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Notes

The Erie Doctrine

and Federal Rule 13(a)

The rationale of Erie R.R. v. Tompkins jeopardizes the applicability of many of the Federal Rules of Civil Procedure in diversity cases. The author of this Note analyzes both the nature of the federal compulsory counterclaim provision and the current standing of the Erie doctrine. He concludes that the strong federal policies behind the compulsory counterclaim rule require that it be applied in diversity cases.

In the leading case of Erie R.R. v. Tompkins, the Supreme Court ruled that the federal courts are bound to apply state law in adjudicating nonfederal questions involving substantive rules of law. The impact of this case was profound and far-reaching; Judge Learned Hand was once moved to remark, "I don't suppose a civil appeal can now be argued to us without counsel sooner or later quoting large portions of Erie Railroad v. Tompkins." The same year that the Erie case was decided, the Federal Rules of Civil Procedure were adopted to "govern the procedure in the United States district courts in all suits of a civil nature . . . ." Since the distinction between substance and procedure is often a shadowy one and since the procedural rules of the states often differ from the Federal Rules, the doctrine of the Erie case raises some doubts as to the applicability of the Rules in diversity cases where most of the issues involved are nonfederal in nature.

The answer to the question of the relationship between the Erie doctrine and the Federal Rules has thus far come only on an ad hoc basis since each of the Rules poses different problems with different underlying considerations. This Note will attempt to sug-

1. 304 U.S. 64 (1938).
3. FED. R. CIV. P. 1.
gest an answer to that question in regard to one Rule not yet considered by the courts—Rule 13(a). This Rule provides:

Compulsory Counterclaims. A pleading shall state as a counterclaim any claim which at the time of serving the pleading the pleader has against any opposing party, if it arises out of the transaction or occurrence that is the subject matter of the opposing party’s claim and does not require for its adjudication the presence of third parties of whom the court cannot acquire jurisdiction, except that such a claim need not be so stated if at the time the action was commenced the claim was the subject of another pending action.

To achieve this objective, the history, policy, and effect of compelling counterclaims will be explored; then the current standing of the Erie doctrine will be examined; and finally the question whether the federal compulsory counterclaim rule applies in diversity cases will be considered in light of these considerations.

I.

The counterclaim concept originated as a cancellation of mutual debts between the parties—at common law a defendant could reduce plaintiff’s recovery only by pleading a debt arising out of the same transaction as the plaintiff’s claim (recoupment). The assertion by the defendant of a claim not arising out of the same transaction was not allowed at law until provided by statute in 1729. This statutory provision allowing the defendant to plead his claim (set-off) was adapted from earlier equity practice. It was limited to the situation where the claims of both parties were liquidated debts, and the defendant was still not allowed affirmative relief on his claim.

The first liberalizing of these stringent requirements took place in this country. Under the state codes patterned on the Field Code, a defendant could plead claims arising from the same transaction as the plaintiff’s action or, in most states, claims founded on any contract between the parties (counterclaim). A defendant

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7. The original Field Code of 1848, N.Y. Laws 1848, ch. 379, had no provision for counterclaims; the counterclaim mentioned in the text was added by amendment in 1852. N.Y. Laws 1852, ch. 392, §§ 149–50. For those state codes adopting the New York provision, see CLARK, CODE PLEADING § 101, at 642 n.41 (2d ed. 1947).
8. See generally CLARK, op. cit. supra note 7, § 102.
9. Id. § 103.
ant could recover an affirmative judgment on his counterclaim, but generally it had to diminish or defeat the plaintiff's recovery in some way. In England, the old rules of recoupment and set-off were finally replaced by the Judicature Act of 1873 which greatly liberalized the counterclaim concept by allowing the defendant to set up as a counterclaim any claim against the plaintiff that might be the basis for a separate action. This wide latitude in the allowance of counterclaims has now been followed by the federal courts, by those states which have adopted the Federal Rules, and by some of the code states. As one commentator has observed, "a high degree of latitude in the admission of counter-demands would appear to have attained solid recognition as one of the conspicuous desiderata of modern reform."

The development of the compulsory counterclaim is of more recent origin than that of the counterclaim itself. A few early state codes provided for compulsory counterclaims, but Federal Rule 13(a) stems from the Federal Equity Rules of 1912 which provided that "the answer must state in short and simple form any counter-claim arising out of the transaction which is the subject matter of the suit . . . ." The equity rule was interpreted to

10. CLARK, op. cit. supra note 7, § 101, at 650-52.
11. 36 & 37 Vict., c. 66, § 24(3) (now Eng. Rules of Supreme Court, Order XIX, rule 3).
12. See FED. R. CIV. P. 13(b): "Permissive Counterclaims. A pleading may state as a counterclaim any claim against an opposing party not arising out of the transaction or occurrence that is the subject matter of the opposing party's claim." This rule was derived from old Equity R. 30, 226 U.S. 657 (1912). FED. R. CIV. P. 13(c) provides that the counterclaim need not defeat the plaintiff's recovery and may claim relief different in kind than that sought by the plaintiff.
14. Apparently the first broad counterclaim rule was that of Iowa, passed the year before the amendment to the Field Code mentioned in note 7 supra. Iowa Code of 1851, ch. 104, § 1740. Several other code states, including New York, California, Illinois, and Wisconsin, have also allowed wide latitude in the pleading of counterclaims. CLARK, op. cit. supra note 7, § 101, at 643-44.
15. MILLAR, op. cit. supra note 6, at 136.
16. See MILLAR, op. cit. supra note 6, at 137. A New Jersey statute of 1722 provided the first compulsory counterclaim rule—it provided that all set-offs must be pleaded or defendant will "forever after be barred . . . ."
17. Equity R. 30, 226 U.S. 657 (1912). The notes to Rule 13 state: "This is substantially Equity Rule 30 . . . broadened to include legal as well as equitable counterclaims." Advisory Committee Notes to the Rules of Civil Procedure for the United States District Courts, Rule 13, note 1, in 3A BARRON & HOLTZOFF, FEDERAL PRACTICE AND PROCEDURE: RULES EDITION
mean that these counterclaims were barred as the basis for a subsequent suit if not pleaded in the original action, and Rule 13(a) was designed to have the same effect. Rule 13(a) provides that claims arising "out of the transaction or occurrence that is the subject matter of the opposing party's claim" must be pleaded; Equity Rule 30 included only those claims arising out of the same transaction. Nevertheless, Rule 13(a) still utilizes the test developed under the equity rule to determine which counterclaims must be pleaded (any claim having a logical relationship to the claim of the opposing party). About half of the states now have some type of compulsory counterclaim rule, although not all of these rules follow the federal model.

