Getting Beyond Kansas

Samuel Issacharoff
Reiss Professor of Constitutional Law, NYU School of Law, Issacharoff@exchange.law.nyu.edu

Follow this and additional works at: http://lsr.nellco.org/nyu_lewp
Part of the Constitutional Law Commons, Law and Economics Commons, Litigation Commons, and the Public Law and Legal Theory Commons

Recommended Citation
http://lsr.nellco.org/nyu_lewp/66

This Article is brought to you for free and open access by the New York University School of Law at NELLCO Legal Scholarship Repository. It has been accepted for inclusion in New York University Law and Economics Working Papers by an authorized administrator of NELLCO Legal Scholarship Repository. For more information, please contact tracythompson@nellco.org.
GETTING BEYOND KANSAS

Samuel Issacharoff

The American experiment in dual federalism has a persistent problem in defining the boundaries of each sovereign's authority. The familiar refrain on the failings of the Articles of Confederation informs that a centralizing national authority was required for spreading the burdens of taxation, ensuring the internal instrumentalities of commerce, policing the borders and national security of the entire nation, and conducting the foreign affairs of a unified national power.¹ Beyond that, the Founders' vision of the role of the states allowed them to be the primary guardians of the property rights and contractual relations among their citizens and to regulate such matters as domestic relations, education, and even the operation of the political process.²

Much of the constitutional law of the post-World-War-II era turns on the relation between this original organizing vision and the increased powers of the federal government over the relations between the states and their citizens. This essay, however, hearkens back to longer-lived debates dealing not with the civil rights or civil liberties enforceable through the Fourteenth Amendment, but with the core problem of the maintenance of state sovereign authority in the face of the pressures exerted by a rapidly nationalizing market. The case for nationalization, or what I have elsewhere termed "federalization,"³ corresponds to the increasing inability of the states to define the domain of market engagements and, as a consequence, to regulate meaningfully a broad range of matters customarily assigned to the common law.

The case for nationalization of standards or federalization was given its clearest articulation in the post-Founding period by Justice Story, most forcefully in Swift v. Tyson.⁴ Justice Story posited that the new nation was built on the basis of an integrated national market and would require national-level legal institutions and national-level law to superintend the new country's emergence.⁵ As expressed by Chief Justice Shaw of the Massachusetts Supreme Court, "[i]t is greatly desirable, that throughout all the States of the Union, which, to many purposes, constitute one extended commercial community, the rules upon this subject should be uniform."⁶

As is well known, and oft retold in the endless efforts to extol Erie v. Tompkins,⁷ Story's approach foundered on the problem of the two court system.⁸

---

² Id.
⁴ Swift v. Tyson, 41 U.S. 1 (1842).
⁵ Id. at 37 (stating that "the true interpretation and effect [of instruments of a commercial nature] are to be sought, not in the decisions of the local tribunals, but in the general principles and doctrines of commercial jurisprudence")
⁶ Staples v. Franklin Bank, 42 Mass. 43 (1840).
⁷ Guar. Trust v. York, 326 U.S. 99, 109 (1945) (Erie "expressed a policy that touches vitally the proper distribution of judicial power between State and federal courts").
⁸ Erie R.R. Co. v. Tompkins, 304 U.S. 64, 74 (1938) ("Persistence of state courts in their own opinions on questions of common law prevented uniformity; and the impossibility of discovering a
Law's primary function as a regulatory mechanism could never be realized so long as the two sets of sovereigns could assign conflicting obligations on identical conduct. As wonderfully captured in Justice Harlan's concurrence in *Hanna v. Plummer*, the law's commands of primary conduct—understood as the manner in which citizens must lead their daily lives—must be clear so that private ordering may be conducted with certainty and security.

