

Erie Review Problems

Answers & Explanations

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Problem 1

Peggy was employed by Sterling Cooper, P.C. She had a written employment contract specifying a three year term of employment, during which Sterling Cooper could not terminate Peggy's employment except for cause. The contract specifies that "cause for termination includes, but is not limited to, employee misconduct, dishonesty, or unsatisfactory performance of assigned duties."

Before the contract term ended, Peggy was fired. Her boss, Don, told her the reason was poor performance, but Peggy believes the real reason was her rejection of Don's repeated and unwelcome advances.

Peggy sues Sterling Cooper in federal court, asserting a claim for breach of contract under Hudson state law. Assume the court has personal and subject matter jurisdiction.

In her complaint, Peggy seeks compensatory damages for her loss of employment.

Part A

Under Hudson state law, compensatory damages for wrongful termination in breach of an employment contract are limited to an amount equal to three times the plaintiff's annual earnings (wages or salary) in their last year of employment. In contrast, in cases for wrongful termination under federal law, there is no such cap on the amount of compensatory damages. Which rule should the federal court apply in this case?

Answer & Explanation

This problem presents a conflict between state and federal law on the issue of how much a plaintiff may recover in compensatory damages. Since the federal law here does not come from the FRCP or a federal statute, the applicable analysis comes from the Erie/Guaranty Trust/Byrd line of cases. This issue is unquestionably substantive: the legal rules define the defendant's liability. Applying a different rule in federal court than in state court would promote forum shopping for more favorable outcomes: plaintiffs who can bring their claims in federal court (because they can satisfy the requirements for diversity jurisdiction) will do so to avoid the damages cap under state law; plaintiffs who cannot bring their claims in federal court (i.e. because the plaintiff employee and the defendant employer are both citizens of the same state) will have to sue in state court, where their damages will be capped. This type of persistent difference in outcomes in otherwise similar cases is what the

Supreme Court means by “inequitable administration of the laws”, which is the ultimate problem that the Erie doctrine is meant to avoid. Given the strong outcome determination, and the absence of any countervailing federal policy interest at stake, the court must treat this as a substantive issue and apply state law.

Part B

Under Hudson state law, a complaint for breach of contract must include an itemized statement showing the basis and amount of compensatory damages sought. In contract, under FRCP Rule 8(a)(3), the “demand for relief sought” requires only a general statement that the plaintiff seeks compensatory damages.

Which rule should the federal court apply in this case?

Answer & Explanation

This problem presents a conflict between state law and federal law under the FRCP. The applicable analysis comes from *Hanna v. Plumer*. The state and federal rules here are in direct conflict: state law requires an itemized statement of damages; Rule 8(a)(3) does not. While it’s true that Rule 8 doesn’t *prohibit* an itemized statement, so a plaintiff could satisfy both Rule 8 and state law by including such a statement in the complaint, there is still a conflict where state law imposes a more specific or burdensome procedure than the FRCP. See *Hanna v. Plumer* (finding a conflict between state law requiring personal service on defendant and FRCP Rule 4 permitting either personal service on defendant or service by other means). In this situation, the federal court must follow the FRCP provision, as long as it is valid under the Rules Enabling Act, i.e. as long as it regulates procedure and does not alter the parties’ substantive rights, duties, or liabilities. Rule 8 easily passes this test: it simply governs the manner in which a plaintiff presents their claim for damages; it doesn’t in any way affect the plaintiff’s entitlement to recover those damages, which is a substantive issue governed by state law. So, the court should apply Rule 8 and not require an itemized statement of damages in the complaint.

Problem 2

The Carbollic Smoke Ball Company (“Carbollic”) runs an ad in the *Pall Mall Gazette*. The ad claims that the company’s Carbollic Smoke Ball is “clinically proven to prevent colds and flu when used as directed.” In fact, the product does nothing at all, other than emit foul-smelling smoke, and the company never conducted any tests, clinical or otherwise.

