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Federal Civil Procedure--Class Actions--State Truth-in-Lending Claims in Federal Court [*Kristiansen v. John Mullins & Sons*, 59 F.R.D. 99 (1973)]

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FEDERAL CIVIL PROCEDURE—CLASS ACTIONS—STATE TRUTH-IN-LENDING CLAIMS IN FEDERAL COURT

Kristiansen v. John Mullins & Sons, 59 F.R.D. 99 (1973).

Since 1972, when *Ratner v. Chemical Bank New York Trust Co.*[1] held that a suit brought by Master Charge cardholders could not be maintained as a class action, federal courts have regularly denied class certification in suits brought under the Federal Truth-in-Lending Act.[2] Notwithstanding this trend,[3] Judge Bartels of the United States District Court for the Eastern District of New York recently certified a class action in a suit brought under the Act in *Kristiansen v. John Mullins & Sons*.[4] In so doing, Judge Bartels has served notice that *Ratner* and the cases that have followed it have not foreclosed judicial debate on the subject of truth-in-lending class actions.[5]

The *Kristiansen* case will clearly be a valuable precedent for future truth-in-lending class plaintiffs as a decision that runs counter to the prevailing case law against allowance of class actions under the Act. It is perhaps more significant, however, for its application

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1. 54 F.R.D. 412 (S.D.N.Y. 1972).

2. Consumer Credit Protection Act, 15 U.S.C. §§ 1601-1681t (1970). At least 23 district court decisions have followed *Ratner* in denying class actions in truth-in-lending suits. *See* Fischer, *From Ratner to Qui Tam: Truth-in-Lending Class Action Developments*, 24 HASTINGS L.J. 813, 833-34 (1973).

3. This trend has been most fully documented in Fischer, *supra* note 2, and Hausmann, *Class Actions Under the Truth-in-Lending Act*, 1 CLASS ACTION REP. 26 (1972). *See also* Garwood, *Class Action Limits and Case Trends in Truth-in-Lending*, 89 BANKING L.J. 803 (1972); Note, *Class Actions Under the Truth-in-Lending Act*, 83 YALE L.J. 1410 (1974).

4. 59 F.R.D. 99 (1973).

5. Another decision that has expressly rejected *Ratner* is Eovaldi v. First Nat'l Bank, 57 F.R.D. 545 (N.D. Ill. 1972). In *Eovaldi* the court tentatively allowed the class action on the condition that the plaintiffs amend their complaint to sue only for actual damages and attorneys' fees and waive the $100 minimum recovery established by 15 U.S.C. § 1640 (1970). Apparently, the huge liability that could result from class action treatment of even a minor violation of the Act seemed to the court to violate substantive due process. In the absence of such a waiver, therefore, Judge McMillen requested the parties to brief the question of the constitutionality of the damage provisions of the Act in a class action situation. The court pointed out that the lack of a relation between the statutory and actual damages might constitute deprivation of the defendant's property without due process of law.

of the doctrine of *Hanna v. Plumer*[6] to rule 23 of the Federal Rules of Civil Procedure. In *Hanna* the Supreme Court held that where state law called for use of one procedure and the Federal Rules called for another, the federal rule was to be applied in cases based upon diversity of citizenship jurisdiction. The impact of this holding upon state policy was demonstrated in *Kristiansen*, where the court allowed a pendent claim under the New York state truth-in-lending act[7] to proceed as a class action, despite a clear state court decision prohibiting such class suits.[8] Judge Bartels held that in accordance with *Hanna*, the procedural nature of the question of class maintainability overruled the policy considerations that underlay the state court's prohibition.[9]

Plaintiff Helen Kristiansen brought this suit as a class action against John Mullins & Sons, Inc., a retail furniture chain store located in a New York City ghetto area.[10] The plaintiff was one of a large number[11] of Mullins' customers who had purchased furniture on installment sales contracts in which the credit terms were allegedly not disclosed in accordance with federal and state law.[12] De-

6. 380 U.S. 460 (1965).

7. N.Y. Retail Installment Sales Act, N.Y. PERS. PROP. LAW §§ 401-22 (McKinney 1969).

8. Hall v. Coburn Corp. of America, 26 N.Y.2d 396, 259 N.E.2d 720, 311 N.Y.S.2d 281 (1970).

9. 59 F.R.D. at 108-09.

10. It has been argued that Judge Bartels' deviation from the *Ratner* line of cases can be explained by the special equities of the situation in *Kristiansen*. Not only were lower-income groups affected by the defendant's alleged violations, but Mullins' unfair commercial practices had been widely publicized by the New York news media and had been the subject of public hearings by the New York City Department of Consumer Affairs. Schrag, *Recent Developments in Truth-in-Lending*, 2 CLASS ACTION REP. 65 (1973). However, there is no indication in the opinion that these considerations influenced Judge Bartels' decision.

11. The number of members in the class Kristiansen sought to represent is not given in the opinion. According to the plaintiffs' brief, however, the class consisted of "at least 1000 persons and quite possibly several times that number." Brief for Plaintiff at 4, Kristiansen v. John Mullins & Sons, 59 F.R.D. 99 (1973).

12. Specifically, the complaint alleged failures to disclose the following credit information properly: (1) the finance charge as an annual percentage rate computed in accordance with 15 U.S.C. §§ 1605 and 1606 (1970) and required to be disclosed by 15 U.S.C. § 1638(a)(7) (1970); (2) the sum of all periodic payments or to denote that sum "total of payments" as required by 12 C.F.R. §§ 226.8(b)(3) and 226.8(c) (1973). The complaint also alleged the defendant's failure to present the required information in a clear manner, with all numerical amounts and percentages in at least 10-point type, .075-inch computer type, elite-size typewritten numerals, or legible handwriting, as mandated

fendant Mullins opposed the plaintiff's motion for an order certifying the class and moved for dismissal under rule 12(b)(6) of the Federal Rules of Civil Procedure. Judge Bartels ruled that the action was a proper class suit under rule 23(b)(3) for both the federal and the state claims and denied the motion to dismiss.

The first major issue addressed in *Kristiansen* was the propriety of using the class action device to enforce a group claim under the Federal Truth-in-Lending Act. At first reading, rule 23 appears to apply to actions brought under the Act. Under rule 23 a class action can only be maintained if all the requirements of 23(a) and those of one subsection of 23(b) are met. Clearly, a suit alleging common, specific truth-in-lending violations suffered by a sizable class seems to satisfy fully the rule 23(a) requirements of: (1) numerous plaintiffs, (2) common questions of law or fact, (3) common claims or defenses, and (4) fair and adequate representation. However, the courts following the *Ratner* trend have encountered one major obstacle to a finding that the requirements of rule 23(b)(3) have been fulfilled—the Act's $100 minimum penalty.[13] A judgment of

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by 15 U.S.C. § 1631(a) (1970) and 12 C.F.R. § 226.6(a) (1973). Lastly, it was alleged that the language required by 12 C.F.R. §§ 226.8(b) and (c) (1973) had not been included. 59 F.R.D. at 102.

