

A man brought a diversity action against a pharmaceutical company in a federal district court in State A. In his complaint, the man alleged that the company violated State A's false advertising law. The company moved to dismiss the man's action for failure to state a claim on the ground that the false advertising law does not apply to advertising by pharmaceutical companies.

Several lower state courts in State A have recognized the company's defense. The highest state court in State A has never ruled or noted in dicta whether this defense is valid. Based on the lower state courts' decisions, the federal district court ruled that the company's defense applies and granted its motion to dismiss. The man appealed.

State A law permits a federal district court to certify an unsettled question of state substantive law to the state's highest court for clarification.

Is the federal appellate court likely to overturn the dismissal?

- A. No, because the federal district court properly relied on the rulings issued by the state's lower courts.
- B. No, because the federal district court's decision was not clearly erroneous.
- C. Yes, because the federal district court abused its discretion when it dismissed the action.
- D. Yes, because the federal district court failed to certify the issue to the highest state court in State A.

### Explanation:

Federal courts sitting in **diversity** must apply state law to **substantive issues**, including the validity of a defense (as seen here). A federal court interpreting state substantive law must follow the rulings issued by the **state's highest court**. If the state's highest court has **never definitively ruled** on the issue, the **federal court must predict** how the state's highest court would rule by looking to other sources of law. **Priority** is given in the following order:

1. dicta in related decisions by the state's highest court
2. rulings issued by the **state's lower courts** (ie, intermediate appellate courts and trial courts)
3. other **persuasive authority** (eg, rulings issued in other jurisdictions, restatements, public policy)

Here, State A's highest court has never ruled or noted in dicta whether the company's defense is valid, so the federal district court may look to rulings issued by the state's lower courts. Since several lower state courts in State A have recognized the company's defense, the federal district court properly relied on these rulings in dismissing the case. Therefore, the federal appellate court is unlikely to overturn the dismissal.

**(Choices B & C)** A federal district court's interpretation of a state's substantive law involves a pure legal issue that is subject to the *de novo* **standard of review**. A district court's findings of fact in a bench trial are subject to clearly erroneous review, and its discretionary rulings (eg, admissibility of evidence) are subject to abuse of discretion review.

**(Choice D)** A federal district court may, but is *not required* to, certify a question of unsettled state law to the state's highest court for clarification if certification is permitted by the state.

### Educational objective:

A federal court sitting in diversity must interpret state substantive law pursuant to decisions issued by the state's highest court. When no such decisions exist, the federal court should prioritize other sources of law in this order: (1) dicta by the state's highest court, (2) rulings by the state's lower courts, (3) other persuasive authority.

### References

- Stoner v. N.Y. Life Ins. Co., 311 U.S. 464, 467 (1940) (holding that lower state court decisions control in a federal diversity action if the state's highest court has not ruled and no evidence exists that it would rule differently).
- 32A Am. Jur. 2d Federal Courts §§ 351–52 (2020) (explaining that a federal court must determine how a state's highest court would rule on a substantive issue when the issue has not been ruled on by that court).

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**Weight of authority**  
(for state law)