The development of a national market commands some reexamination of why Story's vision failed and why *Erie* became such undisputed gospel. To a large extent, Story's vision of law as the consolidating force in the new nation could not be sustained because of the continuing burden of the dual sovereign system of the United States, the signal American challenge to conventional political wisdom, from Hobbes to Montesquieu, that a nation required an undisputed sovereign authority. Without a central agency for the creation of national law, Story's hope for unification around a federal common law foundered on the rival sources of law, most notably the authority of state courts to implement state law and the nascent role of federal courts attempting to impose an alternative vision of a coherent national future.

Whatever the commitment to *Erie* and its formal glorification of state autonomy, the reality has been that *Erie* was an evanescent tribute to state courts as an antidote to the perceived retrograde impulses of federal courts. Some accommodation had to be made to the increasing sweep of the market. As market conduct increasingly grows beyond local command, however, even Harlan's compromise comes under pressure. It may well be that the standards of care for tort liability or the elements of an enforceable contractual obligation or satisfactory line of demarcation between the province of general law and that of local law developed a new well of uncertainties.

The great example was the rival interpretations of the enforceability of exclusive dealing contracts presented in *Black & White Taxicab & Transfer Co. v. Brown & Yellow Taxicab & Transfer Co.*, 276 U.S. 518 (1928).


*Swift* was hardly controversial when decided: it was a unanimous decision garnering support from a Court with a majority of Jacksonian judges. See *Tony Freyer, Harmony & Dissonance: The Swift & Erie Cases in American Federalism* 2-3 (1981) (noting that even "Democratic stalwarts as Chief Justice Roger B. Taney and Justice Peter V. Daniel" agreed with the decision "written by the nationalist Joseph Story").

See *John Wallace, The Want of Uniformity in the Commercial Law Between the Different States of Our Union* (1851).

Inter-commercial in this united way, our law is essentially defective... where in the North, professing the principles of the English common law, a merchant shall have a contract interpreted in one way in Pennsylvania, another way in New York, and a third way in Boston: and when he goes South with it next week, shall find it open to new constructions;—in Florida, by the Partidas of Spain; in Louisiana, by the Code Civil of France, and in Texas and California, by something which is neither and both; half code, half custom—where in fact, law is a science of geography, almost as much as of justice.

*Id.*
the remedies available for the breach of either are set by state law. That, however, may run afoul of the constitutional commitment to free movement of goods and services across the entirety of the nation. An outlier state imposing liability on a basis discordant with that of all other states, or imposing contractual obligations that are not priced into the overwhelming range of transactions, or exacting punishment disproportionate to the market benefits provided by a good or service in other states, all risk grave harm to the conception of the integrity of the national market.

At the same time, inherited jurisdictional barriers and the centrality of state courts (at least until recently) in fixing the common law obligations of tort and contract and property require that market conduct, even if conducted nationally, be accountable somewhere. And, needless to add, whatever the allures of a distant and unknown somewhere may be, there is the inevitable need to have some specific location in which to enforce accountability. We may think ultimately of the need for all perceived legal wrongs to have an ability to invoke a home for their redress. For the purposes of this essay, the question is whether that home should be in litigation as on the Silver Screen, the state of Kansas. Or, is there indeed no place like Kansas in the Supreme Court’s imaginative engagement with the Kansas forum in *Phillips Petroleum Co. v. Shutts*?13

I. WHERE DO MARKET HARM OCCUR?

*Shutts* presented the Court with a relatively simple dispute enveloped in a procedural morass. At issue was whether Phillips Petroleum had or had not delayed making payments to royalty owners on its gas leases, thereby profiting improperly from the time value of the moneys withheld.14 The underlying conduct fell under federal oversight under what is now the Federal Energy Regulatory Commission and the claim was simply that Phillips Petroleum failed to pass along to the royalty owners the benefits of interim, non-final regulatory approval of higher prices charged in the natural gas market.15

There appears little doubt that the decision to withhold royalty increases until final approval was a coordinated act by responsible officials at Phillips; there was no claim that any royalty owners were treated differently or that any individual considerations entered into the decision to pay or not. Similarly, the consequences, permissible or not, were not bounded by any geographic considerations; the practice appears to have been uniform across all of Phillips’s gas leases, covering eleven states, and for all 28,000 royalty owners, who, in turn, were dispersed across the fifty states, the District of Columbia, and a number of foreign countries.16 This was a classic “upstream”17 case in which

---

14 Id.
15 Id.
16 Id. at 799.
liability turned entirely on the conduct of the defendant and the individual plaintiffs were simply the passive recipients of that conduct.

