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LIVING IN THE SHADOW: CLASS  
ACTIONS IN NEW YORK AFTER *SHADY  
GROVE*

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**Abstract:** In *Shady Grove Orthopedic Associates, P.A. v. Allstate Ins. Co.*, the Supreme Court wrestled with conflicting state and federal rules governing class action certification in a diversity case. Section 901(b) of New York’s Civil Procedure Law and Rules prohibits certification of class actions in which the plaintiff seeks to recover a “penalty,” unless specifically authorized by statute. Federal Rule of Civil Procedure 23 has no such limitation. Plaintiffs brought a class action in federal district court to recover statutory interest pursuant to a New York law that imposed an interest rate on insurers who delayed payments. The interest payments were considered a “penalty” for the purposes of § 901(b). Thus, a class action was not available in New York state court, but the case could proceed in the federal court if Federal Rule 23 applied. The Supreme Court held in *Shady Grove* that the federal rule governed and that the class action could proceed. Consequently, future claims based on statutory penalties will qualify as class actions in federal but not in New York courts. Because the typical penalty recoveries authorized by New York law are too small to support individual actions, this article argues that the resulting inequitable treatment of claimants is unfair and violates the spirit of *Erie* and its progeny. New York should repeal § 901(b) in its entirety, or should decide on a statute-by-statute basis which, if any, should remain extant.

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## LIVING IN THE SHADOW: CLASS ACTIONS IN NEW YORK AFTER SHADY GROVE

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### INTRODUCTION

lass actions are provided for in Rule 23 of the Federal Rules of Civil Procedure and in Article 9 of the New York Civil Practice Law and Rules (“CPLR”).<sup>1</sup> In many respects, the federal and state class action provisions are similar. Both allow one or more members of a class to sue as representatives of the class.<sup>2</sup> Both require the class to meet standards of numerosity of class members, commonality of questions of law or fact, typicality of claims or defenses of the representative party, and fair and adequate representation by the representative parties.<sup>3</sup> It has been said that the CPLR, which was adopted in 1975, “was modeled to a large extent on Fed. R. Civ. P 23 . . . .”<sup>4</sup> Nonetheless, the federal and New York class action rules diverge in one respect that is relevant here. CPLR § 901(b) prohibits certification of a class in an action “to recover a penalty, or minimum measure of recovery created or imposed by statute . . . .”<sup>5</sup> Rule 23 of the Federal Rules of Civil Procedure contains no such restriction.<sup>6</sup>

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<sup>1</sup> FED. R. CIV. P. 23; N.Y. C.P.L.R. Art. 9 (McKinney 2014) [hereinafter C.P.L.R.].

<sup>2</sup> FED. R. CIV. P. 23(a); C.P.L.R. 901(a).

<sup>3</sup> FED. R. CIV. P. 23; C.P.L.R. 901. *See* DAVID D. SIEGEL, *NEW YORK PRACTICE* § 141 251 (5th ed. 2011).

<sup>4</sup> 3 JACK B. WEINSTEIN, HAROLD L. KORN & ARTHUR R. MILLER, *NEW YORK CIVIL PRACTICE* 901.03 (David L. Ferstendig, ed., 2014).

<sup>5</sup> C.P.L.R. 901(b) (“Unless a statute creating or imposing a penalty, or a minimum measure of recovery specifically authorizes the recovery thereof in a class action, an action to recover a penalty, or minimum measure of recovery created or imposed by statute may not be maintained as a class action.”); *see also, e.g.*, *Sperry v. Crompton Corp.*, 8 N.Y.3d 204, 209 (2007) (Plaintiff sought to certify a class in an antitrust case against chemical manufacturers allegedly involved in price fix-

Responding to this mismatch between state and federal procedure, the Supreme Court in 2010 held in *Shady Grove Orthopedic Associates, P.A. v. Allstate Insurance Co.* that federal courts should not apply CPLR § 901(b) in a diversity case.<sup>7</sup> Thus, the application of § 901(b) now varies depending on whether the case is bought in a federal or state court.