423, 439 (rev. ed. Wright 1960). Rule 13 also is broader than Equity Rule 30 since it requires plaintiff to plead any claims arising from the same transaction or occurrence as defendant's counterclaim. Speed Prods., Inc. v. Tinnerman Prods., Inc., 222 F.2d 61 (2d Cir. 1955).

19. Advisory Committee Notes, Rule 13, note 7, in 3A BARRON & HOLTZOFF, op. cit. supra note 17, at 439.
20. This test was first set out by the Supreme Court in Moore v. New York Cotton Exch., 270 U.S. 593, 610 (1926): "Transaction" is a word of flexible meaning. It may comprehend a series of many occurrences, depending not so much upon the immediateness of their connection as upon their logical relationship. It has been often applied in cases under Rule 13 (a). E.g., National Equip. Rental, Ltd. v. Fowler, 287 F.2d 43 (2d Cir. 1961); Lesnik v. Public Indust. Corp., 144 F.2d 968 (2d Cir. 1944); Rosenthal v. Fowler, 12 F.R.D. 388 (S.D.N.Y. 1952). See also 3 MOORE, FEDERAL PRACTICE ¶ 13.13 (2d ed. 1948). For a thorough examination of the meaning of "transaction or occurrence," see Wright, Estoppel by Rule: The Compulsory Counterclaim Under Modern Pleading, 38 MINN. L. REV. 423, 437-45 (1954).

21. As mentioned in note 13 supra, about 20 states have now adopted the federal rules, and in all of them except Minnesota and New Jersey the compulsory counterclaim provision is similar in effect to Rule 13(a). MINN. R. Civ. P. 13.01 is identical to Rule 13(a) except that "or occurrence" is omitted. The effect of, and the reason for, this change is to eliminate the compelling of counterclaiming tort claims. House v. Hanson, 245 Minn. 466, 72 N.W.2d 874 (1955). N.J. RULE 4:13-1 only compels the counterclaim of "a liquidated debt or demand, or a debt or demand capable of being ascertained by calculation . . . ." This rejects Rule 13(a) and in-
Counterclaim practice has been liberalized to encourage the litigation of all claims between the parties in one lawsuit and to avoid multiplicity of litigation with all of its attendant evils—circuity of action, inconvenience, waste of time and expense for both the court and the parties, and possible injustice. This policy against multiplicity of litigation is basic to the philosophy of the Federal Rules; it lies behind the free joinder of claims by the plaintiff under Rule 18(a) and the liberal third-party practice of Rule 14.

stead follows the previous New Jersey practice of requiring the assertion of all set-offs. See N.J. Rev. Stat. § 2:26-190 (1937).

In California and the states following the California code model a defendant must “set up a counterclaim upon a cause arising out of the transaction set forth in the complaint as the foundation of the plaintiff's claim . . . .” CAL. CIV. PRAC. CODE § 439. But only those claims which tend to diminish or defeat plaintiff's recovery are classified as counterclaims, CAL. CIV. PRAC. CODE § 438, and affirmative relief that does not do so can be secured only by a cross-complaint which is always permissive. CAL. CIV. PRAC. CODE § 442. See generally Comment, 1 U.C.L.A.L. REV. 547, 566-68 (1954).

Arkansas provides that “the defendant must set out in his answer as many grounds of defense, counter-claim or set-off . . . as he shall have.” ARK. STAT. § 27-1121 (1947). Since “counterclaim” under Arkansas law includes all causes of action, ARK. STAT. § 27-1123 (1947), every claim held by the defendant against the plaintiff must be pleaded or will be lost. Corey v. Mercantile Ins. Co., 207 Ark. 284, 180 S.W.2d 570 (1944).


[I]t is our theory of the action . . . that the civil action when brought should include all the points of difference between the parties. This is based on the theory that it is a sound and a desirable thing that all spots of irritation between the parties should be brought out into the open and should be fought over and disposed of at one time. It saves trouble and waste on the part of everyone—the court and all the court machinery and the parties, and it even (and perhaps this is quite important) saves space for the ultimate recording of the result in the files in the clerk's office. So, as you will see, joinder of all kinds as contemplated is very broad, indeed.

ABA, PROCEEDINGS OF THE WASHINGTON INSTITUTE ON THE FEDERAL RULES 58-59 (1938).


[T]he object and purpose of these new rules in equity, including rule 30, is to lessen costs for litigants in the court of equity, bring about more speedy and effective relief to the parties therein, do away with technical questions that may be a hindrance to speedy justice, and settle all matters in controversy between the parties that may fairly arise from the allegations of the complaint.

23. Of course, in any of these situations the judge may order separate trials "in furtherance of convenience or to avoid prejudice." Fed. R.
The Reporter of the Advisory Committee that drafted the Rules summed up the Committee's rationale as follows:

[I]t is desirable that all matters in dispute between litigants be brought to issue and settled as quickly and directly as possible. In general this can be best done in a single action. Such course saves time and expense for the litigants and for the courts; it represents the difference between a single and permanent surgical operation as compared to chronic physicking.

