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Donnelly Act Class Claimants Given New Lease on Life

Plaintiffs get around the restriction of CPLR §901(b).

Barbara J. Hart and Kesav M. Wable  
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The U.S. Supreme Court's recent decision in Shady Grove Orthopedic Associates, P.A. v. Allstate Insurance Co., —S.Ct.—, 2010 WL 1222272 (March 31, 2010) ("Shady Grove") is another chapter in an ironic tale of unintended consequences. The story involves a federal law (CAFA, the Class Action Fairness Act of 2005), enacted to rein in state based class actions that ironically set the stage for a Supreme Court decision that will permit class actions under New York state's antitrust statute, the Donnelly Act (act), where such suits had previously been prohibited.

As a result, the Supreme Court has inadvertently, through CAFA, accomplished what the New York state Legislature tried but failed to do, vindicating the Donnelly Act's purpose and that of a 1998 amendment to the act creating standing for indirect purchasers.

In Shady Grove the question presented was whether New York's Civil Practice Law §901(b), which prohibits class actions in suits seeking penalties or statutory minimum damages, is preempted by Rule 23(a) of the Federal Rules of Civil Procedure governing the maintainability of class actions in federal court. Writing for a plurality of the Court, Justice Antonin Scalia answered this question in the affirmative.

The 5-4 decision dramatically changes the landscape for class action litigants in New York, and in particular for those plaintiffs seeking relief under the Donnelly Act, by making it possible to bring such actions on behalf of a class.

Before the Shady Grove decision, the courts of New York had historically concluded that Donnelly Act claims could not be brought on a classwide basis by operation of CPLR §901(b), which provides that "[u]nless 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."

The Donnelly Act permits those who sustain damages as a result of certain antitrust violations to recover treble damages along with costs and attorneys' fees. New York courts have historically concluded that treble damages are punitive in nature. Consequently, New York courts have summarily disallowed class actions for treble damages under the Donnelly Act, finding that it imposes a "penalty" and thus falls within the exclusion of CPLR §901(b).

Then Congress passed CAFA, which created mandatory federal jurisdiction for class actions that meet certain criteria. Under CAFA, the proper jurisdiction for most Donnelly Act class actions is now the federal courts, where class action procedure is governed by federal rule 23. Rule 23 differs from New York's class action statute and contains no provision that prohibits class actions for punitive damages.

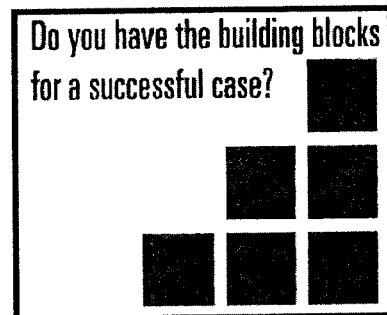
The 'Shady Grove' Decision

Shady Grove Orthopedic Associates, P.A., was the assignee of health insurance benefits payable to a patient suffering from injuries arising out of a motor vehicle accident. Shady Grove, 2010 WL 1222272, at \*3.

The patient used her benefits under a policy issued in New York by Allstate Insurance Co. as partial payment for the care she received. Id. When Shady Grove tendered a claim for the assigned benefits, Allstate had 30 days to pay the claim or deny it under New York law. Id. Allstate's payment was tardy and Allstate refused to pay the statutory interest that accrued on the overdue benefits. Id.

Shady Grove filed a diversity suit in the Eastern District of New York to recover the unpaid statutory interest on behalf of itself and a class of others to whom Allstate owes interest. Id. Finding that statutory interest is a "penalty" under CPLR §901(b), the district court held that the proposed class action was prohibited by New York law and dismissed the suit for lack of jurisdiction. 466 F.Supp.2d 467 (E.D.N.Y. 2006).

