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Rule 68: Erie Go Again - Costs, Attorneys' Fees, and Plaintiffs' Offers - Substance or Procedure

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RULE 68: *Erie* GO AGAIN—COSTS, ATTORNEYS' FEES, AND PLAINTIFFS' OFFERS—SUBSTANCE OR PROCEDURE?

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I. INTRODUCTION

Erie[1]—a small word, but one that can produce post-traumatic stress symptoms in attorneys, causing them to revert to their days as trembling law students in first semester Civil Procedure. A sweeping new trend in state law is threatening to cause problems once again in district court diversity cases. Federal Rule of Civil Procedure 68 is an offer of judgment—a settlement device—to help unclog overloaded court dockets. Rule 68, in its current form, is rarely used and does not serve its intended purpose. States, not satisfied with the effectiveness of Rule 68, have enacted rules of their own. These state rules may be in direct conflict with Federal Rule 68 and may cause *Erie* problems for federal courts sitting in diversity.

This article addresses the scope of the Federal Rules of Civil Procedure, the variations and effectiveness of Federal Rule 68 and some state counterparts, the analysis necessary for applying state or federal law in diversity cases in general, and an analysis for the offer of judgment rules in federal courts. Specifically, Part II of this article gives a brief overview of the Federal Rules of Civil Procedure ("FRCP") and the analysis necessary for federal courts sitting in diversity. Part III discusses FRCP 68, its elements, purposes, characteristics, and effectiveness, as well as an introduction to states' reactions to FRCP 68 and its ineffectiveness. Part IV shows how some federal district and circuit courts have approached this issue to date. Finally, Part V provides a roadmap that courts may use to handle this question under *Erie*.

II. FEDERAL DIVERSITY JURISDICTION

Federal courts have a duty "to ascertain and apply state law when deciding cases within their diversity jurisdiction."[2] Prior to 1938, federal courts sitting in diversity followed the general rules of the state in which they sat but were not bound by common law. This approach was due in part to early interpretation of the Rules of Decision Act[3] ("RDA"), as exemplified in the *Swift* doctrine.[4] The RDA requires "use of state law when the difference between state and federal law might substantially affect the outcome of the case."[5]

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1. Erie R.R. v. Tompkins, 304 U.S. 64 (1938).

2. GENE R. SHREVE & PETER RAVEN-HANSEN, UNDERSTANDING CIVIL PROCEDURE § 37, at 155 (2nd ed. 1994) (citing 28 U.S.C. § 1332 (1994)).

3. The RDA is found at 28 U.S.C. § 1652 (1994).

4. The *Swift* doctrine permitted federal courts to create "federal general common law" based upon a court's own independent judgment as to what the common law of a state was or should have been for all areas of conduct not regulated directly by state statute. *See* Swift v. Tyson, 41 U.S. 1 (1842).

5. SHREVE, *supra* note 2, at 155.

The *Swift* doctrine, consisting of *Swift v. Tyson*[6] and its progeny, "permitted federal judges to displace state law with federal common law simply because the federal court's diversity jurisdiction had been invoked."[7] The followers of the *Swift* doctrine "hoped it would promote uniformity among state and federal courts."[8] Although the *Swift* doctrine did promote uniformity among federal courts, it resulted in a lack of uniformity between state and federal courts because state law was continuously displaced. This split between state and federal courts encouraged forum-shopping by creating a "regime in which the choice of state or federal court might determine what substantive law would govern."[9]

In 1938, the Supreme Court's decision in *Erie R.R. v. Tompkins*[10] brought an end to the reign of the *Swift* doctrine.[11] The Supreme Court overruled *Swift's* interpretation of the RDA, noting that "the uniformity of law sought by the advocates of the *Swift* doctrine had not materialized."[12] What *Swift* actually did was provide "non-citizens the forum-shopping advantage of invoking diversity jurisdiction to evade state common law rules, when plaintiffs who shared the citizenship of their defendants could not."[13] The same was true of non-resident defendants who enjoyed the option of removal, while resident defendants did not.

The underlying purpose of the *Erie* doctrine was to avoid forum-shopping and inequitable outcomes. In 1938, the same year that *Erie* was decided, Congress adopted the FRCP.[14] These rules "created a separate and distinctive code of procedure for federal courts in all cases, including diversity cases . . . ."[15] Now, when a federal court is faced with the issue of which law to use, either the RDA and *Erie* or the FRCP under the Rules Enabling Act ("REA") governs the decision. When a conflict exists between a state rule or policy and the FRCP, the REA controls. When the conflict is between a state rule or policy and a federal rule or policy other than one of the FRCP, the RDA and *Erie* control.

The first question that must be answered when analyzing whether to apply state or federal law[16] is whether the RDA and *Erie* govern or whether a federal rule of civil procedure and the REA govern. Under the RDA, 28 U.S.C. § 1652 (1994), federal courts, in civil cases, must apply "[t]he laws of the several states, except where the constitution or treaties of the United States or Acts of Congress otherwise require or provide."[17]

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6. 41 U.S. 1 (1842).
7. SHREVE, *supra* note 2, § 38[B].
8. *Id.* at 157.
9. S.A. Healy Co. v. Milwaukee Metro. Sewerage Dist., 60 F.3d 305, 309 (7th Cir. 1995), *cert. denied*, 516 U.S. 1010 (1995).
10. 304 U.S. 64 (1938).
11. SHREVE, *supra* note 2, § 38[C].
12. *Id.* at 158 (discussing Erie R.R.v. Tompkins, 304 U.S. 64 (1938)).
13. SHREVE, *supra* note 2, § 38[C].
14. The Rules Enabling Act of 1934 delegated lawmaking authority to the Supreme Court to make rules governing "general rules of practice and procedure" for cases in the federal courts. 28 U.S.C. § 2071-74 (1994).
15. S.A. Healy Co. v. Milwaukee Metro. Sewerage Dist., 60 F.3d 305, 309 (7th Cir. 1995), *cert. denied*, 516 U.S. 1010 (1995).
16. This article does not deal with intrastate conflict of laws.
17. 28 U.S.C. § 1652 (1994) states, "[t]he 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." The REA is an "Act[] of Congress" within the meaning of the RDA.

