North Carolina Observations on Federal Jurisdiction under the New Class Action Act

By Jerry Hartzell

In enacting the Class Action Fairness Act of 2005,[1] Congress provided a fundamental redefinition of federal jurisdiction over state-law class actions. The legislation arose from a congressional determination that state courts are not the best forum for deciding class cases with substantial out-of-state effects. The new Act broadens jurisdiction *per se*, but then retracts some of the breadth by providing for federal courts to "decline to exercise" jurisdiction under many circumstances.

Bruno Budrovic/SIS

North Carolina has not been a center of class action litigation,[2] and North Carolina was not perceived to be part of the problem that the new Act was intended to rectify. Nonetheless, in at least one way the new Act could affect North Carolina more than most other states: the "certified question" procedures that the Act's supporters claim will allow states' highest courts to retain an element of control over the meaning of their state's laws is unavailable in North Carolina.

Beyond this, North Carolina will be affected as all states are: more class cases based on state law will either end up in, or will take a detour through, federal court. The most definite result may be uncertainty and delay, as federal courts are asked to interpret the meaning of complicated new rules for determining federal jurisdiction in connection with class cases, and as federal judges determine whether they may or must decline to exercise the jurisdiction that the new Act has conferred.

Congressional Findings about State Courts

As part of the Act, Congress adopted find-

ings that recognize the legitimacy and value of class actions permitting "the fair and efficient resolution of legitimate claims." Congress also found "abuses of the class action device," and that "[c]lass members often receive little or no benefit from class actions." The findings conclude with the observation that forms the basis for the expansion of federal diversity jurisdiction over class cases:

> (4) Abuses in class actions undermine the national judicial system, the free flow of interstate commerce, and the concept of diversity jurisdiction as intended by the framers of the United States Constitution, *in that state and local courts* are—
>
> (A) keeping cases of national importance out of federal court;
>
> (B) sometimes acting in ways that demonstrate bias against out-of-state defendants; and
>
> (C) making judgments that impose their view of the law on other states and bind the rights of the residents of those states."

(Emphasis added.)[3] Thus, according to Congress, "state and local courts" were among the culprits creating class action problems.

North Carolina Courts Not Part of Problem

As an initial observation, it seems fair to conclude that North Carolina courts were *not* among the culprits. Proponents of federal class action legislation were not reluctant to criticize state systems they regarded as unfair, and North Carolina was not a target of their criticisms.

One of the most vigorous proponents of federal class action reform legislation has been the US Chamber of Commerce. For four years its US Chamber Institute for Legal Reform has published an annual assessment of state courts based on a poll of "in-house general counsel or other senior litigators at public corporations."[4] In this poll North Carolina courts have always ranked in the middle of the pack. With a "1" signifying the state legal system corporate counsel regard as best (Delaware) and a "50" the worst (Mississippi), North Carolina has ranked from 16th in 2001 to 20th in 2004. In its treatment of class actions, North Carolina's 2004 ranking was 14th.[5]

One of the US Chamber's allies in its efforts to change the legal landscape affecting business interests has been the American Tort Reform Association,[6] which has used colorful language in identifying "judicial hellholes" in a report issued in 2004. The 2004 report lists nine jurisdictions as "hellholes," such as Madison County in Illinois, the entire state of West Virginia, and, closer to home, Hampton County in South Carolina. Four additional courts, such as the Supreme Court of Utah, were identified as worthy of "dishonorable mention." North Carolina's courts have avoided the ATRA's criticisms.

Moreover, the North Carolina courts do not seem to have engaged in the congressionally identified problem of "making judgments that impose their view of the law on other states and bind the residents of those states." Congress would doubtless have approved of the restraint that North Carolina trial courts are required to observe by the North Carolina Court of Appeals' decision in *Stetser v. Tap Pharmaceuticals*,[7] an opinion by Chief Judge Martin holding that the Due Process Clause bars a North Carolina court from certifying a national class against out-of-state defendants applying other states' laws.[8] The use of a state court in one state to prescribe remedies for out-of-state residents based on their home states' laws (such as, for instance, a North Carolina court adjudicating New York residents' rights to recover based on New York law) was at the heart of the concerns expressed by many commentators on the Act, including the judges in the Federal Judicial Conference.[9]

Federal Court Interpretation of State Law

To the extent the new Act increases the flow of state-law cases to federal court, it can be expected to create strains on "judicial federalism." For cases that do end up staying in federal court, this strain could be particularly acute in North Carolina.