The same policy underlies compelling the pleading of those claims that arise from the same transaction or occurrence as the principal action; it is intensified, however, by the belief that courts should allow only one lawsuit over a single controversy, and all logically related claims should be settled in that single action. As the Advisory Committee's Reporter explained it:

This is the general philosophy, which is a modern one of limiting the number of lawsuits possible over one controversy. It is required rather generally in these rules as well as in the pleading reform of the present day that you should settle all matters that you start litigating in a single action, and that it isn't the proper thing to have a defendant's claim, arising out of the affair that must be litigated . . . the subject matter for separate suit. The defendant should be forced to bring it in and it should be settled at the same time.

Although the compulsory counterclaim provision is effective in carrying out the policy of the Federal Rules against multiplicity of litigation, its severity seems anomalous. Rule 13(a) is the only section of the Rules that seems contrary to their underlying philosophy, and the underlying philosophy of procedural reform generally, of simplifying pleading requirements. The Reporter said,
in explaining the Rules, "it seems to me [that] . . . on the whole it is a little difficult to make such a serious mistake that you lose your rights, and I think that is one of the advantages of the rules." Yet Rule 13(a) provides an opportunity for just such a serious mistake—a party who mistakenly does not plead a claim logically related to those of his opponent does lose his rights. This occurs, of course, when he incorrectly thinks his claim is not logically related to his opponent's claim and chooses not to counterclaim it. But it also occurs when the defendant's claim has not fully ripened or has not even been ascertained when the action begins. The obvious example of such an undiscovered but existing claim is the possible latent injury suffered as a result of some tort such as an automobile accident. A defendant who fails to plead these injuries in a suit arising out of the accident would seem to be foreclosed by Rule 13(a) from ever enforcing the claim. A party may also fail to plead a compulsory counterclaim in a situation where the defendant is only nominally interested in the principal suit, and the person who defends in fact has no interest in asserting the nominal defendant's personal counterclaims. This situation is most likely to occur where the defendant is insured and the insurer takes over the lawsuit.

These harsh results arising from the apparent severity of Rule 13(a) can be tempered by equitable administration of the Rule. Rule 13(f) provides for amendment of the pleadings for an omit-

of the underlying philosophy of the Rules "is a shift of emphasis from rigid adherence to a prescribed procedure to a distinct effort to bring about the disposition of every case on the merits without regard to compliance with detailed requirements of adjective law . . . ."; Clark, The Handmaid of Justice, 23 WASH. U.L.Q. 297, 308 (1938): "The practically universal trend of reform has been in favor of less binding and strict rules of form enforced upon the litigants and their counsel . . . ."

29. CLEVELAND INSTITUTE 219.

30. Another example of such a claim occurs in an action to recover for the value of services rendered. There may be a defect in performance which will not come to light until long after the principal suit, but which is currently existing and actionable and therefore within Rule 13(a).

31. See Keller v. Keklikian, 362 Mo. 919, 244 S.W.2d 1001 (1951), where defendant's insurer settled the claim of the plaintiff before defendant asserted his counterclaim; under a counterclaim statute identical to Rule 13(a), the court held that the defendant was barred from later asserting his claim. It has been argued that this result is no different from the result without the compulsory counterclaim rule, at least in those cases where the insurer loses the suit. Wright, supra note 20, at 460-64.

Because of the possibility of latent injuries and of the defense of a negligence action by an insurer, the Advisory Committee on the Rules of Civil Procedure of Minnesota recommended that tort claims not be included under the compulsory counterclaim rule. Bench & Bar of Minn., Sept. 1950, pp. 17-18. This recommendation was subsequently followed. See note 21 supra.
ted counterclaim. This provision is liberally applied; therefore, an omitted counterclaim can quite easily be set up before the action terminates. Even after judgment has been entered, Rule 60(b) might be used to reopen the judgment; then, an amendment could be allowed under Rule 13(f). Another way of restraining the harsh effect of Rule 13(a) is dependent on the theory of its enforcement. A compulsory counterclaim under Rule 13(a) which is not pleaded is clearly barred from being asserted later, but the grounds for this bar are uncertain. Probably a majority of the cases rest this bar on the res judicata concept of "merger" and "bar"—the original action includes all counterclaims arising out of

32. FED. R. CIV. P. 13(f):
Omitted Counterclaim. When a pleader fails to set up a counterclaim through oversight, inadvertence, or excusable neglect, or when justice requires, he may by leave of court set up the counterclaim by amendment.


34. FED. R. CIV. P. 60(b):
Mistakes; Inadvertence; Excusable Neglect; Newly Discovered Evidence; Fraud, etc. On motion and upon such terms as are just, the court may relieve a party or his legal representative from a final judgment, order, or proceeding for the following reasons: (1) mistake, inadvertence, surprise, or excusable neglect; . . . or (6) any other reason justifying relief from the operation of the judgment. . . .

This rule is to be liberally construed and applied. E.g., Tozer v. Charles A. Krause Milling Co., 189 F.2d 242, 245 (3d Cir. 1951). But see Edwards v. Velvac, Inc., 19 F.R.D. 504, 507 (E.D. Wis. 1956), where the court refused to open a judgment where the only "excusable neglect" was in failing to make timely appeal under Rule 73(a), since "to use Rule 60(b) for the purpose of circumventing another rule . . . would be a perversion of the rule and its purpose."

35. Cf. Williams v. Blitz, 226 F.2d 463 (4th Cir. 1955), where the court remanded a default judgment to be set aside if delay in making an answer asserting permissive counterclaims was due to excusable neglect.