The RDA and *Erie* provide a default rule. If there is no federal rule or statute on point, then the court must ask whether the application of the federal policy affects the outcome of the litigation in such a way that it would give an incentive to a party to choose the federal court over the state court. This question is known as the "outcome-determination" test as formulated in *Guaranty Trust Co. v. York.*[18] If the answer to the outcome-determination test is "no," then there is no "conflict," and the federal policy is applied. If the answer is "yes," that is, if federal policy would affect the likelihood of success, the court must then balance the state's interest in having its procedures followed and the federal government's interest in administering justice as an independent system.[19] This analysis is known as the *Byrd* balancing test, as formulated in *Byrd v. Blue Ridge Rural Electric Cooperative, Inc.*[20] The balancing test essentially weighs the importance of the state policy, the importance of the federal policy, and the extent to which the outcome of the case will be affected. The greater the effect on the outcome, the more likely it will be that state law will control.[21]

If there is a federal rule or statute that is on point, then the REA controls the analysis. In *Hanna v. Plumer*,[22] the Supreme Court modified the *Guaranty Trust* outcome-determination test. The Court held that because the outcome-determination argument was too literal-minded, it was more important to ask

> whether application of the [state] rule would make so important a difference to the character or result of the litigation that failure to enforce it would unfairly discriminate against citizens of the forum state, or whether application of the rule would have so important an effect upon the fortunes of one or both of the litigants that failure to enforce it would be likely to cause a plaintiff to choose the federal court.[23]

Furthermore, in *Hanna*, the Supreme Court noted that the purpose of the *Erie* doctrine was to (1) discourage forum-shopping, and (2) avoid inequitable administration of the laws.[24] By finding rules that may be unfavorable to defendants inapplicable in diversity cases, courts create an additional incentive for the defendant to seek removal to federal court. The Court noted that trivial variations between the state and the federal rules are not likely to influence the decision to remove to federal court.

In order for *Hanna* to apply, the state rule must be valid and there must be a *direct* conflict between a federal procedural rule and a state rule.[25] Furthermore, *Erie* was not meant to preclude forum-shopping entirely, only forum-shopping that would result in different applications of substantive law or inequitable administration of the law.[26] *Hanna* focuses its analysis on the earliest phases of

18. 326 U.S. 99 (1945).
19. *Id.*
20. 356 U.S. 525 (1958).
21. *Id.*
22. 380 U.S. 460 (1965).
23. *Id.* at 468 & n. 9.
24. *Id.* at 468.
25. *Id.* at 470.
26. *Id.*

an action and looks to see if the conflicting rules or statutes will affect the outcome or the size of the award. If the conflict is prospectively outcome-determinative, then a rule is valid unless it violates the REA. *Hanna* mandates that a FRCP is valid if it does not exceed "the congressional mandate embodied in the [REA] []or transgress[] constitutional bounds."[27] In such a case, state law would be subordinate to the federal rule. To date, no court has held any federal rule invalid. Under *Hanna*, the rule is simple: so long as an applicable FRCP "is constitutional and complies with the [REA]," the FRCP controls.[28]

Hanna controlled application of the *Erie* doctrine for fifteen years, but in 1980, with its decision in *Walker v. Armco Steel Corp.*, the Supreme Court shifted from favoring federal law to favoring state law.[29] In *Walker*,[30] the Court did not follow the approach it announced in *Hanna* because it found "no direct conflict between the Federal Rule and the state law."[31] The Court held that, in order for there to be a "direct" conflict, the application of the state rule would have to "thwart some purpose the federal rule was intended to achieve."[32] Finding the federal rule "not applicable" rather than "invalid," the Court held that *Hanna* did not apply.[33] Instead, the policies behind *Erie* controlled.[34] Therefore, under *Walker*, a court must determine if a seemingly applicable federal rule is broad enough in scope; if not, the rule is simply not applicable.[35] If a rule is not applicable under *Walker*, then the analysis turns to the twin aims of *Erie* announced in *Hanna*—to discourage forum-shopping and avoid inequitable administration of the laws.

III. OFFERS OF SETTLEMENT RULES

The Federal Rule of Civil Procedure 68 governs offers of judgment. Many states have adopted this rule, or some variation of it. The language and application of these state offer of judgment rules range from minor differences such as slightly different wording to extreme differences in procedural, as well as substantive, rights and recoveries. These differences are causing some dissension in the district courts.

A. FRCP 68

Rule 68 of the Federal Rules of Civil Procedure allows a defendant to "serve upon the [plaintiff] an offer to allow judgment to be taken against the [defendant] for the money or property . . . with costs then accrued."[36] If the plaintiff rejects the offer and proceeds to trial, and he obtains a judgment that is less favorable

27. *Id.* at 464.
28. SHREVE, *supra* note 2, § 40[B].
29. *Id.*
30. 446 U.S. 740 (1980).
31. *Id.* at 752.
32. *Id.*
33. *Id.* at 748.
34. *Id.* at 751.
35. *Id.*
36. FED. R. CIV. P. 68.

than the offer the defendant made, the plaintiff loses the costs he would have received as part of his judgment. The plaintiff also has to pay the defendant's costs that accrued after the date of the offer. Basically, under Rule 68, the plaintiff in this situation should have taken the offer and saved both the defendant and himself the additional costs of going to trial.