The Federal Truth-in-Lending Act, on which the first, second, and third causes of action were based, was passed by Congress for the purpose of fostering competition among businesses that extend credit to consumers by ensuring full disclosure of interest rates in a uniform fashion. The goal of the Act is to enable consumers to "shop around" for the best credit terms and to prevent the "uninformed use of credit." 15 U.S.C. § 1601 (1970). The Act, as implemented by Federal Reserve Regulation Z, 12 C.F.R. §§ 226.1-.13 (1973), sets forth a detailed set of requirements for the full disclosure of interest rates in standardized form. It provides for civil liability for violations of the Act to the extent of twice the amount of the finance charge, with a minimum recovery of $100 and a maximum of $1,000. 15 U.S.C. § 1640(a)(1) (1970). The Act further provides that a defendant found to be civilly liable under the Act must also pay the attorneys' fees of the plaintiff and the costs of the action. 15 U.S.C. § 1640(a)(2) (1970).

The New York state act invoked by Kristiansen in her fourth, fifth, and sixth causes of action incorporated the disclosure requirements of the Federal Act by reference and provided for liability for violation in an amount equal to the credit service charge imposed. N.Y. Retail Installment Sales Act, N.Y. PERS. PROP. LAW §§ 401-22 (McKinney 1969).

Because of the claims under both of these acts, the defendant urged dismissal on the ground that recovery under both the federal and the state acts would be duplicative. Judge Bartels met this argument by pointing out that it went only to the amount of any ultimate recovery rather than to the viability of the claims themselves and ruled that this matter should not be decided prematurely on a motion to dismiss. 59 F.R.D. at 110.

13. Note 12 *supra*. *See, e.g.*, Linn v. Target Stores, Inc., 61 F.R.D. 469

$100 for each of a large number of plaintiffs could spell financial ruin for a defendant, and this threat to defendants has been the basis of the controversy surrounding truth-in-lending class actions.[14] More than any other single factor, this possibility has prompted courts to refuse to permit class actions under the Act.

In his seminal decision in *Ratner*, for example, Judge Frankel of the United States District Court for the Southern District of New York refused to expose the defendant bank to the possibility of a $13,000,000 judgment for violations in the monthly billing statements of 130,000 Master Charge cardholders.[15] The particular violation of the Act involved was set out by Judge Frankel in his earlier decision granting plaintiff's motion for summary judgment on the merits.[16] The violation consisted of the bank's failure to include in its billing statement the annual percentage rate of interest that would be charged on credit items not paid for within 25 days after

(D. Minn. 1973); Goldman v. First Nat'l Bank, 56 F.R.D. 587 (N.D. Ill. 1972); Shields v. First Nat'l Bank, 56 F.R.D. 442 (D. Ariz. 1972); Wilcox v. Commerce Bank, 55 F.R.D. 134 (D. Kan. 1972); Rogers v. Coburn Fin. Corp., 54 F.R.D. 417 (N.D. Ga. 1972).

14. The possibility of financial ruin for the defendant has produced some strange bedfellows. Potential defendants and their counsel understandably dread the possibility of ruinous judgments against them. Davenport, *Class Suits Against Banks: The Lingering Specter*, 89 BANKING L.J. 787, 788 (1972). But also, many consumer advocates fear that the possibility of huge liabilities arising from unrestricted truth-in-lending class actions may produce a judicial backlash which would be counterproductive to their cause. *Cf.* Fischer, *supra* note 2, at 813. It is noteworthy, however, that there are no reports of a truth-in-lending class action ever having gone to trial on the merits. This fact may be attributable to the ability of plaintiffs' attorneys to use the threat of a class action to force settlement.

The problem of inordinate recoveries may be eliminated, or at least reduced, by legislative action. On July 23, 1973, the Senate passed a resolution that includes an amendment limiting recovery in a class action under the Act to the lesser of $100,000 or 1 percent of the net worth of the defendant corporation. S. Res. 2101, 93d Cong., 1st Sess., 119 CONG. REC. S14,428 (daily ed. July 23, 1973). An amendment recommended by the Federal Reserve Board to change the maximum liability to the *greater* of $50,000 or 1 percent of net worth was rejected by vote of the Senate. The congressional record of debate on the bill includes a discussion of the practical effects upon class actions under the Act that might be created by the proposed amendments. 119 CONG. REC. S14,403-31 (daily ed. July 23, 1973).

15. Judge Frankel wrote: "The proposed recovery of $100 each for some 130,000 class members would be a horrendous, possible annihilating punishment, unrelated to any damage to the purported class or to any benefit to the defendant, for what is at most a technical and debatable violation of the Truth-in-Lending Act." 54 F.R.D. at 416.

16. Ratner v. Chemical Bank N.Y. Trust Co., 329 F. Supp. 270 (S.D.N.Y. 1971).

the billing. The bank argued unsuccessfully that the Act did not require disclosure of any interest rate for the 25-day "free-ride" period, since no interest began to accrue until after this period was over.

In its decision on the merits, the *Ratner* court held that the bank's omission constituted a violation of the Act. In the subsequent ruling that disallowed the class action, however, the court characterized the violation as extremely technical and debatable.[17] Moreover, the court held that the actual harm to the purported class resulting from the violation was insignificant and did not justify imposition of the large $13,000,000 liability. According to *Ratner*, therefore, propriety of a truth-in-lending class action is to be decided by weighing the amount of the potential liability, the debatability and technicality of the violation, and the likelihood of actual harm.

The *Kristiansen* court, however, did not use this type of "balancing" approach. It did not view the possibility of a $100,000 judgment against Mullins as an obstacle to allowing the class action under the Act, even though such a liability might have proved financially disastrous to the defendant. In concluding that the suit could be maintained as a class action, the court first rejected the defendant's contention that the terms of the Act indicated a legislative intent to preclude truth-in-lending class actions.[18] Mullins had contended that the Act's award of a minimum recovery of $100 and attorneys' fees to a successful plaintiff provided sufficient incentive for individual enforcement of the Act.[19] The defendant argued that class actions were inappropriate under the Act because these provisions for enforcement by "private attorneys general" manifested congressional intent to preclude enforcement by consumer class actions.[20] The court, however, found nothing in the language or legislative history of the Act to justify this contention.[21] On the contrary, the court reasoned that the use of the class action device not only was consistent with the "private attorney general" concept, but was an indispensable means for implementing it effectively.[22] The

17. Note 15 *supra.*

18. Although no court has yet rejected a truth-in-lending class action solely on the ground that it could not lie under the Act (Fischer, *supra* note 2, at 819), several decisions preceding *Kristiansen* considered this factor. *See, e.g.*, Kriger v. European Health Spa, Inc., 56 F.R.D. 104 (E.D. Wis. 1972); Shields v. First Nat'l Bank, 56 F.R.D. 442 (D. Ariz. 1972).

19. 59 F.R.D. at 103.

20. *Id.*

21. *Id.*

22. *Id.*

court reasoned that if class actions were not allowed, the recovery available under the Act would provide insufficient incentive to induce the number of individual suits necessary to ensure widespread, scrupulous compliance with the Act.[23]

Having thus decided that class actions were available under the Act, the court addressed the question whether to allow the class action under the factual situation of the particular case. It first found that the four prerequisites of rule 23(a) had been met,[24] and then held that rule 23(b) had been complied with, in that the conditions of subsection (3) were present.[25] The court thus in short order ruled that the federal claim should proceed as a class action.