36. "If the action proceeds to judgment without the interposition of a counterclaim as required by subdivision (a) of this rule, the counterclaim is barred." Advisory Committee Notes, Rule 13, note 7, in 3A BARRON & HOLZOFF, op. cit. supra note 17, at 439. Of the authorities cited in this note of the committee, all of which deal with previous practice under Equity Rule 30, only two consider the grounds for the bar: Marconi Wireless Tel. Co. v. National Elec. Signaling Co., 206 Fed. 295, 298 (E.D.N.Y. 1913) ("Rule 30 plainly requires that . . . all claims shall be litigated in one suit, and that thus the matter shall be rendered res judicata and future litigation avoided.") and SIMKINS, FEDERAL PRACTICE 663 (rev. ed. Schewppe 1934) ("[A] counterclaim growing out of the cause of action or subject-matter of the suit will be waived if not set up in the suit under this rule."). That there is some confusion in the cases on this matter is demonstrated by the statement in Union Paving Co. v. Downer Corp., 276 F.2d 468, 470 (9th Cir. 1960), that "if a party fails to plead these causes of action as counterclaims, he is held to have waived them and is precluded by res judicata from ever suing upon them again."
the same transaction or occurrence, and such counterclaims are "merged" in a judgment for the party holding them and "barred" by a judgment against him.\textsuperscript{37} Those cases which hold that the defendant by failing to plead the compulsory counterclaim waives the right to bring a later action (or is estopped from doing so) may, however, lead to a better result.\textsuperscript{38} Such a rule gives the court broader discretion to determine whether under the circumstances of the particular case the claim should be barred. If the defendant's claim was unknown to him at the time of the principal action, he cannot be held to have waived it nor should he be estopped from later asserting it; the same result should follow when the defendant in the first suit had only a nominal interest. In view of the potential harshness of the compulsory counterclaim rule, it seems likely that the courts will employ the more flexible waiver doctrine in a case where the defendant would otherwise be deprived of an opportunity to litigate his claim.\textsuperscript{39}

Another basic criticism of Rule 13(a) is the unfairness with which it may operate. It discriminates against the defendant since he may be bound to bring a claim that the plaintiff would not be forced to bring. The Rules provide only that "the plaintiff ... may join either as independent or as alternative claims as many claims either legal or equitable or both as he may have against the opposing party."\textsuperscript{40} As this language clearly shows, plaintiff's joiner of claims is completely permissive.\textsuperscript{41} Furthermore, the rule


\textsuperscript{38} E.g., General Cas. Co. v. Fedoff, 11 F.R.D. 177 (S.D.N.Y. 1951) (waiver); Douglas v. Wisconsin Alumni Research Foundation, 81 F. Supp. 167 (N.D. Ill. 1948) (estoppel). For a complete statement of this basis for the bar and its effects, see generally Wright, supra note 20, at 428–36.

\textsuperscript{39} Courts generally do not favor a defense that bars a plaintiff's otherwise valid claim; this is demonstrated by Judge Clark's remark that "the defense of res judicata is universally respected, but actually not very well liked." Riordon v. Ferguson, 147 F.2d 983, 988 (2d Cir. 1945) (dissenting opinion). Compare the statement in Ross v. T. C. Bateson Constr. Co., 270 F.2d 796, 800 (5th Cir. 1959): "Though the general policy of the federal rules is to discourage separate actions which create a multiplicity of suits, we should not become so engrossed with this idea of preventing multiple suits that we deprive a litigant of his day in court."

\textsuperscript{40} FED. R. Civ. P. 18(a). (Emphasis added.)

\textsuperscript{41} Velsicol Corp. v. Hyman, 103 F. Supp. 363, 366–67 (D. Colo. 1951). Some commentators have suggested that plaintiffs be compelled to join all of their claims, but the law has not yet followed this suggestion. E.g.,
against splitting a cause of action (a part of the theory of res judicata) does not preclude the plaintiff from bringing separate actions on claims that would fall within Rule 13(a) because the “logical relationship” test for determining whether a counterclaim is compulsory is much broader than the res judicata concept.

Another example of the unfairness of Rule 13(a) is that it may work to take the initiative in bringing the action away from the plaintiff. The plaintiff should be able to institute the action in the court and at the time of his choice within the restrictions of venue requirements and statutes of limitations, but under Rule 13(a) a person against whom a legitimate claim is held may institute the litigation by bringing an artificial claim arising out of the same transaction or occurrence as the legitimate claim and force the injured party to counterclaim.

The Federal Rules were designed to be “construed to secure the just, speedy, and inexpensive determination of every action.”


42. See Speed Prods., Inc. v. Tinnerman Prods., Inc., 222 F.2d 61 (2d Cir. 1955), where plaintiff’s claim should have been pleaded as a compulsory counterclaim in its reply to defendant’s compulsory counterclaim, but the plaintiff’s failure to counterclaim could not be pleaded as a bar under res judicata or collateral estoppel.

Cf. Ross v. T. C. Bateson Constr. Co., 270 F.2d 796 (5th Cir. 1959), where the court held that a subcontractor in an action for damages caused by contractor’s delayed performance was not barred by his earlier action against the contractor for the value of his services. Yet it seems clear that the contractor would have been forced to counterclaim any damages he suffered through the subcontractor’s delay in the original action. Eastern Transp. Co. v. United States, 159 F.2d 349 (2d Cir. 1947).

43. Professor Millar argues that to take away the injured party’s liberty of assertion in this manner actually creates an inequality of advantage between him and his opponent. MILLAR, op. cit. supra note 6, at 137–38. See Ohlinger, Jurisdiction, Venue and Process as to Counterclaims and Third-Party Claims; Rules 13 and 14 of the Federal Rules of Civil Procedure, 6 Fed. B.J. 420, 432–33 (1945), where the author says that the statutory right of convenience of venue should not be disposed of on the grounds of avoiding multiplicity. See also DiGiovanni v. Camden Fire Ins. Ass’n, 296 U.S. 64, 71 (1935), where the Court refused equitable relief to avoid the burden of numerous suits and recognized that “the exercise of equitable jurisdiction on this ground, while preventing a formal multiplicity of suits, would nevertheless be attended with more and deeper inconvenience to the defendants than would be compensated for by the convenience of a single plaintiff . . . .”

44. For instance, if an insurer brings an action to cancel a policy, the insured must counterclaim to recover any benefits due under the policy. Union Cent. Life Ins. Co. v. Burger, 27 F. Supp. 544 (S.D.N.Y. 1939). A declaratory judgment action to establish the insurer’s liability will have the same effect. Home Ins. Co. v. Trotter, 130 F.2d 800 (8th Cir. 1942).