The Second Circuit affirmed and found that there was no conflict between federal rule 23 and CPLR §901 (b). 549 F.3d 137, 143-144 (2008). It held that Rule 23 concerns only the criteria for determining



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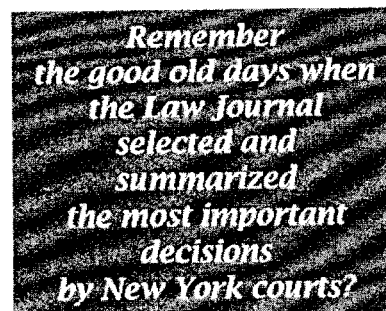
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whether a given class can and should be certified, whereas §901(b) addresses "an antecedent question: whether the particular type of claim is eligible for class treatment in the first place..." *Shady Grove*, 2010 WL 1222272, at \*4. Allstate adopted this rationale in its appeal to the Supreme Court. *Id.*

Justice Scalia found this distinction between eligibility and certifiability to be artificial. *Id.* ("[R]elabeling Rule 23(a)'s prerequisites 'eligibility criteria' would obviate Allstate's objection—a sure sign that its eligibility-certifiability distinction is made-to-order"). He further found that both Rule 23 and §901(b) sought to govern the same issue, namely "the procedural right to maintain a class action." *Id.* at 5, n. 4.

Therefore, given that Rule 23 "unambiguously authorizes any plaintiff in any federal civil proceeding, to maintain a class action if the Rule's prerequisites are met," *id.* at 7, it could not be construed in such a way that it could peaceably coexist with §901(b). *Id.*

Scalia next addressed whether Rule 23 falls within the statutory authorization conferred by the Rules Enabling Act, the organic statute that authorizes the Supreme Court to promulgate rules of procedure. 28 U.S.C. §2072(a). This authorization is limited however, by §2072(b), which states that the rules "shall not abridge, enlarge or modify any substantive right." 28 U.S.C. §2072(b).

In this respect, Scalia disposed of Allstate's arguments that focused on whether the rule affected a litigant's substantive rights, noting that "most procedural rules do." *Id.* at 8. The appropriate test is whether the rule "really regulat[es] procedure—the judicial process for enforcing rights and duties recognized by substantive law [...]." *Id.* citing *Sibbach v. Wilson & Co.*, 312 U.S. 1, 14 (1941). More specifically, Justice Scalia cautioned against an analysis predicated on whether the state law at issue, in this case, CPLR §901(b), was either substantive or procedural because this would lead to an inconsistent application of the federal rules. *Id.* at 9.<sup>8</sup>

Applying the standard articulated in *Sibbach*, the Court found that Rule 23 was not unlike other procedural rules allowing multiple claims to be litigated together in a single suit and, accordingly found §901(b) to be preempted by a valid federal rule. *Id.* at 8-9

#### Act's 1998 Amendment Didn't Help

It is not a novel observation that somewhere between the Assembly floor and the bench, the legislative intent of enabling class actions on behalf of indirect purchasers that informed the 1998 amendment to the Donnelly Act got lost in translation.<sup>10</sup>

Indeed, when confronted with a transcript of a floor debate between Assemblyman Stranieri and Assemblyman Brodsky, where Brodsky clearly articulates the amendment's intention of allowing for indirect purchaser class action suits, the court in *Lennon v. Phillip Morris Companies Inc.* conceded that it was handcuffed by the rules of statutory construction that restricted its inquiry to the plain language of the statute.<sup>11</sup> The court then honed in on the bitter truth about the Donnelly Act:

*Indirect purchasers have been afforded essentially a right of action which is hollow in effect, despite the purpose of GBL §340(6) and what the legislature may have intended. ...Without the class action procedure, the indirect purchasers are unlikely to utilize GBL §340(6).*

*Id.* at 585.

Despite recognizing the need for class action standing, the *Phillip Morris* court had to reconcile the fact that the New York state Legislature had passed on at least two opportunities to amend the statute to confer it, and thus, declined to assume responsibility for what is essentially a legislative task. *Id.*

The Court of Appeals confirmed this view in *Sperry v. Crompton Corp. et al.*, 8 N.Y.3d 204 (2007), definitively holding that the treble damages provision under the Donnelly Act was a penalty for purposes of CPLR §901(b) and therefore, not recoverable in a class action. *Id.* at 209. Like the *Phillip Morris* court, the *Sperry* court looked to the plain language of GBL §340 and noted that the statute's language does not address private class actions. *Id.* at 211.