Significantly, this conclusion was reached without any discussion of the arguments relied upon by courts that have denied class actions under the Act. The *Ratner* court and those that have followed its lead[26] have found that class actions were inappropriate in cases

23. *Id.* The court added that the complexity of the calculation of credit charges in an installment contract also tends to discourage individual suits. *Id.* at 104.

The notion that the recovery provided by the Act is insufficient to ensure compliance with the Act is subscribed to by the Federal Reserve Board, which is responsible for promulgating regulations for the administration of the Act. 15 U.S.C. § 1604 (1970). In a letter to the Consumer Credit Subcommittee of the Senate Banking, Housing, and Urban Affairs Committee introducing amendments to the Truth-in-Lending Act (*see* note 14 *supra*), the Board wrote that the threat of class action exposure "elevates a possible Truth in Lending law suit from the ineffective 'nuisance' category to the type of suit which has enough sting in it to insure that management will strive with diligence to achieve compliance." 119 CONG. REC. S14,420 (daily ed. July 23, 1973).

The opinion in *Kristiansen* does not make it clear whether Judge Bartels believed that Congress had actually anticipated enforcement of the Act by class actions or that Congress had mistakenly provided insufficient incentive for individual suits to ensure compliance with the Act.

24. 59 F.R.D. at 104. Rule 23(a) reads as follows:

> (a) *Prerequisites to a Class Action.* One or more members of a class may sue or be sued as representative parties on behalf of all only if (1) the class is so numerous that joinder of all members is impracticable, (2) there are questions of law or fact common to the class, (3) the claims or defenses of the representative parties are typical of the claims or defenses of the class, and (4) the representative parties will fairly and adequately protect the interests of the class.

FED. R. CIV. P. 23(a).

25. 59 F.R.D. at 106. Rule 23(b) requires that the conditions of one of three possible subsections be met. Subsection (b)(3), under which most truth-in-lending class actions have been brought is met only if "[t]he court finds that the questions of law or fact common to the members of the class predominate over any questions affecting only individual members, and that a class action is superior to other available methods for the fair and efficient adjudication of the controversy."

26. *See* notes 2, 3 *supra.*

where immense liabilities, unrelated to actual harm, could result from highly technical violations of the Act. These courts have pointed to the requirement of rule 23(b)(3) that where the basis of a class action is the predominance of common questions of law and fact, the judge may certify the class only if it appears that the "class action is superior to other available methods for the fair and efficient adjudication of the controversy."[27] In turn, these courts have defined "superiority" to include a measure of fairness, which is deemed violated when inordinately large recoveries result from the minimum liability provision of the Act.

There are various ways in which the *Kristiansen* court could have countered this generally accepted, though questionable reasoning. It could have argued, for example, that the possibility of a ruinous judgment against the defendant is simply not a proper ground for disallowing a class action under rule 23(b)(3). Although it is indisputable that a court is called upon to exercise its discretion in deciding when a class action is a "superior" procedure in a given controversy, the four factors that 23(b)(3) requires a court to examine in determining the applicability of the rule[28] have nothing to do with the possible financial impact that allowance of the class might have upon the defendant. Therefore, even though the phrasing of rule 23(b)(3) and the notes of the Advisory Committee[29] make it clear that the rule's list of relevant factors is not exhaustive, to look to the financial impact of permitting the class action is to add a consideration of a different nature from those set forth in the rule. Such an addition opens an entirely new area of inquiry, which cannot be justified by the language of rule 23(b)(3). Furthermore, even if this inquiry were proper, it would reveal that courts frequently enforce judgments that result in bankruptcies in areas ranging from mortgage foreclosures to recoveries under the securities laws.[30]

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27. FED. R. CIV. P. 23(b)(3).

28. Rule 23(b)(3) lists four factors that must be weighed in making this decision:

> (A) the interest of members of the class in individually controlling the prosecution or defense of separate actions; (B) the extent and nature of any litigation concerning the controversy already commenced by or against members of the class; (C) the desirability or undesirability of concentrating the litigation of the claims in the particular forum; (D) the difficulties likely to be encountered in the management of a class action.

FED. R. CIV. P. 23(b)(3).

29. The notes state, "Factors (A)-(D) are listed, non-exhaustively, as pertinent to the findings." 39 F.R.D. 69, 104 (1966).

30. This point was noted in Turoff v. Union Oil Co., 61 F.R.D. 51, 54 (N.D. Ohio 1973).

The argument that a court ought somehow to weigh the gravity of the violation and the scope of the harm against the potential liability is not only unsupported by the text of rule 23, but is also without any support in the Truth-in-Lending Act itself. The Act makes no distinction between minor technical violations, which may cause slight harm, and substantial ones, which may gravely prejudice the ability of consumers to make an informed choice of credit. On the contrary, it can be argued that the very purpose of providing a $100 minimum recovery under the Act was to encourage suits for violations involving negligible, speculative, or unprovable damages.[31] Arguably, therefore, recovery for a class should not be denied merely because damage to its members is slight in proportion to the amount of a possible judgment against the defendant. Courts that have rejected class actions under the Act because of the possibility of a disproportionately large recovery have thus ignored the purpose of Congress in providing for a $100 minimum recovery.

The significance of the problem of disproportionate recoveries in truth-in-lending class actions is illustrated by the lengths to which some courts have gone in order to avoid imposing severe judgments in situations in which they felt the class suit should be maintained. For example, in *Eovaldi v. First National Bank*[32] the District Court for the Northern District of Illinois permitted a class action to proceed on the condition that the plaintiffs' attorneys amend their complaint to waive the $100 minimum recovery and sue only for actual damages and attorneys' fees.

Such a remarkable solution to what judges have viewed as the problem of disproportionate recoveries demonstrates judicial sensitivity to the potential plight of the defendant in a truth-in-lending class suit. The question then becomes, why did the *Kristiansen* court not respond in any way to this generally decisive issue? It could have disposed of the *Ratner* rationale by showing that *Ratner* was incorrect in viewing a disportionate recovery as an absolute bar to class treatment. Alternatively, the court could have distinguished the factual situation in *Kristiansen* and argued that even if the *Ratner* result did have merit based on the peculiar facts of that case, employing this approach would not require rejection of the class under the facts of the instant case.[33] In contrast to the *Ratner*

31. *See* Fischer, *supra* note 2, at 816.

32. 57 F.R.D. 545 (N.D. Ill. 1972).

33. Judge Bartels did point out that "closed-end" contracts were involved in *Kristiansen*, as distinguished from "open-end" contracts, which were at issue in *Ratner*. In footnote two of his opinion he stated, "Open-end credit sales

situation, the alleged violations in *Kristiansen* were clear, and not based on disputable technicalities.[34] Additionally, the figure of $100,000 in damages is quite small in comparison with the damages of $13,000,000 involved in *Ratner*, and it may not even have represented a substantial sum in proportion to defendant's assets.[35]

But in order to have distinguished *Ratner* properly, the *Kristiansen* court would have been required to determine how to weigh the various considerations that compelled disallowance of the class in *Ratner*. The elements of disputability of the violation, size of the class, and the likelihood of actual harm would have had to have been measured in accordance with some standard. In *Ratner* such a measurement was not necessary, since each of the elements was present in an extreme form. Whether the failure of the bank to state the annual percentage rate during the "free-ride" period constituted a violation of the Act was a very close question, the 130,000 member class was extraordinarily large, and the actual harm to the plaintiffs was very doubtful, since most of the cardholders probably knew how much interest they would have to pay after the "free-ride" was up.