Finally, the dispute was not worthy of individual litigation. Upon final regulatory approval, Phillips paid the withheld funds, amounting to only three or four million dollars a year.\(^\text{18}\) Since the dispute covered only the interest owing on the delayed payments and since that money was spread over 28,000 class members, private enforcement was a non-starter unless the claims were aggregated.\(^\text{19}\) As Justice Rehnquist found for the Court, since “this lawsuit involves claims averaging about $100 per plaintiff; most of the plaintiffs would have no realistic day in court if a class action were not available.”\(^\text{20}\)

Everything about \textit{Shutts} smacks of national concerns. The underlying conduct was in a federally-regulated part of the economy; the scope of the alleged harm was nationwide and stemmed from a common course of dealing; and the conduct of the defendant did not differentiate among the plaintiffs depending on their residence or whether they had moved during the time of the challenged non-payments. The problem was that the underlying claims sounded in state law and could not possibly meet the jurisdictional threshold for diversity. Much as the conduct may have been a straightforward claim of contract breach for any particular individual, the common course of dealing across the thousands of affected parties and the dozens of jurisdictions threatened to collapse any meaningful claim for an effective legal forum for the dispute.

Looking back on \textit{Shutts}, the ease with which the Court dealt with these difficult concepts is striking. \textit{Shutts} may very well provide the first sustained application of a \textit{Mathews v. Eldridge}\(^\text{21}\) style balancing test to the due process concerns in personal jurisdiction, anticipating by a few years the approach explicated more fully in \textit{Asahi Metal Industry v. Superior Court of California}.\(^\text{22}\) For Justice Rehnquist, the limited burdens placed on an out-of-state absent class member “are not of the same order or magnitude as those it places upon an absent defendant.”\(^\text{23}\) Without risk of an enforceable adverse judgment, without the burdens of discovery or even pleading, the limited demands upon the absent plaintiff could withstand a lesser threshold of protection against a foreign judgment, one that could be satisfied by mere notice and the ability to opt out.

Similarly, the class issues seemed self-evident to the Court. Justice Rehnquist reemphasized the core understanding of class action economics as “permit[ting] the plaintiffs to pool claims which would be uneconomical to litigate individually.”\(^\text{24}\) While the terminology of “negative value” class actions was not yet developed, the idea is the same. Some procedural accommodation must be found for cases that could not be sustained because of the transaction

\(^{18}\) \textit{Shutts}, 472 U.S. at 800.

\(^{19}\) \textit{Id.} at 820.

\(^{20}\) \textit{Id.} at 809.


\(^{22}\) \textit{Asahi Metal Indus. v. Superior Court of Cal.}, 480 U.S. 102 (1987).

\(^{23}\) \textit{Shutts}, 472 U.S. at 808.

\(^{24}\) \textit{Id.} at 809.
costs of prosecuting the claims, regardless of the merits. Even the jurisdictional
requirement that plaintiffs be afforded only the opportunity to opt out rather than
affirmatively choosing to opt into the class was driven by the economics of the
case: "Requiring a plaintiff to affirmatively request inclusion would probably
impede the prosecution of those class actions involving an aggregation of small
individual claims, where a large number of claims are required to make it
economical to bring suit."25 Under the press of a classic "if-as-to-one, then-as-to-
all" case in which a unitary question defined the entirety of the dispute, other
than the mechanical computations of each individual's pro rata harm, the Court
had little trouble seeing that this was self-evidently a case demanding class
treatment.