Rule 68 only allows defendants to make this offer. Plaintiffs cannot make an offer or a counter-offer. Additionally, the defendant does not receive costs when he wins outright; the plaintiff must receive a favorable judgment, but the judgment must be less favorable than the offer the defendant made.

The rule is essentially a rule of procedure—not only because the rule is one of federal civil procedure, but because it outlines the procedure a litigant must follow to make an offer and receive costs.[37] The stated purpose of the rule was to "discourage[] . . . protracted litigation and vexatious lawsuits,' . . . lessen the burden on an already taxed justice system,"[38] and "to significantly increase the incentives for settlement by attaching financial penalties (through a cost-shifting mechanism) to the rejection of a settlement offer that was eventually proven (by the verdict) to have been reasonable."[39] The rule does not create a cause of action. It only provides a tool by which an early settlement can be achieved and costs can be recovered once a cause of action is initiated in court. Rule 68 is a rule of "devices intended to provide incentives for parties to conclude disputes at an early stage when the outcomes are reasonably predictable."[40]

Rule 68 is not tied to an underlying cause of action. Any defendant may employ Rule 68 in federal court. Rule 68 tells a defendant (1) when to make an offer, (2) how to make an offer, (3) what the offer must contain to be valid, (4) how long the offer must remain open, (5) what to do with an accepted offer, and (6) how to get "costs" after an offer has been rejected.[41]

B. State Versions of Rule 68

Many states have adopted FRCP 68 or some version of it. Many other states, frustrated with the ineffectiveness of FRCP 68, have enacted alternative offer of judgment rules or statutes. While the federal rule was intended to provide a mechanism to help relieve strained court dockets by creating incentives for parties to settle at an early stage of litigation, FRCP 68 is rarely utilized. The amount of "costs" that are cut off and shifted are negligible and fail both to provide an incentive for one party to even make an offer and for the other party to seriously consider the offer.

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37. FRCP 68 and applicable state rules mentioned in this article are appended.

38. LESLIE S. BONNEY ET AL., *Rule 68: Awakening a Sleeping Giant*, 65 GEO. WASH. L. REV. 379, 380 (1997) (citing Mallory v. Eyrich, 922 F.2d 1273, 1277 (6th Cir. 1991)).

39. BONNEY ET AL., *supra* note 36, at 380 (citing Delta Air Lines, Inc. v. August, 450 U.S. 346, 352 (1981)).

40. JAY N. VARON, *Promoting Settlements and Limiting Litigation Costs by Means of the Offer of Judgment: Some Suggestions for Using and Revising Rule 68*, 33 AM. U. L. REV. 813, 816 (1984) (citing Delta Air Lines, Inc. v. August, 450 U.S. 346, 356 (1981)).

41. *See* FED. R. CIV. P. 68.

Several states, through adoption, amendment and court interpretation, have attempted to make the rule more accessible by providing more incentives for parties to settle and mandating harsher consequences for rejecting an offer.[42] Some states allow both plaintiffs and defendants to make offers.[43] Others allow prevailing defendants to recover costs.[44] Some states' rules are self-executing or mandatory, while others leave a determination of the costs up to the discretion of the court. Some states allow the offeror to recover under a much broader definition of costs than is employed by the federal rule—including attorneys' fees, double costs, expert witness fees, traveling expenses for additional depositions, and enhanced prejudgment interest.[45]

States' rules broadly defining costs typically have two parts. The first part is similar to the federal rule in that it, like FRCP 68, is procedural in nature, that is, it tells a party how, when, where and to whom to make an offer. In addition, the first part lists the procedural requirements that one must follow in order to comply with the rule and to recover costs if a settlement is not reached. The second part of the rule is generally more substantive in nature, that is, it creates in the offeror a right to a significant amount of money. This amount to which the offeror is entitled in the event that the offeree does not settle, can and will affect the outcome of the case and the amount of judgment that can be obtained. For example, a "state law denying the right to attorneys' fees or giving a right thereto . . . reflects a substantial policy of the State . . . ."[46] Courts have also determined that statutes regarding prejudgment interest are substantive in nature.[47]

IV. DISTRICT AND CIRCUIT COURTS THAT HAVE ADDRESSED THE ISSUE OF APPLYING STATE RULES IN FEDERAL COURTS

As one court has noted, "[t]he applicability of state procedural rules in federal diversity litigation is a knotty issue."[48] Whether, or how, these amendments will

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42. *See* Alaska (ALASKA R. R.C.P. 68)(ALASKA STAT. § 09.30.065 (Lexis 1962)); Arizona (ARIZ. ST. R.C.P. 68); California (CAL. CIV. PROC. CODE § 998 (West 2000)); Colorado (COLO. REV. STAT. ANN. § 13-17-202 (Bradford 1999)); Florida (FLA. STAT. ch. 768.79)(FLA. STAT. ANN. § 45.061 (West 1983))(FLA. ST. R.C.P. 1.442); Louisiana (LA. CODE CIV. PROC. ANN. art. 970 (West 1972)); Michigan (MICH. R. R.C.P. M.C.R. 2.405); Minnesota (MINN. R. CIV. P. 68); Nevada (NEV. R.C.P. 68); New Jersey (N.J. R. SUPER. TAX SURR. CTS. R. CIV. P. 4:58-1, 2-4); North Dakota (N.D. R. CIV. P. 68); Oklahoma (OKLA. STAT. tit. 12, § 1101.1 (West 1991)); Tennessee (TENN. R. R.C.P. 68); Wisconsin (WIS. STAT. ANN. § 807.01 (West 1994)); Wyoming (WY. R. R.C.P. 68).