But if any or all of these items had been less extreme, how should the court have balanced them? If the violations had been obvious, would the $13,000,000 judgment have then been appropriate? Or if there had been only a few cardholders, would the class have been permissible? Clearly, fashioning a rule for an objective measurement of the factors relevant under the *Ratner* approach is difficult. It requires not only that each element be evaluated individually, but also that it be weighed against the other factors. Such a process is very unlikely to provide a uniform rule for determinining the allowability of truth-in-lending class actions.

For this reason, the *Kristiansen* court would have been on firm

present more difficult and complex problems for class actions than closed-end credit sales." 59 F.R.D. at 102 n.2. "Open-end" credit agreements are those, best typified by the gasoline credit card, which involve repeated credit purchases billed on a monthly basis. "Closed-end" credit transactions are those in which a buyer takes immediate possession of the goods, which he pays for on an installment basis. Open-end suits are typically brought on behalf of a huge number of credit card holders alleging highly technical violations in their monthly statements. Closed-end suits are likely to involve smaller classes of less affluent consumers asserting more significant attempts to obscure interest rates on the part of creditors.

34. *See* note 12 *supra*.

35. The size of the potential liability in *Kristiansen* is uncertain. It is at least $100,000, but perhaps several times that amount. *See* note 11 *supra*.

ground if it had issued a forthright rejection of the *Ratner* rationale. Since it did not, there remains much doubt whether the court permitted the class action because it felt the facts of the case did not compel disallowance under the *Ratner* approach or because it believed that approach was wrong.

It is important to note that an express rejection of the *Ratner* rationale would not have necessitated a holding that truth-in-lending class actions should invariably be permitted. On the contrary, the circumstances of an individual case might well give rise to sound reasons for disallowing a class. For example, where the violation is so strictly technical as to have caused no harm to the plaintiffs, it could be argued that the court ought not burden itself and the defendant with a class action. The precept that the law does not concern itself with trifles could properly be brought to bear in examining the nature of the violation apart from the amount of the recovery.

For example, if a credit agreement presented an interest rate properly in every respect except that it used 9-point type instead of the 10-point type required by the Act,[36] a court could find such a violation to be *de minimis*. However, the size of the possible recovery should not be allowed to influence the court's judgment in deciding whether such a violation is trifling. This decision ought to be made independently, not through the process of balancing the degree of harm against the financial interests of the defendant as *Ratner* would require.

Indeed, *Ratner* itself provides excellent evidence of the distortion of a court's perspective that can result from estimating the seriousness of a truth-in-lending violation under the influence of class action pressure. In its decision on the merits the *Ratner* court granted plaintiff's motion for summary judgment without difficulty. It referred to the defendant's arguments as "weak,"[37] "demonstrably wrong,"[38] and contrary to the "thrust of the Act."[39] In its later ruling on the class action, however, it characterized the defendant's illegal activity as "at most a technical and debatable violation."[40] In all probability, the possibility of a $13,000,000 judgment modified the court's view of what had at one time seemed a substantial and obvious violation. It is precisely this sort of influence that

36. 15 U.S.C. § 1631(a) (1970).
37. 329 F. Supp. at 275.
38. *Id.*
39. *Id.* at 276.
40. 54 F.R.D. at 416.

should not taint a court's evaluation of the significance of a truth-in-lending violation, since the threat of a huge liability makes every violation appear to be a trifle.

A circumstance other than the nature of the violation that might also call for the rejection of a truth-in-lending class action is the presence of improper solicitation of litigation. A number of courts have refused to allow class actions under the Act where it appeared that the plaintiffs' attorneys were motivated primarily by their own interests in initiating the litigation.[41] The extent to which attorneys may benefit from antitrust class actions at the expense of those they purport to represent has been explained in detail by William Simon.[42] When a defendant corporation is faced with even the slightest possibility of the certification of a class action that would result in a huge liability, it generally is willing to settle out of court for a sum which, though substantial, represents a fraction of the potential recovery.[43] In the course of settlement negotiations, it is often agreed that the bulk of this sum will go to the fees of the plaintiffs' attorneys with the remainder to be divided among the class members. The plaintiffs' attorneys, therefore, receive a windfall, and the class members get very little. Simon presented as an example of such a result the settlement of a suit against the Playboy Club from which each class member received bar chits good for three drinks, while counsel for the class was awarded $275,000.[44]

Such a result can likewise occur in truth-in-lending class actions. When a claim involving a debatable violation of little or no conceivable harm is asserted on behalf of an immense number of class members, a court should be alert to the possibility that the interests of the class members might well be sacrificed to those of their attorneys in the course of settlement. Such a suit should be closely examined[45] and, when appropriate, disallowed for failure to fulfill the require-

41. *E.g.*, Shields v. First Nat'l Bank, 56 F.R.D. 442 (D. Ariz. 1972); Buford v. American Fin. Co., 333 F. Supp. 1243 (N.D. Ga. 1971).

42. Simon, *Class Actions: Useful Tool or Engine of Destruction*, 55 F.R.D. 375 (1972).

43. *Id.* at 389-90.

44. *Id.* at 378.

45. In Buford v. American Fin. Co., 333 F. Supp. 1243 (N.D. Ga. 1971), one of the reasons for denying a truth-in-lending class action was that the attorney for the class was also a member of it. The potential abuse of rule 23 invited by this situation prompted the warning that "[u]ntil otherwise directed this court, for one, intends to carefully scrutinize every action in which plaintiffs seek monetary relief and wish to represent a class of similarly situated persons . . . ." *Id.* at 1251.

ment of rule 23(a)(4) that the representative parties fairly and adequately protect the interests of the class.[46]

In addition to the nature and extent of the violation and the presence of improper solicitation of litigation, a third factor for court consideration in deciding the propriety of a truth-in-lending class action is the practical availability of enforcement by the Federal Trade Commission, the primary enforcement agency under the Act.[47] Since the capacity of the agency to supervise credit transactions is finite, it has been held that class actions are most appropriate as a secondary enforcement device to ensure that small credit institutions not scrutinized by the FTC comply with the Act.[48] Thus the "private attorney general" concept, implicit in consumer class actions, takes up only where regulation by the FTC leaves off. Therefore, in a suit brought on behalf of numerous plaintiffs against a large corporation there is less justification for allowing the class, since FTC action would be a more efficient means of enforcement of the Act.

Perhaps the failure of the *Kristiansen* court to discusss the difficulties associated with disproportionate recoveries can only be explained by reference to the attitude it expressly adopted toward the class action device in the latter part of the decision. For as will be shown below, in permitting class hearing of the pendent state claim, the court held that the class action was strictly a procedural tool, without substantive impact.[49] Similarly, in deciding to allow class treatment of the federal claim, the court looked only to procedural considerations. The method by which the court could most fairly and efficiently adjudicate the claims of a large number of parties was its sole concern,[50] and it did not find it necessary to inquire into matters beyond the express prerequisites of rule 23.

