in civil actions in the courts of the United States, in cases where they apply.*

1.1 Legal Naturalism

> *Est quidem vera lex recta ratio naturae congruens, diffusa in omnes, constans, sempiterna, quae vocet ad officium iubendo ... Huic legi nec obrogari fas est neque derogari ex hac aliquid licet neque tota abrogari potest, nec vero aut per senatum aut per populum solvi hac lege possumus, neque est quaerendus explanator aut interpres eius alius, nec erit alia lex Romae, alia Athenis, alia nunc, alia posthac, sed et omnes gentes et omni tempore una lex et sempiterna et immutabilis continebit, ...*[1]

Cicero, *De Re Publica* [Of The Republic], Book III Section 22 (trans. Clinton W. Keyes, 1928)

- Implications of natural law theory for understanding common law:
  - The common law is not specific to any time or place, but is "general" and consistent with natural justice
  - To the extent that common law rules vary among jurisdictions, this merely reflects imperfect apprehension of the true common law

[1] True law is right reason in agreement with nature; it is of universal application, unchanging and everlasting; ... It is a sin to try to alter this law, nor is it allowable to attempt to repeal any part of it, and it is impossible to abolish it entirely. We cannot be freed from its obligations by senate or people, and we need not look outside ourselves for an expounder or interpreter of it. And there will not be different laws at Rome and at Athens, or different laws now and in the future, but one eternal and unchangeable law will be valid for all nations and all times ...

1.1.1 Swift v. Tyson (1842)

Facts

- Tyson (NY) gave bill of exchange to speculators as payment for land.
- Speculators didn't really own the land
- Speculators gave Tyson's bill to Swift to pay off a pre-existing debt.
- Swift had no involvement in nor knowledge of the swindle
- Swift sought to cash the bill, and Tyson refused to honor it, contending it had been procured by fraud.
    - This was a legitimate defense under NY law.
    - Other jurisdictions held that bona fide holder in due course, taking without knowledge of the fraud, is entitled to payment—and maker must sue the defrauding party to recover.

Holding

- Fed. Ct. not bound by decisions of NY court and should apply "general common law" to decide the case

Rationale

- Rules of Decision Act: "the laws of the several states"
    - Story says this means only statutes and established local usages
    - Does not—cannot—mean common law judicial decisions
        - Judicial opinions are not "law", merely evidence of what the law is.
- Fed courts—like any court—must try to discern and apply the true common law rules
    - Fed court may look to state court decisions, but only as guidance, not controlling
- Policy concern: uniform law across the country to facilitate national commerce

Questions

- What if there had been a NY statute adopting the rule that fraud is a defense even against a holder in due course without notice?
- Federal Court, sitting in diversity, in NC. The NC Supreme Court has held that contributory negligence is a complete bar to recovery.
    - Must the federal court follow the decision of the NC Supreme Court?
    - If not, and if the fed. ct. concludes instead that the proper common law rule is comparative fault, what implications would that have?

1.1.2 Black & White Taxicab v. Brown & Yellow Taxicab (1928)

Facts & Procedural History

- B&Y (KY corp.) and L&NRR (KY corp.) wanted to enter contract giving B&Y exclusive rights to L&N's Bowling Green, KY, station.
  - Agreement would be void under prior KY state court decisions
- B&Y reincorporated in TN, contract executed in TN
- B&Y (TN corp.) then sued B&W (KY corp.) and L&N (KY corp.) in KY federal court, seeking an injunction prohibiting B&W from interfering with contract between B&Y and L&N
  - What's the significance of B&Y's reincorporation in TN?
    - Created diversity, allowing B&Y to sue in federal court: forum shopping for favorable law
    - Why was L&N named as co-defendant?
      - Necessary party, because it was a party to the contract at issue
      - L&N didn't actually contest the injunction, and it did not join in the appeal by B&W
  - If KY law (as stated by KY state courts in prior cases) applies, what result?
- Federal trial court declined to follow KY state court precedent, instead held that the contract was lawful, and thus granted injunction

Holding

- Following Smith v. Tyson, federal trial court properly applied "general common law", not bound by KY state court decisions

What's the problem?

