

7th Circuit overturns plethora of diversity jurisdiction cases

Meridian Security Insurance Co. v. Sadowski, et al., 441 F.3d 536 (7th Cir. 2006).

Today's 7th Circuit case is one of first impression and overturns a plethora of cases applying the wrong test to determine diversity jurisdiction as to the jurisdictional amount. The test is that jurisdiction exists unless it is legally impossible for recovery to exceed the minimum (\$75,000). And, those cases applying the test that jurisdiction does not exist unless there is a reasonable probability that the recovery will exceed the minimum are overturned.

Meridian Security Insurance Co. filed suit in federal court asserting diversity jurisdiction and seeking a declaratory judgment determination that it owed no defense and no indemnity to its insured, The Rose Depot of Arlington Heights, for a lawsuit filed against the insured Rose Depot under the Federal Telephone Consumer Protection Act (TCPA) for sending unsolicited fax advertisements.

The underlying suit, *Haddad v. The Rose Depot*, filed in state court, sought damages under the TCPA (47 U.S.C. § 227(b)(3)) of \$500 for each unsolicited fax ad sent by Rose Depot (\$1,500 if a willful and knowing violation) on behalf of Haddad and a class of more than 50 recipients of such fax ads.

Rose Depot moved to dismiss the complaint for declaratory judgment of Meridian contending: (1) an insurer's duty to indemnify its insured is premature for decision until the insured is found liable; and (2) where indemnity is unripe for determination, the amount of indemnity an insurer might owe cannot be counted toward the amount in controversy for diversity jurisdiction. The District Court granted dismissal.

The 7th Circuit, in a decision written by Judge Frank H. Easterbrook, vacated the dismissal, found subject matter jurisdiction, and remanded for a decision of the insurance coverage dispute on its merits.

The 7th Circuit clarified the rule for determining subject matter jurisdiction based upon the amount in controversy in diversity cases — a rule often misinterpreted. "Jurisdiction exists unless it is legally impossible for the recovery to exceed the minimum" is the standard and not the often used test that "jurisdiction does not exist unless there is a 'reasonable probability' that the recovery will exceed the minimum." (441 F.3d at 542-43). The



Federal Courts

By Jay S. Judge

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Court emphatically stated:

"Reasonable probability that jurisdiction exists," a phrase with no provenance and no following outside this circuit, is banished from our lexicon." (441 F.3d at 543).

Easterbrook began the Court's discussion of the amount in controversy, noting it could be reached by considering indemnity or defense amounts the insurer could owe:

"The Telephone Consumer Protection Act prohibits most unsolicited commercial solicitations by facsimile and permits the court to award \$500 per fax, a sum that may be trebled if 'the defendant willfully or knowingly violated this subsection or the regulations prescribed under this subsection.' 47 U.S.C. § 227(b)(3). Haddad proposed to represent a class of 'more than 50' recipients of fax ads, and Meridian calculated the stakes of its federal suit by multiplying \$1,500 (the maximum award per fax) by 51 (the minimum size of the class), which yields \$76,500, or \$1,500 more than the minimum required for federal jurisdiction. See *Brill v. Countrywide Home Loans Inc.*, 427 F.3d 446 (7th Cir. 2005), which holds that \$1,500 multiplied by the number of class members is the amount 'in controversy' under the Telephone Consumer Protection Act. The expense of providing a legal defense against Haddad's suit also counts for purposes of § 1332, but Meridian did not try to estimate this, thinking that the indemnity alone suffices.

Addressing the issue of whether the insurer's potential indemnity exposure or liability under the policy could and should be considered in determining the amount in controversy and holding it must be, the 7th Circuit explained:

"Because the duty to defend extends to many suits in which there will be no duty to indemnify — for defense depends on what the plaintiff alleges, while indemnity is limited to what the plaintiff proves, see *Lockwood International, B.V. v. Volm Bag Corp.*, 273 F.3d 741, 745-47 (7th Cir. 2001) — a declaratory judgment that the insurer need not defend means that it need not indemnify either, whether or not the plaintiff makes good on his contentions. Had the district court concluded, as Meridian maintained, that the insurance does not cover Haddad's allegations, it would have prevailed on defense and indemnity at a stroke. No more is needed to show that the value of indemnity was 'in controversy' on the date this federal case began.