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46. Failure to fulfill the requirement of rule 23(a)(4) was one of the grounds for denying the class action in Shields v. First Nat'l Bank, 56 F.R.D. 442 (D. Ariz. 1972), another truth-in-lending class action in which the plaintiffs' attorney was also a member of the rejected class.

47. 15 U.S.C. § 1607(c) (1970).

48. Turoff v. Union Oil Co., 61 F.R.D. 51, 55 (N.D. Ohio 1973).

49. *See* text accompanying note 91 *infra.*

50. Curiously, in reaching the determination as to the relative efficiency of the class action proceeding, Judge Bartels proceeded under an assumption that was at odds with his own earlier conclusion. He had previously concluded that the financial incentive was insufficient to encourage individual suits under the Act. 59 F.R.D. at 103. Later in the same opinion, he apparently concluded that the class action procedure was necessary in order to avoid the inefficiency that could result from the litigation of a large number of individual claims. *Id.* at 106. However, if class treatment were not allowed, and assuming the

While cases such as *Kristiansen* and *Ratner* demonstrate the lack of complete predictability in the federal court treatment of truth-in-lending class actions, *Hall v. Coburn Corp. of America*[51] left no doubt that class actions would not be allowed in cases under New York State truth-in-lending law. There, plaintiff Hall alleged that printed retail installment contracts through which defendant Coburn had provided financing for carpet purchases failed to meet the requirements of the New York Retail Installment Sales Act,[52] the forerunner of the present New York truth-in-lending law. The contract forms had been prepared by Coburn and distributed to various retail carpet sellers. The contracts of sale had thereafter been assigned by the sellers to Coburn. Hall alleged that the aggrieved class consisted of all persons who had purchased merchandise by means of these contracts.

Without reaching the merits of the case, the New York Court of Appeals rejected the proposed class action. It stated: "[T]here must be more of a common interest than the fact that a number of persons made a number of quite different and unrelated contracts with a number of different and unrelated sellers using the same written form which is claimed to be illegal."[53] However, this

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correctness of the earlier conclusion that the Act offered insufficient incentive for individual suits, it is probable that no more than a few members of the rejected class would bother to sue individually. Thus, the class action device would not be required in order to avoid inefficiency, since the few claims could be handled efficiently by joinder of the parties. In effect, Judge Bartels' justification for allowing the class action was that it solved the very problem it created—the presence of a large number of claims. Other courts have denied class actions in order to avoid the problem altogether. *See* cases listed in Fischer, *supra* note 2.

This conflict between the court's earlier conclusion and later assumption is a result of its failure to contend with a central issue inherent in consumer class actions generally. A consumer class action brings before the court a large number of parties who would be unlikely to bring suit on their own initiative and, therefore, forces a court to decide whether or not to provide a mechanism for righting the wrongs against a class, the majority of the members of which possibly do not know or care that they have been wronged. Of course, courts may be faced with the necessity of making this decision less frequently in the future, in view of the Supreme Court's recent holding in Eisen v. Carlisle & Jacquelin, 417 U.S. 156 (1974), that plaintiffs must bear the cost of notice to the class in a rule 23(b)(3) action.

51. 26 N.Y.2d 396, 259 N.E.2d 720, 311 N.Y.S.2d 281 (1970).

52. N.Y. Retail Installment Sales Act ch. 599 [1957], N.Y. Laws 657, *as amended*, N.Y. PERS. PROP. LAW §§ 401-14 (McKinney 1969). The suit in *Hall* was initiated before July 1, 1969, the effective date of the Federal Truth-in-Lending Act and the state amendment which incorporated it into New York law.

53. 26 N.Y.2d at 400, 259 N.E.2d at 721, 311 N.Y.S.2d at 282.

procedural basis for the holding in *Hall* is not entirely convincing. Arguably this case is just the sort in which class treatment would be appropriate, since the use of a single printed contract form should create identical issues of law in the claims of each of the class plaintiffs. Indeed, the court of appeals admitted that the cases dealing with the requirements for a class action in New York were inconsistent and that it was forced to rely upon an "overall appraisal"[54] of them in deciding to reject the class. Clearly, given this inconsistent case law, the court could have allowed the class without departing from these earlier precedents.

It is probable, therefore, that the court's decision not to allow the class action was actually determined by the policy considerations set forth in the opinion. The court reasoned that class action suits under the New York statute would unnecessarily harass finance companies that underwrote credit sales. The real problem of retail credit buying, it stated, was the high cost of credit. This problem would not be solved by allowing truth-in-lending class actions. Rather, the court continued, the primary beneficiaries of such class suits would be the attorneys who activated the litigation.[55]

The federal court deciding *Kristiansen* was thus faced with a clear state court holding that truth-in-lending class actions were inappropriate because they gave rise to harassment of credit institutions and undesirable solicitation of litigation. The policy behind the New York ruling was clear. Therefore, the question Judge Bartels had to decide was whether the existence of this state policy required disallowance of class treatment of Kristiansen's pendent state claim, even though rule 23 permitted class treatment for the identical federal claim.[56]

The *Kristiansen* court concluded initially that analysis of this issue should proceed on the same basis regardless of whether the court was hearing a state claim based on pendent or on diversity jurisdic-

54. *Id.* at 401, 259 N.E.2d at 721, 311 N.Y.S.2d at 283.

55. *Id.* at 404, 259 N.E.2d at 723, 311 N.Y.S.2d at 286. *See* notes 41-45 *supra* and accompanying text.

56. In footnote 14 of his opinion Judge Bartels disposed of the suggestion that the court should avoid collision with state law by refraining from exercising pendent jurisdiction altogether. 59 F.R.D. at 109 n.1. He noted that the complaint in *Hall* was filed in the state court before the effective date of the federal and amended state truth-in-lending acts, and thus before any basis for pendent jurisdiction existed. However, this fact seems irrelevant since the *Hall* statements of policies against harassment of credit institutions and encouragement of solicitation of litigation should apply equally to the present state act.

tion[57] and then proceeded to apply its interpretation of the doctrine of *Erie Railroad Co. v. Tompkins*[58] and its progeny. In *Erie* the Supreme Court reversed the traditional rule of *Swift v. Tyson*[59] by holding that in a diversity action a federal court must apply the substantive law of the state in which it sits, as reflected not only in the state's statutes but also in its judicial decisions. The court based this conclusion on three different grounds. First, it held that the federal courts had no power to declare rules of substantive law beyond that granted specifically by the Constitution.[60] Therefore, the federal courts were not to create their own federal common law but rather, state substantive law had to be applied. Secondly, the Court construed the word "laws" in the Rules of Decision Act,[61] which was passed by the Congress in 1789 to establish a rule for the choice of law in diversity actions, to mean both judicial and statutory law.[62] Finally, the Court looked to policy considerations underlying the Constitution and the Rules of Decision Act and concluded that unfairness to diversity defendants would result from a declaration and application of federal common law, since a plaintiff could choose the forum that offered law most favorable to his claim.[63]

Erie clearly established that all state substantive law had to be applied in diversity actions in federal courts. The more difficult question, which *Erie* left unanswered, was: "What is substantive law

57. The court cited Briskin v. Clickman, 267 F. Supp. 600 (S.D.N.Y. 1967), and Mintz v. Allen, 254 F. Supp. 1012 (S.D.N.Y. 1966), to support this conclusion. Of course, Judge Bartels could have avoided the issue of allowability of the class action in the pendent claim by exercising his discretion to refuse to hear it at all. Fundamental to the concept of pendent jurisdiction is the idea that needless decisions of state law should be avoided as a matter of comity. United Mine Workers v. Gibbs, 333 U.S. 715, 728 (1965). By hearing the pendent claim in *Kristiansen*, the court arguably generated needless friction between federal and state law, and it thus ought to have denied hearing of the pendent claim altogether. Nevertheless, Judge Bartels found it proper to hear the state claim and refused to "emasculate" the pendent jurisdiction of the court by limiting the state cause of action to individual treatment for the sake of comity. 50 F.R.D. at 100, 110.