- Assume B&W (the KY corp.) sued to challenge the contract
  - If case stays in KY, court applies KY law
  - What will B&Y (TN corp.) do?
    - Remove and get benefit of favorable federal common law
    - But can't remove if L&N is joined as co-defendant, because then no complete diversity (L&N, B&W were both KY corporations)
- Now assume KY state law (rather than federal law) favors enforcing the contract:
  - If B&Y (TN) sues B&W (KY) and L&N (KY) in KY state court to enforce the contract, may B&W remove to take advantage of more favorable federal law?
    - There is complete diversity
    - But forum defendant rule would prevent removal

1.2 Legal Positivism

> *The common law is not a brooding omnipresence in the sky but the articulate voice of some sovereign or quasi-sovereign that can be identified;*

Southern Pac. Co. v. Jensen, 244 US 205, 222 (1917) (Holmes, J. dissenting)

> *It is very hard to resist the impression that there is one august corpus, to understand which clearly is the only task of any Court concerned. If there were such a transcendental body of law outside of any particular State but obligatory within it unless and until changed by statute, the Courts of the United States might be right in using their independent judgment as to what it was. But there is no such body of law. The fallacy and illusion that I think exist consist in supposing that there is this outside thing to be found. Law is a word used with different meanings, but law in the sense in which courts speak of it today does not exist without some definite authority behind it. The common law so far as it is enforced in a State, whether called common law or not, is not the common law generally but the law of that State existing by the authority of that State without regard to what it may have been in England or anywhere else. It may be adopted by statute in place of another system previously in force. But a general adoption of it does not prevent the State Courts from refusing to follow the English decisions upon a matter where the local conditions are different. It may be changed by statute, as is done every day. It may be departed from deliberately by judicial decisions, as with regard to water rights, in States where the common law generally prevails.... Whether and how far and in what sense a rule shall be adopted whether called common law or Kentucky law is for the State alone to decide.*

Black & White Taxicab v. Brown & Yellow Taxicab, 276 U.S. at 533-34 (Holmes, J., dissenting) (citations omitted)

1.2.1 Erie RR Co. v. Tompkins (1938)

Facts

- Tompkins injured by Erie's train, while walking along tracks in PA
- Tompkins sued in SDNY
  - Erie incorporated in NY
  - At the time, citizenship of corp. was determined by state of incorp. only

Issue

- Substantive issue: Whether Erie owed Tompkins a duty as a licensee (in which case liable) or only as a trespasser (in which case not liable)
- Procedural issue: Whether federal court may apply "general" common law, or must follow Pennsylvania common law

Arguments

- Erie:
  - PA law should control

    - PA Supreme Court had determined that trespasser liability applied in such cases
- Tompkins:
    - Disputed that PA courts had decided the issue as Erie contended
    - Assuming that were true, what should federal court do?
    - Absent a PA statute, fed. courts should apply general common law

Holding

- PA law is controlling on federal court sitting in diversity.
    - Remanded for determination of what PA law is
- Brandeis opinion:
    - Legislative history of RDA
        - Early draft specified both "statute law" and "unwritten or common law"
        - Story's interpretation (limited to statutes and established local usages) was wrong
            - But, what about the fact that Congress never amended the statute after Swift?
            - See Butler dissent
    - Perverse/undesirable consequences of Swift rule
        - Taixcab case as example
        - Swift rule encourages forum shopping as between state and federal court
            - Parties might change residence merely to get into federal court and seek more favorable law
            - Especially feasible for corporations—just reincorporate elsewhere
        - Swift rule discriminates against state residents:
            - Different rules apply in cases between citizens of different states (in fed. ct.) than in cases between citizens of same state (in state ct.)
        - Result is lack of uniformity, not the uniformity that Storey said justified Swift rule
    - Constitutional concern
        - Basis is unclear: Brandeis doesn't cite any particular constitutional provision
        - Seems to be saying Congress can't impose rules of decision in diversity cases
        - But denies he is holding RDA unconstitutional
        - Says he is merely finding Story's interpretation of the statute improper
            - But if that's the case, what's the point of having the statute at all?
        - This is where Brandeis brings in Holmes & positivism
- Reed's concurrance
    - Criticizes Brandeis for relying on Constitutional ground
    - The issue is one of statutory interpretation: Story got it wrong (Reed agrees with Holmes's positive view of "law")
    - "No one doubts federal power over procedure"
        - Why?
    - How to distinguish between procedure and substance?
- Butler's dissent