And yet, the Court went further. Justice Rehnquist intriguingly contrasted
the claims in Shutts to conventional litigation by finding the class action
proceeding to be "quasi-administrative" in nature, as opposed to adjudicatory as
customarily understood.26 The Court did not provide any further guidance about
what was gained by viewing the matter as "quasi-administrative" since
presumably the full panoply of due process rights would attach regardless of
whether the case was seen as adjudicatory rather than administrative, or vice
versa. Nonetheless, the term "quasi-administrative" reflects an assessment that a
"private attorney general" action to challenge a claimed wrongful conduct across
a mass of similarly situated royalty owners was not readily conceived of as
simply an arithmetic compilation of a series of individual claims. In the first
instance, the Court appears quite satisfied that the individual claims would not
have a life of their own except as part of the aggregate.27 But more critically, the
designation as "quasi-administrative" indicates an understanding of the case as
almost a stand-alone entity,28 one in which the reviewing court must assess
whether standardized royalty interests *writ large* have or have not been honored
by the conduct of Phillips Petroleum.

Once conceptualized as a matter of an entity comprised of all similarly
situated royalty interests, where the litigation happens to go forward is almost a
matter of happenstance. The overriding interest is that it proceed in only one
place and that place has to be somewhere. Under the facts presented, the Court
was willing to accept that, as for Dorothy years ago, there was indeed no place
like Kansas. But even here, the Court was simply replaying the conflict that had
bedeviled Justice Story over a century earlier. Treating the royalty claims as
quasi-administrative in nature meant that a single judge should look at the matter
as a whole and resolve it once and for all. But the dual court system meant that
there was no appropriate tool for centralizing the dispute in *the* most appropriate
forum, only for considering whether Kansas was *an* appropriate forum. At that

25 Id. at 812-13.
26 Id. at 809.
27 See id.
28 Here I am borrowing David Shapiro's provocative characterization of a class action as an
independent entity, although I use the idea somewhat differently to address the nature of the
aggregated claims rather than the aggregated claimants. See David L. Shapiro, *Class Actions: The
point, the Court could only say that there was no reason to think that Kansas could not serve as an appropriate place to hear the issues, so long as the minimal individual interests in the remote prospect of pursuing individual actions were satisfied through notice and the ability to opt out.29

Were Shutts to go forward now, the result might be different in one critical regard. The multistate character of the class and the amount in controversy would likely suffice to trigger federal jurisdiction under the newly minted Class Action Fairness Act ("CAFA").30 If we go back to the introductory concerns in this essay, CAFA can be seen as responsive to one of the problems animating Justice Story’s concerns in Swift v. Tyson.31 We may think of Shutts as resolving one problem of nationwide market cases: the need to have some forum available for the efficient resolution of a common dispute. Shutts resolved the question of personal jurisdiction effectively, but left a gaping hole. While it was all well and good that some court have the power to hear all the related claims as a unitary package, there was still an odd feature to that court being a state court in a state with relatively little to do with the underlying case.

As expressed by John Beisner, the leading proponent and draftsman for CAFA, in his Senate testimony on behalf of the bill:

Who should be charged with responsibility for handling such types of large-scale, interstate class actions involving issues with significant national commerce implications—federal judges who are selected by the President and confirmed by the U.S. Senate or state court judges who are elected by a few thousand voters in a rural county?32

There is a striking overlay to the arguments advanced by the Federalists at the time of the founding of the Republic for why commercial cases needed to be brought into federal court. The basic argument, consistent with the legislative history of CAFA, was the need to allow for a national body to deal with cases affecting national markets.33 As summarized by John Marshall, the ability to draw cases into federal court on diversity grounds “may be necessary with respect to the laws and regulations of commerce, which Congress may make.”34