Nor did the *Sperry* court find any express language that "denominate[d] [the] enhanced damages provision to be compensatory in nature..." *Id.* at 212-13. Finally, the Court took special note of the fact that the Legislature set out to amend the Donnelly Act's damages provision in 1975, only weeks after the passage of CPLR §901(b).

Clearly, the Legislature was aware of the requirement of making express provision for a class action when drafting penalty statutes, and could have included such authorization in [GBL] §340.

*Id.* at 214.

Considering this fact in conjunction with the Legislature's failure to seize upon several subsequent opportunities to amend the act, the *Sperry* Court was likewise loath to legislate from the bench.<sup>12</sup>

#### CAFA, the Unwitting White Knight

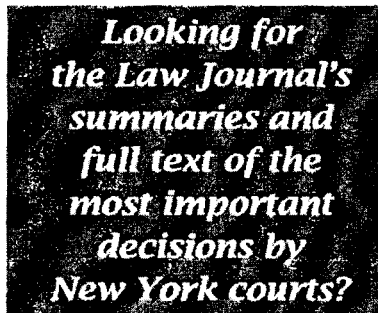
In enacting CAFA, Congress conferred federal district courts with original jurisdiction over any civil action in which the matter in controversy exceeds the sum or value of \$5 million and the class meets the requirement of minimum diversity. 28 U.S.C. §1332(d).

As Justice Ruth Bader Ginsburg noted in her dissenting opinion in *Shady Grove*, CAFA was intended to rein in the "overreadiness of some state courts to certify class actions."<sup>13</sup> Yet, *Shady Grove*'s lawsuit would not have been in federal court but for CAFA, thus pitting Rule 23 against CPLR §901(b)

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The final chapter of this story involves redemption brought about by an improbable confluence of unintended consequences.

Notwithstanding the potential erosive effect that *Shady Grove* may have had on the *Erie* doctrine,<sup>14</sup> the Court's decision unwittingly reanimates the legislative intent informing the passage of the indirect purchaser amendment to the Donnelly Act with its ruling that CPLR §901(b) does not preclude the maintenance of class actions in federal court for claims for punitive damages.

#### Conclusion

Once upon a time, Albany bestowed on indirect purchasers a statute that granted them the right to seek redress for antitrust violations. But because legislation is often piecemeal, this provision standing alone, and the Donnelly Act generally, were essentially useless.

The *Shady Grove* decision embodies the collision between CAFA, by operation of its provisions but not its legislative intent, and CPLR §901(b), resuscitating the legislative intent and indeed any vitality at all of the Donnelly Act.

**Barbara J. Hart** is a partner, and **Kesav M. Wable** is an associate, with *Lowey Dannenberg Cohen & Hart*, in White Plains.

#### Endnotes:

1. Chief Justice John Roberts and Justices Clarence Thomas and Sonia Sotomayor joined Justice Scalia in the judgment and with respect to portions of his opinion. Justice John Paul Stevens filed an opinion concurring in part and concurring in the judgment. Justice Ginsburg filed a dissenting opinion in which Justices Anthony Kennedy, Stephen Breyer, and Samuel Alito joined.

2. General Business Law (GBL) §340 et seq.

3. GBL §340(5).

4. See *Fults v. Munro*, 202 N.Y. 34, 41 (1911); *Potter v. Bierwirth*, 171 A.D. 175 (App. Div. 1916); *Lyke v. Anderson*, 147 A.D.2d 18, 28 (2d Dept. 1989); *Rental & Management Associates v. Hartford Ins. Co.*, 206 A.D.2d 288 (1st Dept. 1994); *Hoffman v. Ryan*, 101 Misc.2d 845 (Sup. Ct. N.Y. County 1979); *Roxbury Light & Power Co. v. Dimmick*, 196 N.Y.S. 320 (Sup. Ct. N.Y. County 1922).

