

A buyer brought a diversity suit in State A federal court against a seller for breach of contract. During the case, the seller engaged in fraudulent conduct, attempted to delay the proceedings, ignored several court orders, and unduly oppressed and harassed the buyer. The judge issued an order to show cause as to why the seller should not be held in contempt. After a hearing, the judge held the seller in contempt and ordered him to pay a fine to the court and the buyer.

At the conclusion of trial, the seller objected to this fine. The seller argued that State A law does not authorize a fine under these circumstances and that the federal court was bound to follow State A law. The seller also argued that no federal statute or rule authorizes this fine for contempt.

If the seller is correct in his arguments, will he likely succeed in his objection?

- A. No, because federal common law allows the court to impose the fine for contempt.
- B. No, because the case was brought in federal court.
- C. Yes, because a federal court sitting in diversity must follow state law.
- D. Yes, because no federal statute or rule authorized the imposition of this fine.

Explanation:

Federal courts sitting in **diversity** must apply **state law** to **substantive** issues and **federal law** to **procedural** issues (**Choice B**). However, there are instances when it is **unclear** whether an issue is **substantive or procedural** (eg, a fine for contempt) and there is **no federal law** (ie, constitutional provision, statute, or rule) that **directly addresses** the issue. When this occurs, the **Erie analysis*** is used to determine if a federal court can supplant state law with federal common law (ie, judge-made rules).

Under the *Erie* analysis, **state law applies** if it is outcome determinative AND there is no federal countervailing interest. State law is **outcome determinative** if the failure to apply state law would result in:

- forum shopping – litigants will be encouraged to sue in federal court to take advantage of benefits not afforded in state court *or*
- inequitable administration of the laws – the application of substantially different rules in federal and state court would cause unfair outcomes.

Here, the contempt fine will not cause forum shopping or the inequitable administration of the laws. That is because contempt fines are ordered only if a party fails to abide by court rules and are not tied to substantive issues underlying the case. As a result, state law is *not* outcome determinative, and the court can apply federal common law to impose the contempt fine over the seller's objection (**Choice C**).

*The Erie and federal-rule analyses seek to ensure that federal courts sitting in diversity apply federal law to procedural issues only. Therefore, the more substantive an issue appears to be, the more likely state law must be applied.

(Choice D) Although no federal statute or rule authorizes the fine, federal courts have *inherent* authority to hold a party in **contempt of court**.

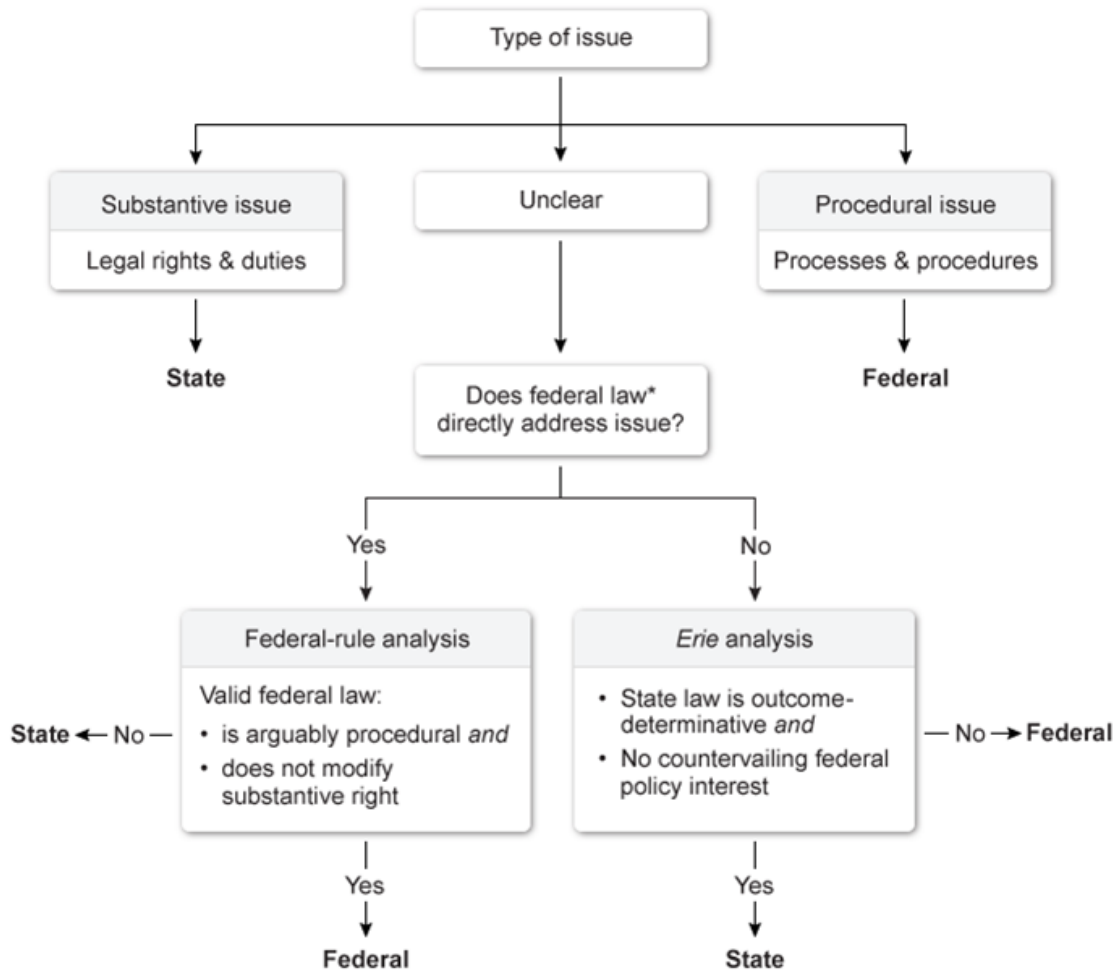
Educational objective:

Under the *Erie* analysis, a federal court sitting in diversity must apply state law if (1) it would be outcome determinative—ie, failing to apply it would result in forum shopping or inequitable administration of the laws—and (2) there is no countervailing federal policy interest.

References

- *Chambers v. NASCO, Inc.*, 501 U.S. 32, 51–53 (1991) (explaining that a federal court sitting in diversity has the inherent authority to impose a fine for contempt even if state law would not permit it).

Choice of law in diversity cases



*Federal law includes federal statutes, rules, and constitutional provisions

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