The effect of Shutts was therefore paradoxical, in the same way that Story’s invocation of the federal interest proved incapable of promoting true uniformity of substantive law. Shutts allowed for one forum to command a case of national

29 See Shutts, 472 U.S. at 812.
31 See supra notes 4-12 and accompanying text.
34 Id. Marshall offered as examples the types of cases that could be expected to arise under this clause, such as suits by creditors, issues over trade and product disputes, and disagreements over interest rates. Id. Needless to add, the dispute in Shutts was exactly over the interest rate issues anticipated by Marshall.
dimensions, but could do nothing to ensure the appropriateness of the forum. So, while making a case against a national, diffuse policy possible, it also allowed for widespread forum shopping. The legislative history of CAFA is replete with anecdotal evidence of the development of magnet fora, jurisdictions thought to be welcoming to one or another set of litigants with favorable procedures or juries or rules of evidence. In this sense, CAFA completes the centralizing function of Shutts by allowing not just consolidation of upstream, national market harm cases, but their centralization under federal oversight.

II. HOW ARE MARKET HARMS COMPUTED?

Unresolved by Shutts was a more serious issue that has come to dominate national class action law twenty years later. The second issue presented in the case was whether or not Kansas could not only serve as the forum state for the litigation, but apply its laws to the substance of the dispute. Under the facts presented, the Kansas courts had decreed that not only could Kansas courts hear the claims, but that the victorious plaintiffs could be awarded the more generous Kansas interest rate calculations, regardless of their state of residency. The result was that in over ninety-nine percent of the claims, litigants with no connection to Kansas were making a claim against an Oklahoma company for Kansas’s definition of penalties for transactions that had nothing to do with Kansas.

For the Court, the application of Kansas substantive law raised a question of constitutional dimensions. In part, the concern was simply faithfulness to substantive obligations, what Richard Nagareda terms the “preexistence principle” by which the procedural needs for aggregation cannot drive the application of substantive law. But the Court, I believe, was searching for a deeper principle that allows parties to order their primary behavior in accordance with a settled understanding of what law applies. As Justice Harlan evocatively expressed this principle in Hanna v. Plumer,

I have always regarded [Erie] as one of the modern cornerstones of our federalism, expressing policies that profoundly touch the allocation of judicial power between the state and federal systems. Erie recognized that there should not be two conflicting systems of law controlling the primary activity of citizens, for such alternative governing authority must necessarily give rise to a debilitating uncertainty in the planning of everyday affairs.

36 Id. at 816.
37 Id. at 815-16.
38 Id. at 822.
Under this view, a reliance interest of constitutional dimensions attaches to the primary actor, here the defendant, in being able to conform its conduct to the risks and rewards of settled law.

Accordingly, Shutts is concerned not with the mechanical application of any law that might conceivably be invoked by the forum state but with a law that is faithful to the nature of the protected expectation interests of the defendant. This does not completely address the scope of the defendant's potential exposure. Certainly, any individual might sue under the home law of his or her forum. But it starts the inquiry because Phillips Petroleum also had to recognize that any individual might sue in Oklahoma under the laws of Oklahoma from which the unified decision on how to distribute rate increases to royalty owners was made. At that point, complicated, and ultimately nearly indeterminate, choice of law rules might apply. But Shutts invites that application of a simple non-arbitrary choice of law rule, such as the law controlling the defendant at the time of the dispositive decision-making—an invitation that several state courts have accepted to mean the application of the defendant's home state law to the defendant's overall conduct.