45. Fed. R. Civ. P. 1. Judge Holtzoff has stated that this rule “is no mere precatory expression of a pious wish. It constitutes an enunciation of the fundamental theory on which the structure was charted.” Holtzoff, supra note 28, at 1059.
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The importance of the "speedy" and "inexpensive" considerations is illustrated by Rule 13(a); the framers of the Rules must have been cognizant of the potential severity and possible injustice of a compulsory counterclaim provision, yet they recommended and the Supreme Court adopted Rule 13(a).

II.

On April 25, 1938, the Supreme Court unexpectedly overturned 96 years of precedent in the federal judicial system. In 1842, *Swift v. Tyson* had held that the Rules of Decision Act required the federal courts to enforce local state statutory law when applicable, but it did not require them to follow the common law as declared by the state courts; federal courts were free to apply general common law without relying on state court pronouncements. The theory of *Swift v. Tyson* was well stated 40 years later by Mr. Justice Bradley: "the Federal courts have an independent jurisdiction in the administration of state laws, co-ordinate with, and not subordinate to, that of the State courts, and are bound to exercise their own judgment as to the meaning and effect of those laws." *Erie R.R. v. Tompkins* overruled this doctrine by holding that federal courts are bound by the common law as it is declared by state courts. The federal courts must follow state substantive law in resolving nonfederal questions whether the state law is declared by the state legislature or by the state courts.

46. *Erie R.R. v. Tompkins*, 304 U.S. 64 (1938). Much has been made of the fact that the issue was not properly before the Court (it was not raised either in the briefs or in the oral arguments) and of the anomaly of Mr. Justice Brandeis, who had often refused to pass on improperly raised questions, seemingly going far out of his way to decide *Erie* on these grounds. E.g., *Kurland, Mr. Justice Frankfurter, the Supreme Court and the Erie Doctrine in Diversity Cases*, 67 YALE L.J. 187, 188-89 (1957).

47. 41 U.S. (16 Pet.) 1 (1842).

48. "That the laws of the several states, except where the constitution, treaties or statutes of the United States shall otherwise require or provide, shall be regarded as rules of decision in trials at common law in the courts of the United States in cases where they apply." Judiciary Act of 1789, ch. 20, § 34, 1 Stat. 92 (1789) (now 28 U.S.C. § 1652 (1958)).


50. 304 U.S. 64 (1938).

51. This change in the law is based in part on a change in judicial outlook and in theories of jurisprudence. In 1938 the common law was no longer viewed as "a transcendental body of law outside of any particular State but obligatory within it unless and until changed by statute ...." *Black & White Taxicab & Transfer Co. v. Brown & Yellow Taxicab & Transfer Co.*, 276 U.S. 518, 533 (1928) (Holmes, J., dissenting). Now rights are considered to exist only when created by a particular authority, and when state-created rights are involved, they must be enforced as created. See *Guaranty Trust Co. v. York*, 326 U.S. 99, 101-03 (1945) (Frankfurter, J.); *Black & White Taxicab*, *supra* at 532-36.
The basis of the *Erie* decision was threefold:

First, the legislative history of the Rules of Decision Act had established a congressional intention to require federal courts to follow the established common law of the states as well as the states' statutory laws; therefore, *Swift v. Tyson* was erroneous. The validity of this construction of the act has been generally accepted and seems reasonable in view of the purpose of the act.

Second, the Constitution grants neither Congress nor the federal courts power to declare rules of substantive law applicable to state-created rights; therefore, *Swift v. Tyson* was unconstitutional. Although the Court expressly stated that it would not have abandoned the doctrine of *Swift v. Tyson* but for its unconstitutionality, this section of the opinion has been widely regarded as dictum.

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52. See Warren, *New Light on the History of the Federal Judiciary Act of 1789*, 37 Harv. L. Rev. 49, 81–88 (1923), which was referred to as the "recent research of a competent scholar" in the *Erie* opinion. 304 U.S. at 72.

53. 304 U.S. at 71–74.


55. 304 U.S. at 78–80. Mr. Justice Reed in a separate concurring opinion objected to basing the decision on constitutional grounds, 304 U.S. at 90–92. It appears that Mr. Justice Stone also had misgivings about the strong constitutional language in the opinion, for he seems to have felt that Congress might have power to enact substantive law to be applied in the federal courts. See Mason, *Harlan Fiske Stone: Pillar of the Law* 480–81 (1956). In addition to Reed's objections, two justices did not reach the *Swift v. Tyson* issue. Since only eight Justices heard the case, if Stone had also written a separate opinion on this point there would have been no majority opinion. For the possible effect of this on the precedent value of the opinion, see generally Comment, *Supreme Court No-Clear-Majority Decisions: A Study in Stare Decisis*, 24 U. Chi. L. Rev. 99 (1956).

56. 304 U.S. at 77–78.


*If respondent's contention is correct, a constitutional question might be presented. *Erie R. Co. v. Tompkins* indicated that Congress does not have the constitutional authority to make the law that is applicable to controversies in diversity of citizenship cases. . . . We therefore read § 3 narrowly to avoid that issue.*

350 U.S. at 202. Some commentators feel that this language revitalized
—and perhaps rather unsound dictum. Recently, however, some commentators have recognized a constitutional basis for the Erie doctrine in the make-up of the federal system. The exclusive power of the states to make their own substantive law binding in their own courts is unquestioned, and a separate federal law dealing with state-created rights in federal courts cripples this state power and may defeat legitimate state interests reflected in substantive law. Whether this consideration of federalism has constitutional status or is only a matter of judicial discretion, it should be a factor in any evaluation of the Erie doctrine.