Under our dual state/federal system of law and governance, a state's highest court is supposed to be the ultimate arbiter of the meaning of that state's laws. This, of course, is the familiar *Erie* rule, after *Erie R. Co. v. Tompkins*, 304 U.S. 64 (1938). A federal court faced with a state law issue is tasked with responsibility to make a prediction or "*Erie* guess" as to how the state's highest court would decide the issue.

The body of law that has built up around the "*Erie* guess" process includes a well accepted concept of deference: that federal courts should, if possible, avoid these guesses as to state law when the state-law issue is truly unclear and the issues involved are significant. A recent Eleventh Circuit case states the principle: "Where there is doubt in the interpretation of state law, a federal court may certify the question to the state supreme court to avoid making unnecessary *Erie* guesses and to offer the state court the opportunity to interpret or change existing law."[10] The phrase "interpret or change" seems noteworthy: we all recognize that courts, particularly appellate courts of final jurisdiction, not only "interpret" the law, they also "change" it.[11]

Both federal judges, speaking through the Federal Judicial Conference, and state judges, speaking through the Conference of Chief Justices, expressed concern about the effect of increased federal court diversity jurisdiction on judicial federalism. The Conference of Chief Justices referred to earlier versions of the Act as representing "an unwarranted incursion on the principles of judicial federalism underlying our system of government."[12] In 1999 the Federal Judicial Conference opposed federal class action jurisdictional changes "based on concerns that the provisions would add substantially to the workload of the federal courts and [were] inconsistent with principles of federalism."[13]

In March of 2003, however, the Federal Judicial Conference softened its opposition, so long as "federal courts are not unduly burdened and states' jurisdiction over in-state class actions is left undisturbed . . . ." In fact, such state court jurisdiction over "in-state class actions" was not "left undisturbed." The Act expands jurisdiction, but creates mandatory and discretionary rules under which the federal courts will or may "decline to exercise" the jurisdiction they possess.

For state-law cases that do remain in the federal courts, the Senate committee report gave one suggestion for preserving judicial federalism—the use of a "certified question" process:

> [I]f federal court judges are not familiar with state law on a particular issue, they have the authority to ask a state court to "certify" a question of law e.g., to advise them how a state's laws should be applied in an uncharted situation. This procedure allows the federal courts to apply state law appropriately and gives states the ability to manage their legal systems without becoming bound by other states' interpretations of their laws.[14]

Unfortunately, the certified question process (whatever its merits) is unavailable in North Carolina: North Carolina is one of two states that does not permit this procedure.[15]

The Upcoming Debate About What the New Act Means

Traditionally, rules governing federal jurisdiction have at least had the appearance of being relatively clear, and have been interpreted relatively consistently. Certainly there are arcane issues that emerge in connection with the "arising under" and diversity language of 28 U.S.C. §§ 1331 and 1332. However, the basic statutory standard for federal jurisdiction is simply stated and reasonably well understood.

In contrast, the new class action federal jurisdiction statute is quite complex, and its structure and syntax seem to be modeled after the Internal Revenue Code. Class actions based on state law will (with some exceptions) be subject to federal jurisdiction so long as $5 million or more is in controversy, and so long as there is some minimal element of diversity. The diversity element will be far less meaningful than formerly, satisfied if any plaintiff is a citizen of a state different than any defendant. The Act creates exceptions to this grant of federal jurisdiction.

As noted above, the Act also creates another category of cases as to which federal judges are *required* to "decline to exercise" jurisdiction, and it creates yet another category of cases as to which federal judges *may* decline to exercise jurisdiction, prescribing multi-factor tests for each. These rules are too intricate to permit reasonable summary. In short, however, the greater the extent to which a class case concerns North Carolina plaintiffs, North Carolina law and North Carolina defendants, the greater the likelihood that the case will be remanded or relegated to state court.

While a succinct summary of the jurisdictional provisions of the Act may be impossible, it is easy to conclude that these provisions are complicated, that they break much new ground, and that interpretation of the Act will consume judicial resources for a number of years.

Judicial Resources

Responding to a criticism that the new Act would "result in delays for injured consumers," the Senate report dismissed this criticism as stemming from "baseless concerns about the federal courts' caseload."[16] I have had the privilege of hearing two federal judges, both from districts outside North Carolina, speak publicly about the new Act. These federal judges were indeed concerned about their case loads, and their observations certainly seemed to be based on solid information that the judges knew from first-hand experience.