In response to *Shady Grove*, two New York Second Department Appellate Division judges have called for the repeal of CPLR § 901(b).<sup>8</sup> They argue that the *Shady Grove* decision makes CPLR § 901(b) “relatively useless” and that it encourages forum shopping by claimants who qualify for diversity jurisdiction.<sup>9</sup> Further, the federal/state divide on this issue creates arbitrary inequities for plaintiffs in New York who are unable to meet the jurisdictional requirements of the federal courts. For the reasons discussed below I recommend repeal of CPLR § 901(b).

#### BACKGROUND

The passage of CPLR § 901 in 1975 had the intent and effect of liberalizing opportunities to commence a class action in the state.<sup>10</sup> The passage was not without resistance: Some business groups argued that class actions should not be permitted to seek statutory penalties or minimum recoveries because they could allow “excessively harsh results.”<sup>11</sup> This led to the addition of § 901(b). “Hence, the final bill . . . was the result of a compromise among competing interests.”<sup>12</sup>

Because no prohibition of class actions similar to CPLR § 901(b) is found in Federal Rule 23, *Shady Grove* presented the Supreme Court with a classic “*Erie*” problem.<sup>13</sup> *Erie* and its progeny prescribe the law federal courts must apply when sitting in diversity if state and federal rules diverge.<sup>14</sup> The basic *Erie*

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ing. New York’s antitrust statute, General Business Law § 340, provides for treble damages, which the court deemed a penalty, thus precluding certification under § 901(b)).

<sup>6</sup> See *Shady Grove Orthopedic Assocs., P.A. v. Allstate Ins. Co.*, 559 U.S. 393, 397 (2010) (“Rule 23 provides a one-size-fits-all formula for deciding the class-action question”).

<sup>7</sup> *Id.* at 393.

<sup>8</sup> Thomas A. Dickerson et al., *New York State Class Actions: Making It Work-Fulfilling the Promise: Some Recent Positive Developments and Why CPLR 901(b) Should Be Repealed*, 77 ALB. L. REV. 59, 69–70 (2014).

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

<sup>10</sup> See *Sperry*, 8 N.Y.3d at 210–11.

<sup>11</sup> *Id.* at 211.

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

<sup>13</sup> *Erie R.R. Co. v. Tompkins*, 304 U.S. 64, 78–79 (1938) (except in matters governed by the federal constitution or laws, federal courts must apply state law in diversity cases).

<sup>14</sup> See *Gasperini v. Ctr of Humanities, Inc.*, 518 U.S. 415 (1996) (a New York law specifying the standard by which jury verdicts are reviewed governs in diversity cases); *Hanna v. Plumer*, 380 U.S. 460 (1965) (federal procedural rules are generally controlling in cases brought in federal court, thus, the applicable Federal Rule of Civil Procedure governs the method of service for diversity cases in federal courts); *Guaranty Trust Co. v. York*, 326 U.S. 99 (1945) (the outcome of litiga-

rule prescribes that “federal courts sitting in diversity apply state substantive law and federal procedural law.”<sup>15</sup> The issue in *Shady Grove* was whether the federal courts should apply the proscription of CPLR § 901(b) even though Federal Rule 23 did not have a similar limitation on class actions.<sup>16</sup>

The *Shady Grove* plaintiffs had commenced a class action in the Eastern District of New York on behalf of health care providers who sought statutory interest payments allegedly owed because the defendant insurance company had not paid underlying claims within the time required by New York law.<sup>17</sup> Federal jurisdiction was based on diversity.<sup>18</sup> The District Court dismissed the action, holding that the case could not be brought as a class action because the statutory interest plaintiffs sought was a “penalty” under § 901(b), and that the latter provision governed diversity cases in federal as well as state courts.<sup>19</sup> Therefore, held the District Court, the individual claim of the class representative did not meet the amount in controversy required by 28 U.S.C. § 1332.<sup>20</sup> Federal jurisdiction thus turned on whether CPLR § 901(b) was applicable to purported federal class actions.<sup>21</sup>

