

Shady Grove And State Limits On Competition Claims

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The Supreme Court's recent decision in *Shady Grove Orthopedic Associates, P.A. v. Allstate Insurance Co.*, 130 S. Ct. 1431, 176 L. Ed. 2d 311 (2010), means that federal courts can hear certain state-law claims as class actions, even if class-action treatment would be prohibited under state law. For competition law practitioners, the decision requires a re-examination of state-law restrictions on competition claims.

Shady Grove grew out of a dispute between a medical provider and an insurance company over New York's statutory penalty for the late payment of medical claims. The provider sued the insurance company for a penalty amount (about \$500) on the allegedly late-paid medical claims, and also sued on behalf of a class of all other persons who were owed a statutory penalty from the insurance company. The suit was filed in federal court under the relaxed diversity jurisdiction requirements for class actions created by the Class Action Fairness Act of 2005 ("CAFA," 28 U.S.C. §1332(d)(2)).

The district court dismissed the complaint on the grounds that a separate New York statute, N.Y. Civ. Prac. Law Ann. § 901(b), expressly prohibited claims for statutory penalties from proceeding as class actions. The Second Circuit affirmed, finding that §901(b)'s class action block represented a "substantive" rule of state law that must be applied by a district court sitting in diversity. See 549 F.3d 137 (2nd Cir. 2008).

The Supreme Court, by a 5-4 split, reversed, holding that §901(b)'s class action block conflicted with the class action requirements of Rule 23 of the Federal Rules of Civil Procedure. Rule 23, as a valid regulation of procedure in federal court, provides a "one-size-fits-all formula for deciding the class action question." 176 L. Ed. 2d at 317. Because New York's §901(b) attempted to answer the same question – whether a particular claim could be maintained as a class action – the state law could not be applied by the district court.

Justice Scalia wrote the opinion of the Court, and was joined in the judgment of reversal by Chief Justice Roberts and Justices Stevens, Thomas, and Sotomayor. In a separate portion not joined by a majority of the Court, Justice Scalia acknowledged the effect of the Court's decision: "The short of the matter is that a Federal Rule governing procedure is valid whether or not it alters the outcome of the case in a way that induces forum shopping." 176 L. Ed. 2d at 329. Justice Stevens concurred that New York's §901(b) should not be applied to block the class action claim at issue, but articulated a different test: "A federal rule, therefore, cannot govern a particular case in which the

rule would displace a state law that is procedural in the ordinary use 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.” 176 L. Ed. 2d at 333. Finding that certifying a class in this diversity case would not “abridge, enlarge or modify” New York’s substantive rights or remedies, Justice Stevens concurred in the judgment. *Id.* Justice Ginsberg, joined by Justices Alito, Kennedy, and Breyer, dissented, offering a different gloss on the interaction between Rule 23 and New York’s §901(b): “Sensibly read, Rule 23 governs procedural aspects of class litigation, but allows state law to control the size of a monetary award a class plaintiff may pursue.” *Id.* at 347 – 348. Under this view, there would be no collision between Rule 23’s directives on the conduct of class action and a state’s limitations on the remedy for violation of a state law.

A few states have in place statutory provisions addressing whether certain unfair competition claims may be maintained as class actions. Because these provisions, like New York’s §901(b), may “attempt to answer the same question” as Rule 23, it is possible that, after *Shady Grove*, these statutes may not be applicable in diversity cases. In New York, for example, §901(b) has previously been applied by the state’s courts to block class action claims for treble damages under New York’s antitrust statute, the Donnelly Act (General Business Law §340). See *Sperry v. Crompton Corp.*, 863 N.E.2d 1010 (N.Y. 2007). After *Shady Grove*, federal courts sitting in diversity appear to have no bar to hearing treble-damage claims under the Donnelly Act.

Additionally, in Illinois, the state’s antitrust law provides that indirect purchasers may sue for damages individually, however, class action claims on behalf of indirect purchasers may only be brought by the state attorney general. See 740 Ill. Comp. Stat. 10/7(2) (“no person shall be authorized to maintain a class action in any court of this State for indirect purchasers asserting claims under this Act, with the sole exception of this State’s Attorney General . . .”). *Shady Grove* calls into question the validity of Illinois’ restraint on indirect-purchaser class actions.

It remains to be seen how federal courts will resolve these novel issues in the wake of *Shady Grove*. Since the passage of CAFA, federal courts have increasingly become the only available forum for private litigants to assert state-law class action claims. The decision in *Shady Grove* – itself the product of an unusual alliance among the justices – demonstrates one surprising consequence of CAFA: the federal courts can now hear certain state-law claims as class actions, even if a state court could never do so.

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