43. *See, e.g.*, MINN. R. CIV. P. 68.

44. *See, e.g.*, TENN. R. R.C.P. 68.

45. *See, e.g.*, NEV. R.C.P. 68.

46. Tanker Management v. Brunson, 918 F.2d 1524, 1528 (11th Cir. 1990) (citing *Walker v. Armco Steel Corp.*, 446 U.S. 740 (1980)). *See also* Chambers v. NASCO, Inc., 501 U.S. 32 (1991), *reh'g denied*, 501 U.S. 1269 (1991) (holding that a rule shifting attorneys' fees to a losing party is substantive for purposes of determining whether it applies in a diversity suit); Marek v. Chesney, 473 U.S. 1 (1985); DAVID L. KIAN, *The 1996 Amendments to Florida Rule of Civil Procedure 1.442: Reconciling a Decade of Confusion*, 71-AUG FLA. B.J. 32, 35 (July/Aug. 1997) (citing In re Amendments to Florida Rules of Civil Procedure, 682 So. 2d 105, 105-06 (Fla. 1996) and quoting Timmons v. Combs, 608 So. 2d 1, 2-3 (Fla. 1992) (stating that, "[i]t is clear that the circumstances under which a party is entitled to costs and attorney's fees is substantive and that our rule can only control procedural matters.")).

47. Home Indemnity Co. v. Lane Powell Moss and Miller, 43 F.3d 1322 (9th Cir. 1995) (citing Northrop Corp. v. Triad Int'l Mktg. S.A., 842 F.2d 1154, 1155 (9th Cir. 1988) for the proposition that "[s]ubstantive state law determines the rate of prejudgment interest in diversity actions.").

48. S.A. Healy Co. v. Milwaukee Metro. Sewerage Dist., 60 F.3d 305, 309 (7th Cir. 1995), *cert. denied*, 516 U.S. 1010 (1995).

affect diversity actions in federal courts is a question that must eventually be answered. Should a court sitting in diversity apply the state rule? If state law is not applied, and a non-resident defendant need only remove to federal court in order to avoid the adverse effect of a plaintiff's offer to settle, will the purpose of the rule be undermined? Does the removal option not affect forum-shopping?

A. Wisconsin District Courts and the Seventh Circuit

Wisconsin's version of Rule 68 is codified at section 807.01 of the Wisconsin Statutes.[49] Wisconsin is one of sixteen states that currently allow plaintiffs to make offers of judgment.[50] The purpose behind the Wisconsin statute is the same as the underlying purpose of FRCP 68: "to encourage settling cases before trial."[51]

In 1983, the District Court for the Eastern District of Wisconsin consistently applied the federal rule, holding that since the state rule "is a procedural rule, not of substantive state law, the offer has no effect in this court."[52] In both *Hutchinson v. Burning Hills Steel Co.*,[53] and *Klawes v. Firestone Tire & Rubber Co.*,[54] the district court granted the defendant's motion to strike the plaintiff's settlement offer. While acknowledging that each party's arguments "would make for interesting debate," the district court concluded that Rule 68, and, therefore, section 807.01 of the Wisconsin Statutes, was "clearly procedural," despite plaintiffs' efforts to envelop it in the cloak of substance.[55] The court apparently determined—without much more than a knee-jerk reaction and a cursory glance—that section 807.01 of the Wisconsin Statutes, was procedural, and since the FRCP had a valid rule "on point," the federal rule applied without any further analysis.

Five years later, the Western District of Wisconsin reached the opposite conclusion. The court, in *Datapoint Corp. v. M & I Bank of Hilldale*,[56] held that because FRCP 68 was narrower in scope than Wisconsin's rule, it was not applicable. Thus, under *Erie*, the court was compelled to apply the state rule in diversity.

In analyzing this issue, the court looked to the Supreme Court's analysis in *Walker v. Armco Steel Corp.*[57] Essentially, *Walker* requires a court to consider two initial questions when determining whether a rule is substantive or procedural: (1) is a federal rule *sufficiently broad enough* to control the issue, and,[58] if not; (2) is the statute applicable under the principles of *Erie*.[59] The district court

49. *See* WIS. STAT. ANN. § 807.01 in its entirety appended. All state rules, whether they are rules of court or codified in statues, whether they are labeled "offer of judgment," "offer of settlement," or something else, may be referred to as "state's offer of judgment rules," or "state's Rule 68."

50. *See* NEV. R.C.P. 68 for an example of state rules which permit plaintiffs to make offers of judgment.

51. STEPHEN K. WARCH, *Meeting Head On: Offers of Settlement and an Insurer's Potential Bad Faith*, WIS. LAW. 69, Oct. 1996, at 10-11.

52. Hutchinson v. Burning Hills Steel Co., 559 F. Supp. 553 (E.D. Wis. 1983).

53. *Id.*

54. 572 F. Supp. 116 (E.D. Wis. 1983).

55. *Id.* at 119.

56. 665 F. Supp. 722 (W.D. Wis. 1987).

57. *Id.* at 728 (discussing *Walker v. Armco Steel Corp.*, 446 U.S. 740, 748 (1980)).

58. *Datapoint*, 665 F. Supp. at 728.