5. See *Lennon v. Phillip Morris Companies Inc.*, 189 Misc.2d 577 (Sup. Ct. N.Y. County 2001); *Rubin v. Nine West Group Inc.*, 1999 WL 1425364 (Sup. Ct. West Cty Nov. 3, 1999); *Blumenthal v. American Society of Travel Agents Inc.*, 1977 WL 18392 (Sup. Ct. N.Y. County 1977); *Russo & Dubin v. Allied Maintenance Corp.*, 95 Misc.2d 344 (Sup. Ct. N.Y. County 1978); *Cox v. Microsoft*, No. 10151931/2000 (Sup. Ct. N.Y. County, November 2000); *Asher v. Abbott Laboratories*, No. 123431/1999 (Sup. Ct. N.Y. County, October 2000).

6. 28 U.S.C. §1332(d).

7. Alistate's arguments focused on how Rule 23 affected their substantive rights under New York law and argued that §901(b) abridges the right "not to be subjected to aggregated class-action liability in a single suit." *Id.* at 9. The Court rejected this argument and observed that nothing in §901(b) confines its scope to New York law and that most procedural rules will have some collateral effect on substantive rights and obligations. *Id.*

8. "[T]he substantive nature of New York's law, or its substantive purpose, makes no difference. A Federal Rule of Procedure is not valid in some jurisdictions and invalid in others—or valid in some cases and invalid in others—depending upon whether its effect is to frustrate a state substantive law..." *Id.* (emphasis in original). Justice Scalia pointed to the same fallacy in Justice Stevens' concurrence, which reached the same result but based on the finding that §901(b) was merely procedural under New York law and therefore could be displaced by Rule 23. *Id.* at 10 ("Recognizing the impracticability of a test that turns on the idiosyncrasies of state law, *Sibbach* adopted and applied a rule with a single criterion: whether the Federal Rule "really regulates procedure.") (citations omitted).

9. "A class action, no less than traditional joinder (of which it is a species), merely enables a federal court to adjudicate claims of multiple parties at once, instead of in separate suits. And like traditional joinder, it leaves the parties' legal rights and duties intact and the rules of decision unchanged." *Id.*

10. See Gordon Schnell and Sam Ridders, "A Call to Albany: It's Time to Amend the Donnelly Act," *New York Law Journal*, Nov. 12, 2008, Vol 240-No. 93.

11. 189 Misc.2d at 584 ("The excerpts from the floor debate and the letter in opposition may indicate that the legislature intended to allow class actions by indirect purchasers. However, the rules of statutory construction clearly preclude this Court from reaching the provision's legislative history when, as in this case, the language is unambiguously silent; there is no language for this Court to construe").

12. Interestingly, and as noted in the Nov. 18, 2008, article, "A Call to Albany," the *Sperry* court avoided discussing the legislative history of the 1998 indirect purchaser amendment to the Donnelly Act altogether, perhaps implicitly signaling to the Legislature that it was time for lawmakers to reconcile these conflicting interests.

13. 2010 WL 1222272, at \*34 (Ginsburg, J., dissenting) citing S. Rep. No. 109-14, p. 4 (2005) (CAFA prevents lawyers from "gam[ing] the procedural rules [to] keep nationwide or multi-state class actions in state courts whose judges have reputations for readily certifying classes").

14. Noting the "large irony" of the Court's decision with respect to CAFA's legislative intent and the actual outcome for future class action litigants, Justice Ginsburg lamented the erosion of the *Erie*

doctrine: "We have long recognized the impropriety of displacing, in a diversity action, state-law limitations on state-created remedies [...] Congress surely never anticipated that CAFA would make federal courts a mecca for suits of the kind Shady Grove has launched: class actions seeking state-created penalties for claims arising under state law claims that would be barred from class treatment in the State's own courts." Id. at \*33-34 citing *Woods v. Interstate Realty Co.*, 337 U.S. 535, 537 (1949) ("[T]he policy of *Erie*...preclude[s] maintenance in...federal court...of suits to which the State ha[s] closed its courts."). On the other hand, Justice Scalia characterized this ramification as a (perhaps intended) reality of a uniform system of federal procedure. Id. at \* 12 ("Congress itself has created the possibility that the same case may follow a different course if filed in federal instead of state court.") citing *Hanna v. Plumer*, 380 U.S. 460, 472-73 (1965).

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