58. 304 U.S. 64 (1938).

59. 41 U.S. (16 Pet.) 1 (1842).

60. 304 U.S. at 78.

61. Originally promulgated as § 34 of the Federal Judiciary Act of 1789, the Rules of Decision Act provides: "The laws of the several states, except where the Constitution or treaties of the United States or Acts of Congress otherwise require or provide, shall be regarded as rules of decision in civil actions in the courts of the United States, in cases where they apply." 28 U.S.C. § 1652 (1970).

62. 304 U.S. at 72-73.

63. *Id.* at 74-77.

and what is procedural?" The importance and difficulty of answering this question became increasingly clear as the series of Supreme Court decisions following *Erie* threatened the then recently-attained uniformity of procedure in the federal courts under the Federal Rules of Civil Procedure.[64] For under the test that the Court was developing, any rule that could result in a change in the outcome of the case at hand was deemed to be substantive.[65] Since *Erie* required the application of state substantive law almost every Federal Rule seemed to be subject to displacement in diversity actions by its state counterpart. To resolve this problem, the Supreme Court in 1965 decided *Hanna v. Plumer*,[66] the case relied upon by the *Kristiansen* court in deciding to allow class hearing of the pendent claim.

Hanna involved a negligence action brought in a federal district court on the basis of diversity of citizenship. The summons and complaint were delivered to the wife of the defendant executor, a method permitted by rule 4(d)(1) of the Federal Rules of Civil Procedure. In his answer, the defendant urged that the suit could not be maintained, since service of process had been insufficient under a state statute that required in-hand service upon an executor.[67] The district court held for the defendant, and the court of appeals, affirming, concluded that service of process was a matter of substantive law.[68] The Supreme Court reversed, holding that the state statute could not overcome the federal rule.

The majority opinion in *Hanna*, written by Chief Justice Warren, can be divided into two parts. The first part discussed the application of the traditional *Erie* doctrine to the facts of *Hanna*, apart from the significance of the fact that one of the federal rules was involved. The second part examined the status of the Federal Rules vis-a-vis state law and the significance of the Enabling Act, under which the Rules were promulgated.[69]

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64. Ragan v. Merchants Transfer Warehouse Co., 337 U.S. 530 (1949); Guaranty Trust Co. v. York, 326 U.S. 99 (1945).

65. Guaranty Trust Co. v. York, 326 U.S. 99 (1945).

66. 380 U.S. 460 (1965).

67. MASS. GEN. LAWS ANN. ch. 197, § 9 (Supp. 1972).

68. Hanna v. Plumer, 331 F.2d 157, 159 (1964). The court of appeals reasoned that actual record notice appeared as much a substantive state requirement as the state bond-posting requirement that the Supreme Court had held must be complied with in diversity actions in the federal courts. Cohen v. Beneficial Loan Corp., 337 U.S. 541 (1949); *see* text accompanying note 85 *infra*.

69. The Enabling Act provides:

> The Supreme Court shall have the power to prescribe by general

In the first part of its opinion, the majority held that traditional *Erie* analysis would have permitted application of the federal rule in the case.[70] The Court looked behind the "outcome determinative" test for the considerations that underlay *Erie* and found that *Erie* was based on the twin considerations of avoidance of "inequitable administration of the laws"[71] and "forum shopping."[72] The Court reasoned that the Constitution and the Rules of Decision Act required federal courts to be sensitive to considerations of fairness to the defendant in a diversity action. Since it would be unfair to subject a defendant to different substantive laws than those by which he would be bound in the courts of his state, a federal rule that materially altered the "character or result"[73] of a suit would have to give way to state law. Likewise, a federal rule could not be applied if it would lead to "forum shopping" by giving an out-of-state plaintiff the opportunity to select the court, federal or state, that would be more favorable to his claim.

In accordance with this reasoning, the Court concluded that permitting service of process by other than the in-hand method in *Hanna* would not have given rise to the sort of "inequitable administration of the laws"[74] with which *Erie* was concerned, because it would not alter the "character or result" of the litigation. That is, the defendant would not be subjected to any heavier burden in federal court than he would face in state court. Furthermore, the Court stated that the absence of a requirement of in-hand service in rule 4(d)(1) would probably have little effect on the plaintiff's choice of forum.[75] Therefore, the Court ruled that even under traditional *Erie* doctrine there was no obstacle to application of the Federal Rule.

In the second part of the opinion the Court set forth what has emerged as the *Hanna* doctrine, while the alternative holding of the first part of the opinion has been overshadowed.[76] Simply stated,

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rules, the forms of process, writs, pleadings, and motions, and the practice and procedure of the district courts and courts of appeal of the United States in civil actions . . . .

Such rules shall not abridge, enlarge or modify any substantive right . . . .

28 U.S.C. § 2072 (1970).

70. 380 U.S. at 466.

71. *Id.* at 468.

72. *Id.*

73. *Id.* at 467.

74. *Id.* at 468.

75. *Id.* at 469.

76. *See* C. WRIGHT, HANDBOOK OF THE LAW OF FEDERAL COURTS § 59 (2d ed. 1970).

the doctrine holds that where a Federal Rule dictates the use of one procedure and state law dictates another, the Federal Rule must prevail.[77] This results from the reasoning that since a given federal rule cannot be both procedural and substantive, and since Congress believed that the inclusion of the rule in the Federal Rules of Civil Procedure violated neither the terms of the Enabling Act nor the Constitution,[78] then the rule is prima facie procedural in all contexts. Since *Erie* allows the use of federal procedure, the Federal Rule must apply. According to this syllogism, a conflicting state rule can be disregarded unless the Federal Rule in effect enacts substantive law without any express grant of power in the Constitution to do so or unless the Rule violates the command of the Enabling Act that no Rule shall "abridge, enlarge or modify any substantive right. . . ."[79] Applying this reasoning to the specific factual situation of *Hanna*, the Court held that it was within the power of Congress to enact rule 4(d)(1) as a necessary and proper exercise of its power to establish the federal court system under Article III of the Constitution.[80] This was true even though it could be argued that rule 4(d)(1) affected state substantive law, since the power of Congress extended to regulation of matters "which, though falling within the uncertain area between substance and procedure, are rationally capable of classifications as either."[81] As to rule 4(d)(1)'s propriety under the Enabling Act, the Court simply stated that the rule was procedural, since it merely constituted a "mode of enforcing state-created rights."[82]

The majority's analysis of *Hanna* came under immediate attack from Justice Harlan in his concurring opinion. Justice Harlan characterized the court's rule as an "arguably procedural, *ergo* constitutional test,"[83] which gave an unwarranted presumption of validity to the Federal Rules. He argued that the effect of a given rule on state policy should be the starting point in examining its validity.