Third, the Swift rule failed in its aim of promoting a general common law uniform throughout the country and resulted in substantial injustice and discriminatory results; therefore, Swift v. Tyson was unwise. The attempt to promote uniformity of law in all American jurisdictions had failed because of the states’ refusals to adopt the federal courts’ interpretation of the common law, and the only effect of the doctrine was to prevent uniformity in the administration of the law within each state. The outcome of litigation should not depend on the fortuity of diversity of citizenship and choice of a court. Diversity of citizenship jurisdiction was developed to protect the noncitizen from potentially biased state courts, but it only gave him “another tribunal, not another body of law.” The application of independent rules of law in the federal courts greatly discriminated against a citizen of the forum and encouraged the evils of forum-shopping between state and federal courts by a noncitizen litigant. Also, two sys...
tems of courts adjudicating the same rights under different laws created confusion and uncertainty about the state of the law.\textsuperscript{65}

The most difficult problem arising from the \textit{Erie} case is \textit{when} must federal courts apply state law. Mr. Justice Brandeis, in \textit{Erie}, spoke of state law applying to "substantive rules of common law."\textsuperscript{66} But the classification of law as substantive or procedural has always been a perplexing and difficult task;\textsuperscript{67} subsequent developments in the \textit{Erie} doctrine have made it more so.\textsuperscript{68}

In \textit{Guaranty Trust Co. v. York},\textsuperscript{69} the Court revealed that the \textit{Erie} doctrine did not anticipate a classification of "substance" and "procedure" in any traditional sense;\textsuperscript{70} instead, the Court developed an "outcome-determinative" test to ascertain the nature of a par-

\begin{quote}
White Taxicab Co. v. Brown & Yellow Taxicab Co., 276 U.S. 518 (1928). There a Kentucky corporation reincorporated in Tennessee in order that it could sue to enjoin another Kentucky corporation on the basis of a contract void under Kentucky law but enforceable under the federal common law.

Of course, differences in substantive law are not the only reasons for forum-shopping—character of judges and juries, crowdedness of dockets, and availability of various procedural devices are all factors that weigh heavily in the choice of a court. Hill, \textit{supra} note 59, at 451. Also, the \textit{Erie} doctrine merely substitutes one type of forum-shopping for another, for one with a claim against a person subject to the jurisdiction of several federal districts can now forum-shop among the federal courts for the one with the most favorable law.

65. The earlier rule of \textit{Swift v. Tyson} did not contemplate such a system. As pointed out above, courts operating under that rule were also attempting to apply state law to state-created rights—they merely had a different conception of the nature of state law from those courts following the \textit{Erie} doctrine. See note 51 \textit{supra}.

66. 304 U.S. at 78.


68. See the discussion of the distinction between substance and procedure in the scholarly opinion of Judge Magruder in \textit{Sampson v. Channell}, 110 F.2d 754 (1st Cir.), \textit{cert. denied}, 310 U.S. 650 (1940); this case was instrumental in the shaping of the \textit{Erie} doctrine. See also \textit{Curd, Substance and Procedure in Rule Making, 51 W. Va. L.Q.} 34 (1948).


70. But, of course, "substantive" and "procedural" are the same key-words to very different problems. . . . Each implies different variables depending upon the particular problem for which it is used. . . . It is therefore immaterial whether statutes of limitation are characterized either as "substantive" or "procedural" in State court opinions in any use of those terms unrelated to the specific issue before us.

\textit{Id.} at 108–09.

Compare this with the more traditional approach in \textit{Sibbach v. Wilson & Co.}, 312 U.S. 1 (1941), where the Court upheld Rules 35 & 37 as procedural within the meaning of the statute enabling the Court to formulate procedural rules: "The test must be whether a rule really regulates procedure,—the judicial process for enforcing rights and duties recognized by substantive law and for justly administering remedy and redress for disregard or infraction of them." \textit{Id.} at 14.
ticular rule or issue. Matters of substance, under this test, "signifi-
cantly affect the result of a litigation"; 71 matters of procedure
concern "merely the manner and the means by which a right to re-
cover, as recognized by the State, is enforced . . . . " 72 A federal
court adjudicating a state-created right in a case sits as if it were
another state court, and "the outcome of the litigation in the federal
court should be substantially the same, so far as legal rules deter-
mine the outcome of a litigation, as it would be if tried in a State
court." 73

Obviously, the outcome-determinative test, if strictly applied in
diversity cases, would result in the application of many state rules
usually considered procedural. Almost any procedural rule can
conceivably affect the outcome of a case, and therefore, under
York, state rules would take precedence over federal rules when
the two conflict. A rigid rule like the outcome-determinative
test invites mechanical application since it considers only the pos-
sible effects of a federal rule on outcome without considering
the interests that the Erie doctrine was designed to protect. 74
When that test alone is utilized, there is little room for consider-
ing whether the decision affects federal-state relationships, wheth-
er the possible change in outcome is potentially unjust to one of
the litigants, or whether following the federal rule actually encour-
ages forum-shopping.

A new approach to the application of the Erie doctrine was an-
nounced in 1958 in Byrd v. Blue Ridge Rural Elec. Co-op. 75
There the trial judge followed state practice by deciding the ex-
estence of facts supporting a statutory affirmative defense instead
of allowing the jury to decide the issue. The Supreme Court held
that the defense presented a fact question that was to be deter-
mined by the jury notwithstanding the contrary state rule. In
reaching this result, the Court first determined that the state prac-

71. 326 U.S. at 109.
72. Ibid.
73. Ibid.
74. The Supreme Court has upheld state procedural rules over federal
rules in several cases in rather mechanical opinions. In Ragan v. Merchants
Transfer & Warehouse Co., 337 U.S. 530 (1949), a state rule as to when
the statute of limitations is tolled (upon service of a summons) was applied
rather than Federal Rule 3 ("A civil action is commenced by filing a com-
plaint with the court."). In Woods v. Interstate Realty Co., 337 U.S. 535
(1949), a state rule as to capacity to sue was applied rather than Federal
Rule 17(b) ("The capacity of a corporation to sue or be sued shall be de-
termined by the law under which it was organized."). In neither case did
the Court discuss the interests protected by Erie. Cf. Bernhardt v. Poly-
graphic Co., 350 U.S. 198 (1956); Cohen v. Beneficial Industrial Loan
tice of allowing the trial judge to decide the issue was merely "a form and mode of enforcing the immunity" created by the defense; it was not "an integral part of the special relationship created by the statute . . . and not a rule intended to be bound up with the definition of the rights and obligations of the parties." The Court conceded that if the outcome-determinative test alone were used there would be a strong case for following state law; it then found:

But there are affirmative countervailing considerations at work here. . . . Thus the inquiry here is whether the federal policy favoring jury decision of disputed fact questions should yield to the state rule in the interest of furthering the objective that the litigation should not come out one way in the federal court and another way in the state court.