"Many decisions in this and other circuits count the potential outlay for indemnity toward the amount in controversy whether or not adjudication about indemnity should be deferred until the state case is over. See, e.g., *Grimmell Mutual Reinsurance Co. v. Shierk*, 121 F.3d 1114 (7th Cir. 1997); *Motorists Mutual Insurance Co. v. Simpson*, 404 F.2d 511, 515 (7th Cir. 1968); *Maryland Casualty Corp. v. United Corp.*, 111 F.2d 443, 447 (1st Cir. 1940). The contrary argument has been made often enough that both of the principal treatises on federal practice cover the topic, and both conclude that the potential obligation counts toward the jurisdictional minimum. 12 Moore's Federal Practice B Civil § 57.22[8][b] (2005 rev.); Charles Alan Wright, Arthur R. Miller & Edward H. Cooper, 14B Federal Practice & Procedure § 3710 at 262-70 (3d ed. 1998). Wright, Miller, and Cooper add that the argument for the exclusion of the potential indemnity 'never has been accepted by the federal courts.' This passage needs amendment, now that several judges in the Northern District of Illinois have swallowed the bait, but it could be revised in light of today's decision to say that the position 'never has been accepted by any federal court of appeals.'"

And, Easterbrook explained that because an insurer and insured in a declaratory judgment action over coverage are a single plaintiff and a single defendant, the anti-aggregation of claims rule does not prevent jurisdiction:

"Appellees offer additional arguments in defense of their judgment, as they are entitled to do. One is that, because

none of the class members would be entitled to recover more than \$1,500, the rule against aggregating multiple litigants' claims to reach the jurisdictional floor, see *Snyder v. Harris*, 394 U.S. 332, 89 S.Ct. 1053, 22 L.Ed.2d 319 (1969), prevents a federal court from exercising jurisdiction. Yet Meridian has not aggregated multiple parties' claims. From its perspective there is only one claim — by its insured, for the sum of defense and indemnity costs. *Hunt v. Washington State Apple Advertising Commission*, 432 U.S. 333, 347-48, 97 S.Ct. 2434, 53 L.Ed.2d 383 (1977), holds that the anti-aggregation rule does not apply to a federal declaratory-judgment action between a single plaintiff and a single defendant, just because the unitary controversy between these parties reflects the sum of many smaller controversies. No more need be said on this subject."

Then, the 7th Circuit addressed the key, seminal issue on appeal — did Meridian have to "prove" by "reasonable probability that jurisdiction exists"? Easterbrook provided a detailed, in-depth analysis of the rule and concluded two tests govern the jurisdictional amount issue: (1) jurisdiction exists if the amount is pleaded unless it is legally impossible for recovery to exceed the in excess of \$75,000 amount; and (2) the so-called "proof" issue arises only as to "contested factual assertions" used to assert diversity jurisdiction.

Appellees' other contention — which echoes some language in the district court's opinion — is that Meridian did not "prove" a 'reasonable probability that jurisdiction exists.' The requirement of 'proof' comes from *McNutt v. General Motors Acceptance Corp.*, 298 U.S. 178, 189, 56 S.Ct. 780, 80 L.Ed. 1135 (1936) (if plaintiff's 'allegations of jurisdictional facts are challenged by his adversary in any appropriate manner, he must support them by competent proof'). The 'reasonable probability' language comes from *Shaw v. Dow Brands Inc.*, 994 F.2d 364 366 (7th Cir. 1993), and has been repeated in six other decisions of this circuit plus more than 80 decisions of district judges within our jurisdiction — and, as far as we can ascertain, by no judge outside this circuit. See *Middle Tennessee News Co. v. Charnel of Cincinnati Inc.*, 250 F.3d 1077, 1081 (7th Cir. 2001). Judges of the seven district courts within this circuit now regularly dismiss suits

under the diversity jurisdiction with the observation that the plaintiff has not 'proved' that there is a 'reasonable probability' that the judgment will exceed the threshold.

Explaining the *Shaw* language "reasonable probability that jurisdiction exists" test has been misconstrued and is not "retracted" and not to be used, the Court stated:

"*Shaw*'s mention of 'reasonable probability that jurisdiction exists' thus has been taken to mean that uncertainty about the stakes must be resolved against the proponent of jurisdiction. That's not what *Shaw* set out to establish. In retrospect it is clear that the turn of phrase was infelicitous. We now retract that language; it has no role to play in determining the amount in controversy."