The Supreme Court reversed the courts below, holding that Rule 23 was procedural and that CPLR § 901(b) was in conflict and could not apply in federal courts.<sup>22</sup> In dissent, Justice Ginsburg, on behalf of three other members of the Court, argued that the Court was insufficiently sensitive to the interests of New York and read § 901(b) and Federal Rule 23 so as not to come into conflict.<sup>23</sup> On this account, § 901(b) is a substantive rule, not a procedural rule, and should apply.<sup>24</sup>

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tion in the federal courts should be substantially the same as it would be if tried in state court, insofar as legal rules determine the outcome).

<sup>15</sup> *Gasperini*, 518 U.S. at 427.

<sup>16</sup> See *Shady Grove Orthopedic Assocs., P.A. v. Allstate Ins. Co.*, 559 U.S. 393, 396 (2010).

<sup>17</sup> *Id.* at 397.

<sup>18</sup> *Id.* (“*Shady Grove* filed this diversity suit in the Eastern District of New York to recover the unpaid statutory interest.”).

<sup>19</sup> *Shady Grove Orthopedic Assocs., P.A. v. Allstate Ins. Co.*, 466 F. Supp. 2d 467, 471–72 (E.D.N.Y. 2006), *aff’d*, 549 F. 3d 137 (2d Cir. 2008), *rev’d*, 559 U.S. 393 (2010).

<sup>20</sup> *Id.* at 475 (“Because plaintiff *Shady Grove* concedes that its individual claim does not meet the amount in controversy requirement under 28 U.S.C. § 1332, this court has no diversity jurisdiction to consider it.”); see also 28 U.S.C.A. § 1332(a) (“The district courts shall have original jurisdiction of all civil actions where the matter in controversy exceeds the sum or value of \$75,000, exclusive of interests and costs . . .”).

<sup>21</sup> See *Shady Grove*, 559 U.S. at 398.

<sup>22</sup> *Id.* at 393.

<sup>23</sup> *Id.* at 446 (Ginsburg, J., dissenting) (“The Court, I am convinced, finds conflict where none is necessary. Mindful of the history behind § 901(b)’s enactment, the thrust of our precedent, and the substantive-rights limitation in the Rules Enabling Act, I conclude, as did the Second Circuit and every District Court to have considered the question in any detail, that Rule 23 does not collide with § 901(b).”).

<sup>24</sup> *Id.* at 445 (Ginsburg, J., dissenting) (“New York’s decision . . . to block class-action proceedings for statutory damages therefore makes scant sense, except as a means to a manifestly substantive end . . .”).

## ARGUMENTS FOR REPEAL

In the wake of *Shady Grove*, plaintiffs prohibited from seeking class action certification in New York courts because of CPLR § 901 will pursue their claims in federal court if they can meet the jurisdictional requirements.<sup>25</sup> This raises the dual problems of forum shopping<sup>26</sup> and inequitable application of the laws, running afoul of both the twin aims of *Erie*.<sup>27</sup>

The current post-*Shady Grove* regime incentivizing forum shopping is undesirable because plaintiffs who can assert federal jurisdiction will do so. This will require the federal courts to parse underlying issues of substantive New York law that would better be decided by New York's own courts. Ironically, therefore, one argument for repealing CPLR § 901(b) is that after repeal New York plaintiffs who could assert federal jurisdiction will not necessarily invoke that option. We can expect that given the choice, many parties will prefer state courts. This not only protects New York's sovereignty, it means that the judge most likely to be familiar with state law will be the one applying it.