    - Criticizes Brandeis for raising the Constitutional issue
        - Doctrine of avoidance
    - Statutory concern
        - Cites statute saying court must notify federal government and permit it to intervene in any case where constitutionality of a federal statute is in question

1.2.2 Guaranty Trust Co. of New York v. York (1945)

Issue

- Whether, in an equity suit, a federal court must apply state statute of limitations if forum state's courts would do so to bar suit

Holding & Rationale

- Yes. Where forum state's court would apply SOL to bar equitable remedy, federal court must do likewise
- Erie does not turn on whether state courts characterize a state-law rule as "Substance" or "Procedure"
    - Pragmatic distinction
        - "Substantive" = "significantly affect the result of a litigation"
            - federal court must follow state law rule
        - "Procedural" = "merely the manner and the means by which a right to recover, as recognized by the State, is enforced"
            - federal courts may follow federal rules
- Frankfurter
    - "[A] federal court adjudicating a state-created right solely because of the diversity of citizenship of the parties is for that purpose, in effect, only another court of the State"
    - Therefore, federal court "cannot afford recovery if the right to recover is made unavailable by the State nor can it substantially affect the enforcement of the right as given by the State"
    - So, a rule is "substantive" if it defines or limits the rights/duties/liabilities of the parties
- Dissent (Rutledge):
    - SOL is "remedial" not substantive
    - Federal courts sitting in equity are supposed to follow "the traditional scope of equity as historically evolved in the English Courts of Chancery"
    - Traditionally, SOL is not an absolute bar to suits in equity
    - Congress retains the power to "to control not only how the federal courts may act, but what they may do by way of affording remedies"—i.e. rejects notion that Erie is constitutional doctrine

- Potential unfairness, because forum state may apply its own SOL, even though the case is governed by another state's substantive law. Allows defendants like the Bank in this case to evade justice

1.2.3 Ragan/Woods/Cohen trilogy (1949)

Ragan v. Merchants Transfer & Warehouse Co.

- State law, not FRCP Rule 3, governs when action is "commenced" for purposes of tolling SOL

Woods v. Interstate Realty

- State rule, barring unqualified business from appearing in state court, applies in federal court diversity action

Cohen v. Beneficial Indust. Loan Corp.

- State rule, requiring bond in shareholder derivative suit, applies in federal diversity action, despite lack of bond requirement in FRCP Rule 23.1

1.2.4 Byrd v. Blue Ridge Rural Elec. Coop., Inc. (1958)

Facts

- Injured worker sued Blue Ridge in negligence

Issue

- Substantive
  - Whether plaintiff is an employee, barred from suit under SC workers' compensation statute?
- Procedural
  - Whether employee status is a question for the court (as under SC law) or the jury

Holding

- Federal court may assign question to jury, contrary to state practice
  - Allocation of the decision is not "integral" to the state statutory scheme
  - Countervailing federal policy (7th Amendment) favors allocation to the jury
- Reconciling Byrd with Guaranty Trust
  - "Outcome determinative" means certain to produce a different outcome
    - Viewed ex ante
  - Erie does not require complete uniformity of practice as between state and federal court

2 The Rules Enabling Act

28 U.S.C. § 2072

> *(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 Statesdistrict courts (including proceedings before magistrate judges thereof) and courts of appeals.*
>
> *(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.*
>
> *[* * *]*