59. Dillingham-Healy-Grow-Dew v. Milwaukee Metro. Sewage Dist., 796 F. Supp. 1191, 1193 (E.D. Wis. 1992).

for the Western District of Wisconsin rejected the "on point" language used by the Eastern District of Wisconsin in both *Hutchinson*[60] and *Klawes*[61] and found that the "sufficiently broad in scope" language found in *Walker* was controlling.[62] Once a determination is made that the federal rule is not on point, invalid or narrower in scope than the state rule, the court should focus on the principles of *Erie*.[63]

The district court found that, because FRCP 68 does not encompass offers made by plaintiffs, it is therefore narrower in scope than section 807.01 of the Wisconsin Statutes. Thus, the court must "determine whether the principles of *Erie* . . . require application of Wis. Stat. § 807.01(4) in this case."[64] The intent of *Erie* was to ensure that the outcome of litigation in diversity cases would be the same in federal court as it would be in state court.[65] Because the amount the plaintiff would be entitled to recover would be greater under the state rule than the federal rule, the court held that there was a sufficient difference in outcome to view the rule as one of substance rather than procedure.[66]

Five years later, in the Eastern District of Wisconsin, the court followed the analysis of the Western District in *Dillingham-Healy-Grow-Dew v. Milwaukee Metropolitan Sewerage District*[67] and held that the "Wisconsin statute could be used in federal court in [a] diversity action where no federal rule of civil procedure was broad enough to control the issue and failure to apply [the Wisconsin] statute would mean that [a] different result would be reached in federal court than in state court."[68] The court denied the defendant's motion to strike the offers of settlement and held that "[i]n diversity actions, Wis. Stat. § 807.01(3) and (4) may be utilized in federal court."[69]

Finally, in 1995, the question of which law to apply reached the Seventh Circuit Court of Appeals in *S.A. Healy Co. v. Milwaukee Metropolitan Sewerage District*.[70] Chief Judge Posner pointed out that a rule that seems procedural in the ordinary sense may be deemed substantive if the application or non-application of the rule will affect the outcome of the case.[71] Unfortunately, there is "no clear criterion" for deciding whether a rule should be labeled "substantive" or "procedural" when determining if a state rule should be applied in federal diversity actions.[72]

The Seventh Circuit Court of Appeals noted that there are two situations in which a court must decide which rule to apply. First, when there is a direct conflict between the federal and state rule, the federal rule must be applied[73] if

60. Hutchinson v. Burning Hills Steel Co., 559 F. Supp. 553 (E.D. Wis. 1983).
61. Klawes v. Firestone Tire & Rubber Co., 572 F. Supp. 116 (E.D. Wis. 1983).
62. *Datapoint*, 665 F. Supp. at 728.
63. *Id.*
64. *Id.* at 729.
65. *Id.* at 728 (citing Walker v. Armco Steel Corp., 446 U.S. 740, 745 (1980)).
66. *Datapoint*, 665 F. Supp. at 728.
67. 796 F. Supp. 1191 (E.D. Wis. 1992).
68. *Id.*
69. *Id.* at 1193.
70. 60 F.3d 305 (7th Cir. 1995), *cert. denied*, 516 U.S. 1010 (1995).
71. *Id.* at 309 (citing Guaranty Trust Co. v. York, 326 U.S. 99, 109 (1945)).
72. *S.A Healy*, 60 F.3d at 309.
73. *Id.*

enforcing the state rule would, in effect, invalidate the federal rule.[74] Second, when "the state procedural rule, though undeniably 'procedural' in the ordinary sense of the term, is limited to a particular substantive area, such as contract law . . . or tort law,"[75] the federal court should apply the state rule. Otherwise, the "state's [manifest] intention to influence substantive outcomes would be defeated by allowing parties to shift their litigation into federal court . . . ."[76] The offer of judgment rule does not fall clearly into either category.

The Seventh Circuit held that there was not a direct conflict between the federal and state rule because the Wisconsin rule encompassed offers made by plaintiffs, and the federal rule is limited to defendants only.[77] The court also pointed out that the Wisconsin rule "is not confined to any particular area of the law [, and, while] . . . the rule does not have substantive goals in [an] obvious sense," the rule's effect on the amount of recovery does tend to be a "substantive" consequence.[78]

To determine the extent of the "substantive" consequences, the Seventh Circuit Court of Appeals, like the district court in *Datapoint*,[79] followed the two part analysis set forth in *Walker*.[80] The court held that under the mandate of *Walker*, the "application of the Wisconsin rule in diversity cases would be consistent with the principles of *Erie* and the Rules Enabling Act."[81] The court likened the state rule to that of a rule or statute that allows for punitive damages or attorneys fees, and noted that the allowance of punitive damages, even though "not limited to a particular class of cases . . . [is] applicable in diversity suits . . . ."[82] The court also noted that in *Chambers v. NASCO, Inc.*,[83] the United States Supreme Court held that a "rule shifting attorneys' fees to a losing party is 'substantive' for purposes of determining whether it applies in a diversity suit . . . ."[84]

The current view in the Seventh Circuit is that the federal offers of judgment rule is not sufficiently broad enough to control the issue because it does not encompass offers made by plaintiffs. Thus, there is no direct conflict between the Wisconsin rule and the federal rule. Plaintiffs in Wisconsin federal courts under diversity jurisdiction may, therefore, make offers of judgment pursuant to section 807.01 of the Wisconsin Statutes. The Seventh Circuit has held, however, that if a defendant wishes to make an offer, there is a direct conflict between FRCP 68 and the state rule.[85] The defendant must, therefore, make his offer pursuant to FRCP 68 and not pursuant to the Wisconsin rule.[86] This reasoning does not impair the function of FRCP 68.