Easterbrook explained that the so-called "proof" test applies only to "contested factual assertions":

"What the proponent of jurisdiction must 'prove' is contested factual assertions — for example, where each party resides plus any plans for change of residence, in order to establish domicile, or what state issued a corporation's charter. Jurisdiction itself is a legal conclusion, a consequence of facts rather than a provable 'fact.' The Court made that clear two years after *McNutt*, holding in *St. Paul Mercury* that 'the sum claimed by [the proponent of federal jurisdiction] controls if the claim is apparently made in good faith. It must appear to a legal certainty that the claim is really for less than the jurisdictional amount to justify dismissal.' 303 U.S. at 288-89, 58 S.Ct. 586. Although the proponent of jurisdiction may be called on to prove facts that determine the amount in controversy — such as the economic effect that compliance with the law would have had on GMAC — once these facts have been established the proponent's estimate of the claim's value must be accepted unless there is 'legal certainty' that the controversy's value is below the threshold. See *Rising-Moore v. Red Roof Inns Inc.*, 435 F.3d 813 (7th Cir. 2006).

Addressing Meridian's complaint on which no facts were contested, the 7th Circuit held the test was whether to a legal certainty the claim was less than the jurisdictional amount (\$75,000):

"As we remarked in *Rising-Moore*, this standard usually operates in a transparent and simple way when the case begins in federal court and the complaint asserts an amount in

controversy, as Meridian did here. Defendants might have called on Meridian to prove that it actually had issued an insurance policy to The Rose Depot, that Haddad really sought to represent more than 50 other recipients of junk faxes, and that The Rose Depot had notified Meridian of the claim and tendered its defense. Those are facts, though none of the allegations about them has been contested. Whether damages will exceed \$75,000 is not a fact but a prediction, and with respect to that subject the court must decide whether 'to a legal certainty ... the claim is really for less than the jurisdictional amount.' For the reasons given above (and in *Brill*), a court cannot say that; Haddad's suit exposed Meridian to the expense of mounting a legal defense plus the risk of \$75,000 or more in indemnity.

Clarifying the proper test to determine jurisdiction and the misapplication of the test, the 7th Circuit explained and restated the test now to be applied in all cases:

"Many decisions by district courts in this circuit — of which the decision under review is one example, and *Wilson v. McRae's Inc.*, No. 05 C 2125 (N.D.Ill. Aug. 29, 2005), is another — employ the phrase not as a variant on the preponderance standard (which is how *Shaw* used it) but as a replacement for the standard of *St. Paul Mercury*. Instead of asking whether contested factual allegations have been established by a preponderance of the admissible evidence, some district judges have asked whether these facts demonstrate a 'reasonable probability' that the judgment will exceed \$75,000. Excessive attention to the phrase 'reasonable probability that jurisdiction exists' may lead a judge to neglect *St. Paul Mercury* (as in the decision under review) or get its point backward (the opinion in *Wilson*, after quoting the 'reasonable probability' language, stated that jurisdiction is proper only if 'to a legal certainty' the court is convinced that [that the plaintiff] is entitled to over \$75,000 in damages')."

"Language that came into being as a restatement of 'more likely than not' (the usual preponderance standard) for matters of fact has been misapplied to the inferences drawn from facts. And it has been used to displace the Supreme Court's rule for handling uncertainty about what will happen at trial (jurisdiction exists unless it is legally

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impossible for the recovery to exceed the minimum) with a much different standard (jurisdiction does not exist unless there is a 'reasonable probability' that the recovery will exceed the minimum)."

The Court summarized its ruling vacating the dismissal of Meridian's complaint and the rule to be used to determine diversity jurisdiction:

"To recap: a proponent of federal jurisdiction must, if material factual allegations are contested, prove those jurisdictional facts by a preponderance of the evidence. Once the facts have been established, uncertainty about whether the plaintiff can prove its substantive claim, and whether damages (if the plaintiff prevails on the merits) will exceed the threshold, does not justify dismissal. See, e.g., *Johnson v.*

Wattenbarger, 361 F.3d 991 (7th Cir. 2004). (*Rising-Moore* and *Brill* are other recent instantiations of this principle.) Only if it is 'legally certain' that the recovery (from plaintiff's perspective) or cost of complying with the judgment (from defendant's) will be less than the jurisdictional floor may the case be dismissed. None of Meridian's jurisdictional allegations was contested, so the standard of proof is irrelevant. And, when Meridian filed this suit, a court could not be sure that the plaintiffs in state court were bound to recover less than \$75,000 from The Rose Depot. So this case is properly in federal court under the diversity jurisdiction.

"The judgment of the district court is vacated, and the case is remanded with instructions to resolve the dispute on the merits."