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77. *Id.*

78. In regard to the constitutional issue, Chief Justice Warren wrote in *Hanna*: "We are reminded by the *Erie* opinion that neither Congress nor the federal courts can, under the guise of formulating rules of decision for federal courts, fashion such rules which are not supported by a grant of federal authority contained in Article I or some other section of the Constitution . . . ." 380 U.S. at 471.

79. 28 U.S.C. § 2072 (1970).

80. 380 U.S. at 472.

81. *Id.*

82. *Id.* at 473.

83. *Id.* at 476.

Approaching the issue of choice of law in diversity actions as one governed by the Constitution, he argued that if the application of a federal rule "would substantially affect those primary decisions respecting human conduct which our constitutional system leaves to state regulation,"[84] then the state rule would have to prevail.

Justice Harlan's broad rule might have been obscure indeed had he not illustrated it with examples of how his proposal would have applied to the previous cases in the *Erie* line. The example that is relevant to this discussion is *Cohen v. Beneficial Industrial Loan Corp.*[85] In that case the Supreme Court had held that in a class action under old rule 23[86] brought in federal court under diversity jurisdiction, a New Jersey statute requiring the plaintiff to post a bond in all stockholders' derivative actions had to be given effect. In his *Hanna* opinion, Justice Harlan viewed the statute involved in *Cohen* as designed to inhibit the initiation of "strike suits" and, since it could be expected to accomplish this result, the statute affected "private primary activity."[87] Thus, application of the Federal Rule, which did not require the posting of a bond in such suits,[88] would have affected a "primary decision respecting human conduct"[89] by vitiating the state policy behind the statute. For this reason, Justice Harlan concluded that the Court had properly applied the state statute in *Cohen* by not allowing the suit to proceed as it would have under the Federal Rule.

At the time of *Kristiansen*, the *Hanna* decision, with its two rationales in the majority opinion and its persuasive concurring opinion by Justice Harlan, constituted the controlling precedent on the question of the allowability of the class action on the pendent state claim. The *Kristiansen* court held that *Hanna* required certification of the class action on the pendent claim under rule 23, in spite of the contrary state policy set forth in *Hall*. In reaching this decision, the *Kristiansen* court looked initially to the second part of the *Hanna* majority opinion. It held that under the circumstances of the case rule 23 was one of those matters which could be rationally classified

84. *Id.* at 475 (footnote omitted).

85. 337 U.S. 541 (1949).

86. The class action procedures set forth in old rule 23 were completely revised in 1966. 39 F.R.D. 69 (1966).

87. 380 U.S. at 477.

88. The Supreme Court in *Cohen* held that since rule 23 established the requirements for a stockholders' derivative action without mentioning the posting of a bond, there was no conflict with the New Jersey statute. 337 U.S. at 556. *But see* text accompanying note 107 *infra*.

89. 380 U.S. at 475.

as substantive or procedural.[90] Since its presence in the Federal Rules made the rule presumptively procedural under *Hanna*, the state ruling against class actions could be ignored.[91]

Perhaps because it did not feel comfortable with this simplistic argument, the *Kristiansen* court next turned to Justice Harlan's concurring opinion for additional support. Rather than looking to see if the rule in *Hall* was based on any discernible state policy, however, the Court questioned whether application of rule 23 in the case would infringe any substantive right of the defendant.[92] It reasoned that a truth-in-lending defendant could not be said to have a substantive right to be exempt from class actions.[93] Therefore, it concluded, the rule enunciated in *Hall* did not protect any substantive right and thus did not constitute a "primary decision respecting human conduct," which Justice Harlan believed could not be overcome by one of the Federal Rules.[94]

Although the way in which the *Kristiansen* court used *Hanna* left much to be desired, it is at the outset hard to criticize it for the way it mechanically applied the majority opinion. Indeed, the *Kristiansen* court interpreted the majority opinion exactly as Justice Harlan did,[95] reducing its reasoning to "if it is in the Rules, it must be procedural." A more careful examination of the majority opinion in *Hanna*, considering both its first and second rationales, however, would have led to a different result in *Kristiansen*.

It has been argued persuasively that the first part of the opinion of the Court in *Hanna*, the part which discussed traditional *Erie* doctrine, is completely irrelevant whenever the applicability of one of the Federal Rules is in issue.[96] But if this were true, it would be difficult to explain why the Court devoted so much of its opinion to discussing the propriety of applying rule 4(d)(1) in the light of the policy considerations underlying *Erie*. Furthermore, the Court stated in the last paragraph of its opinion that "a court, in measuring a Federal Rule against the standards contained in the Enabling Act and the Constitution, need not wholly blind itself to the degree to which the Rule makes the character and result of the litigation stray

90. 59 F.R.D. at 108.
91. *Id.* at 108-09.
92. *Id.* at 109.
93. *Id.*
94. *Id.* at 109.
95. *See* text accompanying note 83 *supra*.
96. Ely, *The Irrepressible Myth of Erie*, 87 HARV. L. REV. 693, 738 (1974).

from the course it would follow in state courts. . . ."[97] This statement is a clear reference to the first part of the opinion, which dealt with the twin problems of altering the "character or result" of litigation brought in federal courts under diversity jurisdiction and "forum shopping." The *Hanna* majority must have meant that a case could arise in which an examination of these considerations would argue for not applying the Federal Rule. *Kristiansen* was just such a case.

First, allowance of the class action in *Kristiansen* apparently resulted in inequitable administration of the laws because it subjected the defendant to a much heavier litigation burden than in an individual suit in a New York state court. Moreover, application of rule 23 significantly altered the "character" of the suit in the sense that it placed substantial additional burdens on the defendant in preparing for trial, greatly increased the size of the potential damage recovery, and created the possibility of spawning such evils as litigative harassment and solicitation of litigation. In *Kristiansen*, therefore, the alteration of the character of the suit, at least with respect to the pendent claim, gave rise to just the sort of inequity contemplated by the *Hanna* analysis of *Erie*.

Secondly, the allowability of a class action under truth-in-lending laws in a federal court would plainly lead to "forum shopping." Since *Hall* foreclosed the possibility of bringing a truth-in-lending class action in New York State court, consumers seeking redress for their class would naturally go to federal court, where class actions were available. On those grounds again, traditional *Erie* doctrine would have called for disallowance of class treatment for the pendent claim.

The effect of rule 23 on state law in *Kristiansen* was much greater than that of rule 4(d)(1) in *Hanna*. In *Hanna* the Court was able to state that it would have applied rule 4(d)(1) even if the overriding force given to the Federal Rules in the second part of its opinion was not a factor.[98] This could not have been contended in *Kristiansen*, since the circumstances of the case called for rejection of the Federal Rule under a straight *Erie* analysis. Had the *Hanna* court been faced with the *Kristiansen* situation, it would have been forced to decide whether to follow *Erie* and apply state law in place of the Federal Rule or whether to hold explicitly that the preferred status of the Federal Rules gave rise to an exception to the *Erie* doctrine.