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74. *Id.* (citing Burlington Northern Ry. v. Woods, 480 U.S. 1, 4-5 (1987)).
75. *S.A Healy*, 60 F.3d at 309.
76. *Id.*
77. *Id.*
78. *Id.*
79. Datapoint Corp. v. M & I Bank of Hilldale, 665 F. Supp. 722 (W.D. Wis. 1987).
80. *S.A. Healy*, 60 F.3d at 309 (discussing Walker v. Armco Steel Corp., 446 U.S. 740, 745 (1980)).
81. *S.A. Healy*, 60 F.3d at 311.
82. *Id.* (citing *In re* Air Crash Disaster Near Chicago, 644 F.2d 594, 606 (7th Cir. 1981)).
83. 501 U.S. 32 (1991), *reh'g denied*, 501 U.S. 1269 (1991).
84. *S.A. Healy*, 60 F.3d at 311 (citing Chambers v. NASCO, Inc., 501 U.S. 32, 52-3 (1991), *reh'g denied*, 501 U.S. 1269 (1991)).
85. *S.A. Healy*, 60 F.3d at 311.
86. *Id.* at 312.

B. Florida District Courts and the Eleventh Circuit

The leading case in the Eleventh Circuit, *Tanker Management, Inc. v. Brunson*,[87] involved Florida's offer of judgment rules.[88] Unlike the Seventh Circuit, which held that only plaintiffs could make an offer pursuant to Wisconsin's state rule, the Eleventh Circuit found that both plaintiffs and defendants could make offers of judgment pursuant to Florida's state rule.[89] In *Tanker*, the defendant made an offer pursuant to the state rule and wanted to collect costs under the state rule rather than the federal rule.[90] Florida's rule allows for much broader recovery than does the federal rule.[91] The Middle District of Florida held that the state rule allowing for recovery of attorneys' fees was not preempted by the federal rule; the Eleventh Circuit affirmed the district court's decision.[92]

Florida also allows defendants who make an offer to recover costs when the defendant wins outright. The availability of this recovery is in stark contrast to the recovery permitted by the federal rule, which limits recovery to cases in which the plaintiff wins but recovers less than the offer.[93] At the close of the plaintiff's case in chief, in *Tanker*, the defendant moved for, and the court granted, a directed verdict.[94] The defendant had previously made an "offer of settlement pursuant to F.S.A. § 45.061, an offer of judgment pursuant to F.S.A. § 768.79 and an offer of judgment pursuant to Fed. R. Civ. P. 68."[95] After judgment for the defendant was entered, the defendant filed an application for costs and attorneys' fees, which the district court granted.[96]

The plaintiff appealed contending, *inter alia*, that "the district court erred by . . . awarding Brunson [defendant] costs and attorney's fees."[97] Attorneys' fees are not recoverable under FRCP 68 "unless the underlying statute that creates the cause of action expressly provides that attorney's fees are recoverable as costs."[98] However, section 45.061 of the Florida Statutes provides "that a prevailing defendant *may* recover attorney's fees if the plaintiff unreasonably rejected either a settlement offer or an offer of judgment."[99]

The plaintiff contended that the offer of judgment rules were procedural, and therefore, FRCP 68 preempted section 45.061 of the Florida Statutes under *Erie*.[100] Like the Seventh Circuit, however, the Eleventh Circuit held that the two

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87. 918 F.2d 1524 (11th Cir. 1990).

88. Florida has three rules regarding offers of judgment: (1) FLA. STAT. ANN. § 768.79 "Offer of judgment and demand for judgment"; (2) FLA. STAT. ANN. § 45.061 (West 1983) "Offers of settlement"; and (3) FLA. ST. R.C.P. 1.442 "Proposals for Settlement." These rules, which overlap and conflict with one another, have led to much confusion in practice in the Florida court system.

89. *Tanker Management, Inc.*, 918 F.2d at 1526-28.

90. *Id.* at 1524.

91. *Id.*

92. *Id.*

93. *See* Delta Air Lines, Inc. v. August, 450 U.S. 346 (1981) (holding that a prevailing defendant cannot recover costs pursuant to FED. R. CIV. P. 68).

94. *Tanker Management, Inc.*, 918 F.2d at 1526.

95. *Id.*

96. *Id.*

97. *Id.*

98. *Id.* (citing Marek v. Chesney, 473 U.S. 1, 9 (1985)).

99. *Tanker Management, Inc.*, 918 F.2d, at 1528 (emphasis added).

100. *Id.* at 1526.

rules were not in "direct collision" because FRCP 68 was *not broad enough* in scope to cover the issue of a plaintiff's unreasonable objection.[101] The court also noted that a "state law denying the right to attorney's fees or giving a right thereto . . . reflects a substantial policy of the state, [and] should be followed."[102] The Eleventh Circuit affirmed the lower court's grant of attorneys' fees and costs to the prevailing defendant.

The federal courts in Florida, therefore, have held that Florida's offer of judgment rules are *not* preempted (or displaced) by FRCP 68.[103] The federal courts in Florida, as well as the Eleventh Circuit, have held that both plaintiffs *and* defendants may make offers pursuant to the Florida rules instead of FRCP 68, since the potential recovery is substantially greater under the state rule.[104] This holding is different from that of the Seventh Circuit and the Wisconsin federal courts, which have stated that plaintiffs may make offers pursuant to the state rule, but defendants must make their offers pursuant to the federal rule, since that portion of the state rule is directly covered by, and therefore in conflict with, the federal rule.