Because Shutts left this issue undefined, class action law has largely been cast into the legal limbo, known as choice of law. In case after case, the decision whether to certify a class turns on the manageability concern as to which law should apply and whether a unified trial would be possible given the constraints. Were Shutts to be presented to a trial court today, no doubt the concern over which law applies would dominate the class certification proceeding. And yet for a case dealing entirely with upstream conduct, the attempt to recreate how each individual case would proceed under its own choice of law analysis is entirely bizarre. The Supreme Court has decreed that in any case, regardless of whether it is brought as a class action or not, the choice of law rules applied by a federal court (and presumably by a state court as well) must be those of the forum state. This means that a New York resident suing Phillips Petroleum for the disputed royalty payments could have sued in New York, Oklahoma or Delaware and that a different choice of law regime would have applied in each forum—yielding perhaps a problem with choice of law manageability even for one case. Or put more directly, no party could have a cognizable settled interest in a particular choice of law regime when the results could be disparate across the various states that would have had personal jurisdiction over the claim. Even applying the "preexistence principle," it is not clear that any definite expectation interest preexisted the litigation.

41 See Shutts, 472 U.S. 797.
42 Id.
44 For a general discussion of the choice of law overlay on class action law, see Tobias Barrington Wolff, Preclusion in Class Action Litigation, 105 COLUM. L. REV. 717 (2005).
But Shutts did not fall into the bottomless inquiry suggested by choice of law formalism. The application of Kansas method of computing interest rates was not struck down because each individual class member would need a detailed choice of law analysis to determine what law should apply. It was struck down because it violated the due process rights of the defendant who was suddenly confronted with the imposition of an alien set of legal obligations that had nothing to do with the core of the legal challenge. This was an upstream case about unified conduct undertaken toward all plaintiffs from the vantage point of a centralized decision in Oklahoma, not an action for harms in Kansas. That Kansas happened to be the situs of the courthouse has as much bearing on the substantive law governing the claims as moving the dockets of inundated Louisiana courthouses to Texas should have on the substantive law that applies to Louisiana trials in the aftermath of Hurricane Katrina.

The protection that Shutts offers defendants is that the expedience of where a national case might be tried should not drive the substantive obligations of the parties. Thus, the application of Kansas substantive law to oversee conduct that occurred in Oklahoma and whose impact was felt nationally was "sufficiently arbitrary and unfair as to exceed constitutional limits." That may take the form of the random application of a substantive law foreign to the underlying dispute—as with the claim that Kansas interest rates could be exported across the national dispute for no reason other than the happenstance that suit was filed in Kansas. Or it could take the form of the imposition of made-up, equally inapplicable legal standards that could not have been recognized ex ante as controlling behavior—as with Judge Posner’s famous invocation of Esperanto to characterize a trial judge’s attempt to craft a homogenizing standard of law to govern personal injury cases from exposure to tainted blood products.

Tellingly, Shutts made no constitutional commitment to a choice of law regime. This was brought home in Sun Oil v. Wortman, a follow on case to Shutts, in which the Court found that form law could control the common application of a Kansas statute of limitations, even though most claims had nothing to do with Kansas. At no point did the Court look to choice of law principles to determine which state statute of limitations should apply, relying instead on an analysis of the traditional lex fori powers of courts to apply certain of their own rules.

III. CONCLUSION

At some level, Shutts shows the limitations of what courts can reasonably be expected to do in terms of reconciling our federal structure with the

---

46 Shutts, 472 U.S. at 820.
47 Id. at 822.
48 In re Rhone-Poulenc Rorer, Inc., 51 F.3d 1293, 1301 (7th Cir. 1995).
50 Id.
51 Id. at 725.
commands of the national market. *Shutts* is a watershed case in providing access to a centralizing judicial resolution of common claims of market harm across national and international boundaries. But *Shutts* could not ensure that the appropriate forum would be selected; for that Congress had to intercede by providing expanded diversity jurisdiction through CAFA and thereby allow not only federal court oversight but transfer and consolidations to place the case in the right location. What *Shutts* left for another day, and what continues to bedevil class action litigation, is how to apply a unifying standard of law that is neither arbitrary nor unfair. Here, unfortunately, CAFA is silent and it remains the task for federal courts to grapple with the undeveloped legacy of the substantive law implications of *Shutts*.