97. 380 U.S. at 473.
98. *Id.* at 466.

The *Kristiansen* court apparently interpreted *Hanna* to have adopted the latter view, since it considered only the second part of the majority opinion. But even its application of this portion of *Hanna* was incorrect. For the *Kristiansen* court, as did Justice Harlan, failed to recognize that inclusion of a rule in the Federal Rules made it only "prima facie"[99] procedural. *Hanna* left open the question of when this presumption of a Federal Rule's conformity with the Constitution and the Enabling Act could be rebutted. Again, *Kristiansen* arguably presents such circumstances.

According to the *Hanna* doctrine even one of the Federal Rules of Civil Procedure would have to yield to state law if its substantive effect went beyond the constitutional grant of power to the federal government or violated the constraints of the Enabling Act. Clearly there is no constitutional problem in *Kristiansen*, since application of rule 23 to the New York truth-in-lending laws would not result in any exercise of federal power beyond that used by Congress in providing for class actions under the Truth-in-Lending Act.[100] The Enabling Act, however, does represent an obstacle to a class hearing of the pendent claim in *Kristiansen*, since use of rule 23 would nullify the state substantive law set forth in *Hall*.

The *Kristiansen* court, in the course of its discussion of Justice Harlan's opinion in *Hanna*, ruled that use of the Federal Rule would not infringe the rights of the defendant, since it had no right to be immune from class actions.[101] In so ruling, however, the court ignored the state policy considerations that underlay *Hall*: the need to prevent both harassment of credit institutions and improper solicitation of litigation.[102] Since choice of the Federal Rule vitiated

99. *Id.* at 471.

100. It has been asserted that the Constitution is functionally irrelevant in all cases covered by the Enabling Act, since the Constitution does not establish a "state enclave" model but merely requires the federal government to act within the scope of its enumerated powers. Because these powers are so broad, the argument continues, the Enabling Act imposes a much stricter limitation than does the Constitution. Ely, *supra* note 96, at 706 & n.77.

101. 59 F.R.D. at 109.

102. In defense of Judge Bartels' opinion it can be argued that the discussion of policy considerations set forth in *Hall* could actually be disregarded because they constituted mere dictum, while the narrow ground for rejection of the class suit was the insufficient showing of common interest among the members of the class. *See* text accompanying note 53 *supra*. However, in viewing *Hall* as standing for the broader proposition that class actions were inappropriate in state truth-in-lending cases, Judge Bartels correctly understood that the real reasons for disallowing the class were those reflected in the dictum, and that the narrow procedural grounds for the dismissal were only camouflage for the substantive policies underlying the decision.

these policy considerations, it modified the New York substantive law and thereby violated the Enabling Act.

Defining the word "substantive" as used in the Enabling Act in terms of state policy is not novel. It has been argued by Professor Ely that a procedural rule is "one designed to make the process of litigation a fair and efficient mechanism for the resolution of disputes,"[103] whereas a substantive rule is one established for other reasons.[104] According to this definition, the rule of *Hall* must be classified as substantive, since it sacrifices the fairness and efficiency a class action is supposed to provide in order to effect more important goals of state policy.

The importance of state policy to the choice of law in diversity cases was emphasized by Justice Harlan in his discussion of the *Cohen* case in *Hanna*. Since *Cohen* was apparently not overruled by *Hanna*, the *Kristiansen* court ought to have considered the *Cohen* treatment of state policy because of the similarity of the circumstances of the two cases. As Justice Harlan noted in his opinion in *Hanna*, the bond requirement for stockholders' suits involved in *Cohen* reflected a strong New Jersey state policy against "strike suits" and was designed to have an impact on the "private primary activity" of initiating frivolous suits.[105] In much the same way, the *Hall* decision ought to be viewed as expressing a state policy against the use of harassing class suits under the Retail Installment Sales Act.

The *Hall* ruling was obviously intended to control private litigation against credit institutions, just as the statute in *Cohen* was meant to control shareholder suits. To be sure, the methods of implementing these policies are different. New Jersey's bond requirement affords shareholders some chance to sue derivatively where they can obtain the required sum, whereas New York's blanket prohibition eliminates all state truth-in-lending class actions. However, given the difficulty of raising a bond, the result under both laws could be much the same. Yet in *Cohen* the state policy was recognized and given effect while in *Kristiansen* it was overriden.[106]

103. Ely, *supra* note 96, at 724.

104. *Id.* at 725.

105. 380 U.S. at 477.

106. It is significant that in Mintz v. Allen, 254 F. Supp. 10 (S.D.N.Y. 1966), cited by Judge Bartels merely as authority for the proposition that *Erie* applies equally to pendent and diversity jurisdiction, the court held that, in accordance with *Cohen*, state bond requirements in a stockholders' suit should be enforced by the federal courts in handling pendent claims. The *Kristiansen* court, however, failed to mention this aspect of *Mintz*.

Arguably, *Cohen* can be distinguished from *Kristiansen* in that in the former there was no direct collision between federal and state law, since there was no express federal policy against the requirement of a bond in stockholders' suits.[107] In the latter case there was a clear conflict between the state position on the allowability of truth-in-lending class actions and that of Judge Bartels. Therefore, the result in *Kristiansen* could be explained by arguing that the *presence* of a policy in favor of class actions was of greater weight than the *absence* of a policy against the bond requirement. However, the absence of a bond requirement in the Federal Rules was tantamount to an express statement of a policy against limiting access to the federal courts. In both *Cohen* and *Kristiansen*, therefore, the state laws represented obstacles to the course the litigation would have taken in the federal courts were it not for the existence of the state rules. The former case permitted the state rule to alter that course; the latter did not.

This disparate treatment of state policy may have arisen from the circumstance that in *Kristiansen* the pertinent state policy was set forth in a judicial decision and not in a statute, as it was in *Cohen*. The *Kristiansen* court might well have reacted differently if it had been faced with a statute stating that to protect credit institutions from undue harassment and to discourage improper solicitation of litigation no class action could be maintained under the state truth-in-lending laws. Such a definitive statement of policy might have carried the force of the statute requiring the posting of a bond in stockholders' derivative actions. If Judge Bartels had been confronted with such a statute, he might well have felt compelled to disallow the state class action in *Kristiansen*. Such a plain legislative declaration of policy would have been difficult to ignore and might have appeared more "substantive" if printed among the other provisions of the New York act. If it is true, however, that a legislative expression of state policy would have carried more weight in a federal court than a judicial decision of a state court, then the original issue of *Erie Railroad Co. v. Tompkins*, statutory law versus decisional law, once again appears to exist. This issue was clearly settled in *Erie* and should not have affected the result in *Kristiansen*.

In summary, the decision of the *Kristiansen* court to permit class hearing of the federal cause of action under rule 23 made it necessary for the court to decide whether the pendent claim should also

107. *See* note 88 *supra*.

proceed as a class suit. Traditional *Erie* doctrine apparently required rejection of the class, because its allowance would materially alter the character of the suit. Moreover, rule 23, as applied in *Kristiansen*, violated the Enabling Act, which was designed to preserve such state substantive law as that reflected in *Hall*. Especially since the propriety of class hearing of the federal claim was debatable, the court should have refused the class action on the pendent state claim.

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