C. The Ninth Circuit and Various District Courts within the Ninth Circuit

Within the Ninth Circuit, Alaska, California and Nevada currently have state Offer of Judgment rules or statutes that differ from FRCP 68.[105] Alaska Rule of Civil Procedure 68 allows plaintiffs to make offers and also allows for reasonable attorneys' fees and a stepped-up rate of prejudgment interest as specified in section 09.30.065 of the Alaska Statutes.[106] In *Home Indemnity Co. v. Lane Powell Moss and Miller*,[107] the Ninth Circuit held that Alaska's statute, which allows for enhanced prejudgment interest, was inapplicable in diversity cases. The court held, however, that Alaska's *general* prejudgment statute must be applied in diversity cases because it was a rule of substantive law.[108] The court further held that section 09.30.065 of the Alaska Statutes was "not a prejudgment interest statute; it addresses the procedures for and consequences of making offers of judgment."[109] Prejudgment interest statutes are normally compensatory rules and not penalties, whereas section 09.30.065 of the Alaska Statutes "is punitive in nature," punishing an offeree for not settling when the final judgment indicates that he should have settled.[110] The court held that the district court did not err in

101. *Id.* (citing Walker v. Armco Steel Corp., 446 U.S. 740 (1980)).

102. *Tanker Management, Inc.*, 918 F.2d at 1526 (quoting 6 JEREMY C. MOORE ET AL., FEDERAL PRACTICE ¶ 54.77[2], 1712-1713 (2d ed. 1974) (footnotes omitted)).

103. *Tanker Management, Inc.*, 918 F.2d at 1526-28.

104. *Id.*

105. *See* Florida rules appended.

106. This rule is applicable to all cases filed before August 7, 1997. ALASKA R.R.C.P. 68, as amended through Sept. 1, 1999 is applicable to all cases filed on or after August 7, 1997, and is almost identical to its predecessor, except that it does not direct one to ALASKA STAT. § 09.30.065 (Lexis 1962) but incorporated the language of the statute into the rule.

107. 43 F.3d 1322 (9th Cir. 1995).

108. *Id.* (citing Northrop Corp. v. Triad Int'l Mktg. S.A., 842 F.2d 1154, 1155 (9th Cir. 1988) for the proposition that "[s]ubstantive state law determines the rate of prejudgment interest in diversity actions.").

109. *Home Indemnity Co.*, 43 F.3d at 1322.

110. *Id.*

holding that FRCP 68 controlled because section 09.30.065 of the Alaska Statutes could not "be characterized as a substantive prejudgment interest statute"; it is a *procedural* offer of judgment provision.[111]

Later that year, the Ninth Circuit had the opportunity to address a similar issue stemming from a California case. California's offer of judgment rule is codified at section 998 of the California Civil Procedure Code and allows for an offeror to recover *actual* expert witness fees.[112] Under "[f]ederal law . . . the defendant . . . [can only] recover forty dollars per day per witness."[113] In *Aceves v. Allstate Insurance Co.*, the Ninth Circuit held that state "law controls the substance of [the] lawsuit, but federal law controls the procedure."[114] This proposition is true unless applying the federal law creates an incentive to forum-shop.[115] With little explanation, the court noted that it would be "exceedingly unlikely that section 1821(b) [would] provide[ ] litigants an incentive to sue in or remove to federal courts."[116]

Nevada's offer of judgment rule allows, *inter alia*, plaintiffs to make offers of settlement and to recover attorneys' fees.[117] The District Court of Nevada, in *Nicolaus v. West Side Transport, Inc.*,[118] held that the plaintiff (intervenor) could not utilize the Nevada procedural rule to support its claim for post-offer costs.[119] The court agreed with the Seventh Circuit's holding in *S.A. Healy*[120] that the substantive portion of the state rule allowing plaintiffs to make an offer must be applied in diversity cases, or defendants would have a heightened incentive to remove.[121] The court also held, however, that to allow a recovery of attorneys' fees "would transgress the limits of *Erie*."[122] The court held that allowing a plaintiff-offeror to recover attorneys' fees would create "a disincentive to removal by out-of-state defendants who would otherwise desire the protection and alacrity offered by a federal court."[123] The court called this approach a "limited acceptance of Nevada Rule 68 into diversity cases."[124] This acceptance "reflects a balance between maintaining the integrity of the congressionally sponsored Federal Rules of Civil Procedure . . . and observing 'important state interests and regulatory policies.'"[125]

The Ninth Circuit's analysis differs from the Eleventh and Seventh Circuits' analysis in that the Ninth Circuit focused primarily on the substance/procedure

111. *Id.*
112. CAL. CIV. PROC. CODE § 998(c)(1).
113. Aceves v. Allstate Ins. Co., 68 F.3d 1160, 1167 (9th Cir. 1995) (citing 28 U.S.C. § 1821(b) (1994)).
114. *Aceves*, 68 F.3d at 1167.
115. *Id.* at 1168.
116. *Id.*
117. NEV. R.C.P. 68.
118. 185 F.R.D. 608 (D. Nev. 1999).
119. *Id.*
120. 60 F.3d 305, 309 (7th Cir. 1995), *cert. denied*, 516 U.S. 1010 (1995).
121. *Nicolaus*, 185 F.R.D. at 613.
122. *Id.*
123. *Id.* at 614.
124. *Id.*
125. *Id.* (citing Burlington Northern R.R. Co. v. Woods, 480 U.S. 1, 5 (1987) and quoting Gasperini v. Center for Humanities, Inc. 518 U.S. 415 (1996)).

characterization, rather than the "broad enough in scope" language of *Walker*.[126] Determining that offer of judgment rules are procedural, the Ninth Circuit held that the federal rule must prevail.

V. ANALYSIS OF RULE 68 UNDER *Erie*

If the federal court will not apply the state rule because it is a rule of procedure, two problems emerge. First, if a plaintiff wishes to make an offer of judgment, he will have to forum-shop, selecting the state court over the federal court in order to make an offer. In turn, the non-resident defendant can remove to federal court in order to remove the plaintiff's right to make an offer of judgment. Second, the inapplication of the state rule discriminates against resident defendants because only a non-resident defendant can remove to federal court. If a rule encourages forum-shopping, it is prospectively outcome-determinative.