A recent issue of *The Third Branch*, the "newsletter of the federal courts,"[17] describes the federal courts' substantial resource problems (increasing caseload, reduced funding), and describes the anticipated case load from the new Act as a contributing factor. However while the federal courts' budget problems are real, the federal courts in North Carolina are not among the district courts with the most acute case loads. According to data published by the Administrative Office of the US Courts, using pending cases per judgeship as the measure of docket load, the Eastern District of North Carolina was the 25th most congested out of 94 districts.[18] The Middle and Western Districts ranked 67th and 64th respectively.

Conclusion

The new Act will accomplish the widely shared objective of reducing the risk that a state court in one state will enter a ruling affecting plaintiffs and defendants from other states in cases based on the other states' laws. The Act reduces this risk with a complex set of rules that will permit judicial discretion in some circumstances and will require federal judges to "decline to exercise" jurisdiction in other cases. Whether the benefits of the new Act will outweigh the cost in legal resources arising from its complexity and uncertainties remains to be seen. From a purely North Carolina perspective, the Act seems to have been unnecessary. Congress, of course, does not legislate from a purely North Carolina perspective. ■

Jerry Hartzell is a partner with Hartzell & Whiteman, LLP, in Raleigh. Over the past 27 years the author has participated as counsel for plaintiffs in six class cases or groups of cases, most of which have been in state court.

Endnotes

1. Public Law 109-2 (enacted February 10, 2005).
2. As to the class action case load in federal courts in North Carolina, data published by the Administrative Office of the United States Courts indicates there were 5,179 (putative) class cases pending in the federal courts as of September 30, 2004. The federal district courts with the largest number of class cases were the Southern District of New York (1,063 cases), the Northern District of California (561 cases), the District of Maryland (431 cases) and the Northern District of Illinois (275 cases). In contrast, the Eastern, Middle, and Western Districts of North Carolina had pending nine, ten, and five class cases, respectively. Administrative Office of the United States Courts, Judicial Business 2004, Table X-4 (available on the web at www.uscourts.gov/judbus2004/contents.html).
3. Class Action Fairness Act of 2005, section 2.
4. 2005 State Liability Systems Ranking Study, p. 5 (www.instituteforlegalreform.org/harris/pdf/HarrisPoll2005-FullReport.pdf)
5. www.instituteforlegalreform.org/harris/pdf/HarrisPoll2005-Summary.pdf, Table 9.
6. www.atra.org/. A link to ATRA's study appears in the Chamber's web site. http://www. uschamber.com/press/releases/2004/december/04-163.htm.
7. 165 N.C. App. 1, 598 S.E.2d 570 (2004).
8. 165 N.C. App. at 22-25, 598 S.E.2d at 585-87.
9. See letter of March 26, 2003, from Leonidas Ralph Mecham to Senator Orin Hatch, transmitting and explaining the Judicial Conference's unanimously adopted recommendation dated March 18, 2003. A copy of this letter appears on the Association of Trial Lawyers of America website at http://www.atla.org/homepage/fjc.pdf.
10. *Tobin v. Michigan Mut. Ins. Co.*, 398 F.3d 1267, 1274 (11th Cir. 2005).
11. *See, e.g., Virmani v. Presbyterian Health Services Corp.*, 350 N.C. 449, 472-73, 515 S.E.2d 675, 691 (1999).
12. See letter of March 28, 2002, from Annice M. Wagner, president of the Conference of Chief Justices, to Senator Patrick M. Leahy, chairman of the Senate Committee on the Judiciary, available at http://www.atla.org/homepage/ccj.pdf.
13. See letter cited in note 10, at p. 2.
14. Senate Report 109-14, Section VII, response to "Critics Contentions no. 8" (available at http://frwebgate.access.gpo.gov/cgi-bin/useftp.cgi?IPaddress=162.140.64.21&filename=sr014.pdf&directory=/diskb/wais/data/109_cong_ reports).
15. Jessica Smith, "Avoiding Prognostication and Promoting Federalism: The Need for An Inter-Jurisdictional Certification Procedure in North Carolina," 77 N.C.L. Rev. 2123 (1999). A quick update to Ms. Smith's research indicates there are now only two states that do not have a certified question procedure: North Carolina and New Jersey.
16. Senate Report 109-14, Section VII, response to "Critics Contention no. 7."
17. *The Third Branch*, Vol. 37, Number 4-April 2005 (available at http://www.uscourts.gov/ttb/apr05ttb/hardships/index.html
18. Federal Court Management Statistics 2004 (available at www.uscourts.gov/cgi-bin/cmsd2004.pl. That is, there were 24 federal districts with more cases per judgeship than the Eastern District. Ranking based on "weighted filings" (filings adjusted for case complexity) are roughly comparable.