The Court ultimately held that the strong federal policy against disruption of the judge-jury relationship was dominant in this case.

Thus, the Byrd case sets out two tests for the application of the Erie doctrine to diversity cases. (1) Is the state rule in question an integral part of the state-created right? (2) Are there countervailing federal policies which call for an application of the federal rule? These tests may seem complex and difficult to apply, but when the factors the Court considered are examined, the tests seem to mean little more than that the underlying state and federal policies that are in conflict should be considered and weighed in applying the Erie doctrine. This approach forces a consideration

76. Id. at 536.
77. Id. at 537–38.
78. It has been argued that the Byrd case was decided contrary to state law only because of the strong federal interest in preserving the jury trial. 43 Minn. L. Rev. 580 (1959). If the Court had wished to base its decision on the basis of a right to jury determination, however, they could have much more easily, and much more consistently with previous cases promulgating the Erie doctrine, decided the case solely on seventh amendment grounds. This it failed to do. Only after a full discussion of the judge-jury relationship in the federal courts did the Court note that the policy is "perhaps even more . . . [clear] in light of the influence of the Seventh Amendment . . . ." 356 U.S. at 539.
79. Hill, supra note 59, at 609, says "The . . . [Byrd] case represents a desirable step away from the mechanical application of the outcome-determinative principle, but instead of abating the confusion will probably aggravate it, as federal judges struggle with two new tests more complex than the one replaced."
80. Lower federal courts seem to have adopted this broad interpretation of the case. In Allstate Ins. Co. v. Charneski, 286 F.2d 238 (7th Cir. 1960), a declaratory judgment was dismissed because of a direct state policy against such actions in suits involving insurance claims. The court noted that "an increasing emphasis has been placed on the consideration
of the interests protected by the *Erie* doctrine; thus, the court not only may but *must* consider the effect of its decision on federal-state relationships and the possible appearance of the evils that the *Erie* doctrine was designed to prevent. The *Byrd* case, however, does not represent an overruling of the outcome-determinative test, or even a modification of it, but merely applies the test in a judicious manner.

III.

The ultimate question is now raised: Is Rule 13(a) applicable in federal courts when sitting under their diversity of citizenship jurisdiction, or does the *Erie* doctrine force these courts to apply state law in determining which, if any, counterclaims must be pleaded? Almost half the states do not compel the pleading of any counterclaims, and the compulsory counterclaim provisions of some of the other states apply to different claims or have an effect different from Rule 13(a). In these states the applicability of Rule 13(a) to diversity cases is crucial to those who have failed to set up a counterclaim compulsory under Rule 13(a) and, more often, to those merely deciding what they must plead.

If the rigid outcome-determinative test set out in *Guaranty Trust Co. v. York* is used, there can be little doubt that the compulsory counterclaim rule is within the *Erie* doctrine. This necessitates the application of state law whether or not it is consistent with Rule 13(a). A rule that acts to preclude a party from stating and accommodation of the basic state and federal policy goals involved. . . . A proper line of inquiry must assess the competing policy goals of the two sovereigns." *Id.* at 243–44. In *Jaftex Corp. v. Randolph Mills, Inc.*, 282 F.2d 508 (2d Cir. 1960) (Clark, J.), the court held that the rules governing the validity of service of process on foreign corporations are a matter of federal law in diversity cases because the jurisdiction of federal courts is so involved in their make-up; *Byrd* was characterized as representing a "significant development . . . in making more flexible the outcome-determinative test for the application of the Erie doctrine." *Id.* at 513. *Monarch Ins. Co. v. Spach*, 281 F.2d 401 (5th Cir. 1960), held that evidence inadmissible in the state court was admissible in federal court because of the following two "countervailing considerations": the necessity of allowing a court to regulate its own trials and the liberality with which evidence is to be received under Federal Rule 43(a). In *Iovino v. Waterson*, 274 F.2d 41 (2d Cir. 1959), *cert. denied*, 362 U.S. 949 (1960), Federal Rule 25(a)(1), which allows substitution of parties in case of death, was given effect over a contrary state rule because of the lack of an affirmative state policy against revivor despite the outcome-determinative test.

*But see, e.g.,* Berger *v. State Farm Mut. Auto. Ins. Co.*, 291 F.2d 666 (10th Cir. 1961), where the outcome-determinative test was strictly and mechanically applied with the result that the court followed the state rule controlling election of remedies.

81. See note 21 supra.

82. 326 U.S. 99 (1945).
his claim at all is certainly outcome-determinative. The York case itself presented almost the exact converse of the compulsory counterclaim situation. There the Court, in holding a state statute of limitations applicable in a diversity case, said:

Plainly enough, a statute that would completely bar recovery in a suit if brought in a State court bears on a State-created right vitally and not merely formally or negligibly. As to consequences that so intimately affect recovery or non-recovery a federal court in a diversity case should follow State law.\(^8\)

Since the application of Rule 13(a) in a diversity case would bar recovery in a federal court on a claim not pleaded in an earlier suit—even though the claim would be enforceable in the second action if both suits had been brought in a state court\(^9\)—it seems reasonable to assume that the same court would have decided both cases the same way.