Parties who “shop” for the federal forum may in some cases engage in the kind of manipulation *Erie* sought to end.<sup>28</sup> In *Erie*, the Court singled out a case where a party incorporated in Kentucky re-incorporated in Tennessee solely to achieve diversity with a potential adversary, and thus avoid the unfavorable Kentucky common law, as an example of the lengths parties will go to get into federal court.<sup>29</sup> It would be unfortunate if similar shenanigans result from a party seeking to avoid New York courts and the bar of CPLR § 901(b).

Inequity arises because plaintiff class representatives with claims for statutory penalties will be able to maintain a class action if federal jurisdiction is available, but others similarly situated who cannot invoke federal jurisdiction will not be able to bring their case.<sup>30</sup> There is no apparent substantive justification for the difference: whether federal jurisdiction is available in a particular case has no relation to the substantive merits. As the Court stressed in *Erie*,

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<sup>25</sup> See Dickerson, *supra* note 8, at 69–70.

<sup>26</sup> *Shady Grove*, 559 U.S. at 415 (“We must acknowledge the reality that keeping the federal-court door open to class actions that cannot proceed in state court will produce forum shopping”).

<sup>27</sup> See *Hanna v. Plumer*, 380 U.S. 460, 468 (1965) (identifying the “twin aims of the *Erie* rule: discouragement of forum-shopping and avoidance of inequitable administration of the laws.”).

<sup>28</sup> *Id.*

<sup>29</sup> *Erie R.R. Co. v. Tompkins*, 304 U.S. 64, 73–74 (1938) (discussing *Black & White Taxicab & Transfer Co. v. Brown & Yellow Taxicab & Transfer Co.*, 276 U.S. 518 (1928)).

<sup>30</sup> *Shady Grove* itself is a good example. As Justice Ginsburg notes in her dissent, the recovery that *Shady Grove Orthopedic Associates, P. A.*, the class representative, could have obtained suing as an individual plaintiff would be no more than \$500, whereas the class could recover about \$5 million. *Shady Grove*, 559 U.S. at 436–37 (Ginsburg, J., dissenting). Lawyers' fees and other expenses would obviously make it prohibitive to bring an action of this size for a single plaintiff.

“Thus, the doctrine [of *Swift v. Tyson*] rendered impossible equal protection of the law.”<sup>31</sup> Here, the combination of *Shady Grove* and the continued existence of CPLR § 901(b) renders impossible the equal protection of law.

It might be argued that the same evils of forum shopping and inequitable application of laws arise in other cases in which a federal rule of procedure trumps a state rule that continues to apply in state litigation.<sup>32</sup> I hardly suggest that all such state rules be amended to erase the difference. But § 901(b) presents an unusual case: unlike most *Erie* cases, the § 901(b) prohibition as a practical matter prevents the bringing of many claims *ab initio*. If CPLR § 901(b) applies and federal jurisdiction is wanting, the plaintiff will not be able to bring the case anywhere as a practical matter. In the general run of cases in which the Court has held a federal rule applicable in opposition to a contrary state rule, the difference will be purely procedural and will not bar an entire class of grievants from seeking relief.

*Hanna v. Plumer* is an example.<sup>33</sup> The issue there was whether the federal court sitting in diversity should apply the Massachusetts rule requiring that the administrator of an estate be served by in-hand delivery or the federal rule of service that allowed service on a person of suitable age and discretion.<sup>34</sup> If the latter applied, plaintiff had made proper service.<sup>35</sup> If the former, service was invalid and the action would be barred by the statute of limitations.<sup>36</sup> Although the difference between the state and federal rule was “outcome determinative” in the particular case,<sup>37</sup> the ruling would not bar or enable an entire group of claimants: few if any plaintiffs would make a forum choice based on the method of service required. In any event, the *Hanna* result does not separate an entire class of plaintiffs preferred simply on the availability of federal jurisdiction.

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<sup>31</sup> *Erie*, 304 U.S. at 75.

<sup>32</sup> See *Shady Grove*, 559 U.S. at 418–21 (Stevens, J., concurring) (reviewing various applications of the *Erie* rule).