2.1 Hanna v. Plumer (1965)

Issue

- Whether manner of service is governed by FRCP Rule 4 or by state law

Holding & Analysis

- FRCP Rule 4, not state law, applies, where Rule is validly enacted pursuant to Rules Enabling Act and within the scope of federal power under the Constitution.
- REA v. RDA
  - Erie & subsequent cases interpret RDA
    - Not applicable to Rule adopted under REA
  - York "Outcome determinative" test does not apply to REA analysis
- REA
  - Rule is valid if it "really regulates procedure — the judicial process for enforcing rights and duties recognized by substantive law and for justly administering remedy and redress for disregard or infraction of [those rights and duties]"
  - Rule may not "abridge, enlarge or modify the rules of decision by which the court will adjudicate [the] rights [recognized by substantive law]"
- Inquiry under REA
  - Is there a FRCP on point?
  - If so,
    - Was Rule properly adopted according to the process under the REA?
    - Is the rule "rationally capable of classification" as procedural
- Rationale
  - "Twin aims of the Erie rule"
    - Discourage forum shopping
    - Avoid inequitable administration of the laws

    - If following federal rather than state procedure will not raise either of those concerns, federal court may follow federal procedure
        - Will difference in rule motivate forum shopping?
        - Will difference in rule (predictably) lead to unfair differences in outcome?
- Harlan (concurring)
    - Disagrees with majority's characterization of Erie policy
        - More than just forum shopping and inequitable administration of the laws
        - Fundamentally about federalism
    - Alternative inquiry
        - Will the choice of law "substantially affect those primary decisions respecting human conduct which our constitutional system leaves to state regulation"?
    - Interest in predictability
        - Allow parties to make decisions on how to act, based on understanding of the legal consequences
    - Majority test effectively means no Federal Rule will ever be found lacking
        - Advisory Committee, Judicial Conference, & Supreme Court are presumably reasonable in their determination that rule really regulates procedure

2.2 Erie-Hannah Hybrid Analysis

- Is there a Federal Rule on point?
    - If not, apply Erie analysis
- If so, is there a direct conflict between Federal Rule and state law?
    - If so, apply Federal Rule if valid under REA & Constitution
    - If not, assess whether choice of federal rule will encourage forum shopping or promote inequitable administration of law

2.3 Gasperini v. Center for Humanities, Inc_ (1996)

Issue

- Must federal court apply NY CPLR § 5501
  - Appellate court reviews jury award against "materially deviates" standard

Holding

- Applies Erie-Hanna Analysis
  - No FRCP on point
  - Conflicting policy interests:
    - Applying contrary federal standard ("shocks the conscience") would promote forum shopping
    - But strong federal policy—embodied in 7th Amendment—limiting appellate review of jury questions
  - Split the difference:
    - Apply the substantive standard under NY law
    - Follow modified procedure to respect federal interest:
      - Trial court makes determination under NY standard
      - Appellate court reviews for "abuse of discretion"

Dissent (Scalia, Thomas)

- Majority misapplies Erie
  - RDA applies to "Rules of Law"
    - NY statute is "rule of review", not "substantive" in Erie sense
  - Federal policy concern:
    - Applying the state standard "materially disrupt[s] the federal system" and is contrary to "strong federal policy against allowing state rules to disrupt the judge-jury relationship in the federal court"
  - Should be a Hanna/REA case
    - FRCP Rule 59 (motions for new trial) governs
      - Under 59, federal courts apply "seriously erroneous result"/"miscarriage of justice" standard to review of jury verdict
      - Rule 59 is in direct conflict with NY rule
      - Rule 59 is valid under REA
      - Federal court should apply Rule 59, not NY rule

2.4 Shady Grove Orthopedic Assocs. v. Allstate Ins. Co. (2010)

Issue

- Whether suit may be brought in federal court as class action where NY state law prohibits class action in that type of claim?

Holding & Analysis

- Class action is permitted, pursuant to FRCP Rule 23, notwithstanding state law prohibition, where Rule 23 regulates procedure, not substantive rights
- Is Rule 23 in direct conflict with NY statute?
  - Majority
    - Rule 23 gives plaintiff a right to bring case as class action if conditions are met
  - Dissent
    - Rule 23 merely establishes certification procedure; state law may limit right to bring class action
- Does REA analysis focus on Federal Rule alone, or also on character of state law
  - Plurality
    - Focus is on Federal Rule, not state rule.
    - Otherwise applicability of Federal Rule would vary depending on vagaries of state law
  - Concurrence
    - NY rule on its face applies to claims arising under any law, not just NY law.
    - This is plainly procedural, because it does not define rights & remedies under NY law