After reading the ad, Carlill buys a Carbollic Smoke Ball and uses it as directed three times a day for several weeks. She is chagrined when she contracts the flu anyway. It turns out to be an especially bad case of the flu, requiring hospitalization and expensive medical treatment.

Carlill sues Carbolic for fraud under Euphoria state law. Her complaint alleges that Carbolic's ad made false claims about the health benefits of the Smoke Ball, that Carbolic knew those claims were false, and that Carbolic made those claims with an intent to induce consumers to buy the product. In the complaint, Carlill requests the following relief:

- \$80,000 in punitive and compensatory damages, and
- a permanent injunction prohibiting Carbolic from continuing to run ads making fraudulent claims about the Carbolic Smoke Ball's health benefits.

Carlill files her suit in the U.S. District Court for the District of Euphoria, which has subject matter jurisdiction based on diversity of citizenship.

Part A

FRCP Rule 8(a)(3) provides that a complaint must include "a demand for the relief sought, which may include relief in the alternative or different types of relief." Under this rule, a plaintiff may request both legal remedies (usually money damages) and equitable relief (such as an injunction) in the same complaint.

In contrast, under Euphoria state law, a plaintiff who seeks both legal remedies and equitable relief must file two complaints, one seeking the legal remedy and another seeking the equitable relief. Both complaints will go to the same court, which will treat them as a single action for most purposes. If (either on summary judgment or at trial) the defendant is found liable, the court will then hold a separate hearing to determine whether the plaintiff is entitled to the injunction or other equitable relief sought.

Carbolic objects that Carlill's request for both money damages and an injunction in the same complaint is improper under Euphoria law. Carlill argues that federal law, not state law, governs whether she may seek both types of relief in the same complaint.

Should the court apply state or federal law on this issue?

Answer & Explanation

The answer and explanation here are similar to [Question 1](#), Part B above. Again there is a conflict between state law and a provision of the FRCP, so the Hanna analysis applies. There is a direct conflict between state law, which requires the plaintiff to file two complaints, and the FRCP, which allows plaintiff to seek all relief in a single complaint. The difference is merely procedural: how many complaints must the plaintiff file. It doesn't affect the plaintiff's entitlement to either form or relief, which is governed by state law. So the court should follow FRCP Rule 8, not state law.

Part B

Under Euphoria state law, a consumer asserting a fraud claim based on an allegedly false advertisement must plead and prove the following elements:

1. The defendant made false claims about the product
2. The defendant knew the claims were false
3. The defendant made the claims with the intent to induce consumers to buy the product
4. The plaintiff reasonably relied on the claims in deciding to buy the product.

In contrast, under the FTC Act (a federal statute), an advertiser is liable for false advertising even if it was unreasonable for a consumer to have relied on the defendant's false claims. The FTC Act authorizes the Federal Trade Commission to bring civil suits for false advertising, but does not give individual consumers a private right of action.

The Company moves to dismiss Carlill's complaint for failure to state a claim, because the complaint fails to allege that Carlill reasonably relied on the claims in the ad regarding the supposed health benefits of the Carbolic Smoke Ball.

Should the federal court apply state or federal law on the issue of whether Carlill must allege and prove reasonable reliance?

Answer & Explanation

At first glance, this problem might appear to belong on the Hanna path, because it involves a difference between state law and a federal statute (the FTC Act). However, Hanna does not apply here, because the federal law here does not regulate procedure at all, but rather defines the elements of a defendant's liability for false advertising claims. So the appropriate analysis is on the Erie path. The analysis here is similar to Question 1, Part A: Erie requires that the federal court follow state law, so that there will be consistent outcomes in similar cases regardless of the choice of forum. The fact that the defendant might be liable under the federal FTC Act but not under state law does not present a countervailing federal policy interest that would allow a federal court to disregard state law. This is simply a situation where federal law and state law both regulate the same conduct, but take different positions on when that conduct is actionable and who may bring an action (an affected consumer under state law, but only the FTC under federal law).