<sup>33</sup> 380 U.S. 460 (1965) (federal rule governing method of process service applies in diversity action even though application of the state rule would lead to a different outcome of the action; the federal rule regulates procedure and was authorized by the Rules Enabling Act). For another example, see *Byrd v. Blue Ridge Rural Elec. Coop.*, 356 U.S. 525 (1958) (federal rule governs availability of a jury trial for action brought in federal court).

<sup>34</sup> *Hanna*, 380 U.S. at 461–62.

<sup>35</sup> *Id.* at 461.

<sup>36</sup> *Id.* at 461–62.

<sup>37</sup> *Id.* at 466 (“In this case, a determination that the Massachusetts service requirements obtain will result in an immediate victory for respondent. If on the other hand, it should be held that Rule 4(d)(1) is applicable, the litigation will continue . . .”).

It is worth noting that when confronted with a state rule that would substantially impede the litigation of a particular class of claims, the Supreme Court has generally required the federal rule to give way.<sup>38</sup> As a result, in those cases there is no different treatment of litigants based on the forum in which the case was brought. From that perspective, *Shady Grove* is an outlier because, although § 901(b) *does* substantially limit a class of litigation, the Court has required the state to give way to avoid inequitable results. The Legislative decision that some cases should not be brought as class actions is defensible. But it is not defensible that some claimants can be discriminated against in that way by the happenstance of the rules of federal court jurisdiction.

To be sure, repeal would undo the compromise that led to the passage of CPLR article 9 and liberalized class action practice in New York.<sup>39</sup> In Justice Ginsburg's *Shady Grove* dissent, she writes that New York has a "legitimate interest in keeping certain monetary awards reasonably bounded."<sup>40</sup> This legitimate interest is undermined by *Shady Grove* because some plaintiffs will use the case to avoid CPLR § 901(b). The better and fairer way to implement the goal of reasonably bounding certain monetary awards is suggested by the same dissent.<sup>41</sup> Justice Ginsburg opined that rather than prohibit class actions "wholesale" in penalty cases, "[t]he New York Legislature could have embedded the elimination in every provision creating a cause of action for which a penalty is authorized."<sup>42</sup> Presumably, had New York done so, or were to do so now, the limit would not collide with Federal Rule 23 and would be applied in federal cases. The legislative exercise contemplated would require the Legislature to evaluate each statutory creation of penalties on its own merits. It may well be that some, but not all, penalty-imposing rules would survive such substantive review. By coupling repeal of CPLR § 901(b) with such a review, the Legislature would create a more rational regime governing penalty availability than that existing at present.

#### CONCLUSION

The rule of law should not operate arbitrarily, but that is exactly what the continuing existence of CPLR § 901(b) imposes on New York citizens. This unfortu-

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<sup>38</sup> See *Cohen v. Beneficial Indus. Loan Corp.*, 337 U.S. 541, 557 (1949) (holding that a federal court in New Jersey was bound to apply a state statute that imposes on the plaintiff liability of the cost of the defense if plaintiff loses the derivative shareholder's case); *Woods v. Interstate Realty Co.*, 337 U.S. 535 (1949) (holding that a federal court must apply state law that prohibits foreign corporations from maintaining actions if they have not properly qualified to do business there).

<sup>39</sup> See *Sperry v. Crompton Corp.*, 8 N.Y.3d 204, 211 (2007).

<sup>40</sup> *Shady Grove Orthopedic Assocs., P.A. v. Allstate Ins. Co.*, 559 U.S. 393, 437 (2010) (Ginsburg, J., dissenting).

<sup>41</sup> *Id.* at 447.

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

nate inequitable application of the law is compounded by the incentive to forum shop the current regime creates. A careful legislative review of New York's various statutes authorizing the award of penalties combined with the re-drafting of the law recommended by Justice Ginsburg<sup>43</sup> would eliminate these evils.



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<sup>43</sup> See *infra* text accompanying note 40.