The outcome-determinative test applied in this manner goes far to frustrate the objective of the Federal Rules to provide a uniform procedure for all cases in the federal courts since almost any procedural rule can conceivably be outcome-determinative in this strict sense.\(^8\) The Court in following York actually did make

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8. Id. at 110.

9. Of course, a different problem arises if the first suit is in a state court and the second suit is in a federal court. The federal statute implementing the full faith and credit clause requires that state judicial proceedings "shall have the same full faith and credit in every court within the United States . . . as they have by law or usage in the courts of such State . . . from which they are taken." 28 U.S.C. § 1738 (1958). This language would seem to require the federal court to apply the law of the state to define the scope of the previous action. See Magnolia Petroleum Co. v. Hunt, 320 U.S. 430 (1943); Mills v. Duryee, 11 U.S. (7 Cranch) 481 (1813); Cheatham, *Res Judicata and the Full Faith and Credit Clause: Magnolia Petroleum Co. v. Hunt*, 44 COLUM. L. REV. 330 (1944). Several federal courts have applied state law in such a situation. Zion v. Sentry Safety Control Corp., 258 F.2d 31 (3d Cir. 1958); Grodsky v. Sipe, 30 F. Supp. 656 (E.D. Ill. 1940); cf. Gramm v. Lincoln, 257 F.2d 250, 255 (9th Cir. 1958). Likewise, since federal court judgments are entitled to full faith and credit from state courts, Stoll v. Gottlieb, 305 U.S. 165 (1938), Rule 13(a) should have the same effect in a subsequent state court action as it would in federal court. Several state courts have reached this result, and by assuming that Rule 13(a) barred the claim, refused relief. Horne v. Woolever, 170 Ohio St. 178, 163 N.E.2d 378 (1959), cert. denied, 362 U.S. 951 (1960); Gross v. Fantecchi, 8 Cumb. 148 (Pa. C.P. 1958). *Contra*, Phoenix Ins. Co. v. Haney, 235 Miss. 60, 108 So. 2d 227, cert. denied, 360 U.S. 917 (1959), criticized in 73 HARV. L. REV. 1410 (1960).

several of the Federal Rules in effect inapplicable to diversity cases. Rule 3, which states that an action commences when the complaint is filed, was held not to determine the point at which a state statute of limitations is tolled where the law of the forum state requires service of summons to toll the statute;[6] Rule 17(b), which states that the capacity of a corporation to sue is determined by the law of the state where it was organized, was held not to apply if the corporation does not have capacity to sue under the law of the forum state;[7] Rule 23(b), which states the conditions precedent to the bringing of a stockholder’s derivative suit in the federal courts, was held not to exclude the additional conditions imposed on such suits by the forum state.[8] The Court has also narrowly construed a federal statute independent of the Federal Rules, the United States Arbitration Act, to make it inapplicable in a diversity case.[9]

“But there are affirmative countervailing considerations at work here,”[90] just as there were in the Byrd case. Applying a contrary state rule rather than Rule 13(a) in diversity cases is a threat to the federal interest in reducing multiplicity of litigation and to the federal policy of settling all related claims in a single action. On

It has been argued that the outcome-determinative test is inapplicable to the Federal Rules. “[I]t is submitted that when Congress has exercised that power [over federal court procedure] it has in a sense ‘occupied’ the field and the test should be whether the rule has any relation as to how a federal court shall conduct its business. If it does, the rule should be upheld.” Goodrich, Conflict of Laws § 15, at 43 (3d ed. 1949). See Note, 39 Geo. L.J. 600 (1951). This is essentially the test used to determine the validity of the rules under the Enabling Act, 28 U.S.C. § 2072 (1958), which requires that the “rules shall not abridge, enlarge or modify any substantive right” of any litigant. See Mississippi Publishing Corp. v. Murphree, 326 U.S. 438 (1946); Sibbach v. Wilson & Co., 312 U.S. 1 (1941). See note 70 supra.


All of the cases mentioned above can be distinguished from the compulsory counterclaim situation because they all involve situations where the federal law requires the federal courts to adjudicate a claim that cannot be heard in the state courts; under Rule 13(a), federal courts are foreclosed from adjudicating a claim which state courts would hear. Thus, the Rule 13(a) situation seems similar to Mr. Justice Frankfurter’s dictum in York recognizing the power of Congress to curtail the power of the federal courts through the Norris-LaGuardia Act. 326 U.S. at 105. The Norris-LaGuardia Act example is distinguishable, however, since it merely denies a litigant a federal remedy without affecting his substantive rights under state law. Rule 13(a) does affect those rights since it should have the same effect in a subsequent state court action as it would in a subsequent federal court action. See note 84 supra.

the other hand, absence of a state compulsory counterclaim rule is not an integral part of any state-created right and may only signify an absence of any state policy in regard to reducing multiplicity of litigation. The only state interests to be served by not compelling counterclaims is a feeling of fairness toward one forced to come into the litigation and a possible recognition of the historic right of the plaintiff to institute litigation. When the federal courts are utilized, these considerations are subordinated to the interests of the parties and the courts in settling all related matters in one lawsuit.

Moreover, this is not the type of uniform federal rule which promotes the evils that the *Erie* doctrine was designed to prevent. It seems unlikely that any litigant would choose one court over another merely because one of them has a compulsory counterclaim rule; at least this is not as likely as is forum-shopping on the basis of other procedural advantages that definitely do not come within the *Erie* doctrine (such as the improved discovery methods of the Federal Rules or the opportunity for jury determination of a crucial issue as in the *Byrd* case). In balance, there seems to be no sound reason for applying state law in lieu of Rule 13(a) in diversity actions despite the potentially changed outcome of future litigation, but there are federal interests that can only be protected by its application.

The *Byrd* case seems to indicate a new vitality for those Federal Rules, like Rule 13(a), that were jeopardized by strict adherence to the outcome-determinative test. Those Rules that are based on a strong federal interest should now survive an attack on the basis of the *Erie* doctrine whatever their effect on the outcome of the case.