Stating that a rule is outcome-determinative does not only affect who will win, but it also affects the amount to which the winner is entitled. The state rules discussed in this article allow plaintiffs to make offers that can have a definite effect on the monetary recovery of the case if they are not accepted.[127] Many of these state rules allow for attorneys' fees, expert witness costs, double costs, and enhanced pre-judgment interests.[128] Many state rules also allow a defendant to recover these costs even if he or she prevails.[129] The federal rule only allows the defendant to make an offer, and he cannot recover if he prevails at trial.[130] The only costs recoverable are those allowed by FRCP 54.[131]

The question then becomes whether the differences between FRCP 68 and state offer of judgment rules are differences that would either render the FRCP "inapplicable" or cause the state and federal rules to "directly collide." The federal and state rules directly collide if the application of the state rule would render the federal rule useless or thwart the purposes behind the federal rule. If the rules directly collide, *Hanna* mandates application of the federal rule.[132] If they do not, the Seventh and Eleventh Circuits suggest that the federal rule would be inapplicable because it is outcome-determinative.

A federal rule of procedure is valid if it does not violate the REA.[133] The REA limits federal rulemaking to procedural rules.[134] Holding a rule inapplicable differs from holding a rule invalid. To date, no rule of federal civil procedure has

126. Aceves v. Allstate Ins. Co., 68 F.3d 1160, 1167 (9th Cir. 1995).

127. *See* CAL. CIV. PROC. CODE § 998 (West 2000); FLA. STAT. ANN. § 13-17-102 (West 1983); NEV. R.C.P. 68; WIS. STAT ANN. § 807.01 (West 1994).

128. *See, e.g.*, NEV. R.C.P. 68.

129. *See, e.g.*, FLA. STAT. ANN. § 45.061 (West 1972).

130. *See* FED. R. CIV. P. 68.

131. Those costs include: (1) fees of the clerk and marshall; (2) fees of the court reporter for all or any part of the stenographic transcript necessarily obtained for use in the case; (3) fees and disbursements for printing and witnesses; (4) fees for exemplification and copies of papers necessarily obtained for use in the case; (5) docket fees; and (6) compensation of court appointed experts, compensation of interpreters, and salaries, fees expenses, and costs of special interpretation services.

132. Hanna v. Plumer, 380 U.S. 460, 468 (1965).

133. *Id.* at 471.

134. *Id.*

been held invalid. Federal rules, however, have been held inapplicable in certain situations.[135]

At this point, as discussed in the Seventh and Eleventh Circuits analysis, two questions must be asked under *Walker*: (1) is the federal rule *sufficiently broad* to control the issue; (2) if not, then under *Erie* the statute is applicable.[136] The state offer of judgment rules allow for plaintiffs' offers—the federal rule does not.[137] Some of the state rules allow prevailing defendants to recover costs—the federal rule does not.[138] Many of the state rules allow attorneys' fees, enhanced prejudgment interest, expert witness fees, and double costs, all of which are entitlements so bound up in the definition of the rights and obligations of the parties that they must be substantive in the outcome-determination sense, and are not governed by the FRCP and REA.[139] The federal rule, then, must be construed as narrow in scope and not able to cover these issues of recovery adequately—leading to an inequitable administration of the laws, forbidden by *Erie*.

Under the RDA and *Erie*, the rule must be analyzed under *Guaranty Trust v. York*[140] to determine whether it is outcome-determinative. The analysis is essentially the same as that in *Hanna*. The court, in *Guaranty Trust*, first articulated the outcome-determinative test: "a state law rule that *substantially* determines the outcome of the litigation must be applied."[141] The failure to apply these state rule examples would promote forum-shopping. In this situation, the federal rule's sole purpose is to encourage early settlement and avoid protracted litigation, thereby cleaning up the federal docket. If the state rules were not applied in federal diversity cases, a non-resident defendant would have an incentive *not* to settle and to remove to federal court, creating more litigation in federal courts. Here, the failure to apply the state rule would promote forum-shopping and render the federal rule ineffective.

Conversely, the application of the state rule in federal court actually would enhance the probability of parties settling before trial. Application of the state rule would keep the federal dockets clear in two ways. First, if the case is initially filed in state court, and the parties know that the federal court will apply the state rule, the incentive for defendants to remove to federal court would disappear. Second, assuming that the more extreme state rules do encourage settlement more than the federal rule does, even if parties begin in federal court or remove to federal court due to the heightened risk of not settling, the parties are more likely to settle prior to trial. Either way, the purpose of the federal rule is enhanced by the application of the state rule in federal court. The failure to

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135. *See generally* Gasperini v. Center for Humanities, Inc., 518 U.S. 415 (1996); Walker v. Armco Steel Corp., 446 U.S. 740 (1980); Cohen v. Beneficial Ind. Loan Corp., 337 U.S. 541 (1949); Ragan v. Merchants Transfer & Warehouse Co., 337 U.S. 530 (1949); Woods v. Interstate Realty Co., 337 U.S. 535 (1949) (holding in each case at least parts of the Federal Rules of Civil Procedure inapplicable).

136. *See* S.A. Healy Co. v. Milwaukee Metro. Sewerage Dist., 60 F.3d 305, 309 (7th Cir. 1995), *cert. denied*, 516 U.S. 1010 (1995); Tanker Management v. Brunson, 918 F.2d 1254, 1528 (11th Cir. 1990).

137. *Compare, e.g.*, WIS. STAT. ANN. § 807.01 with FED. R. CIV. P. 68.

138. *Compare, e.g.*, FLA. STAT. ANN. § 45.061 (West 1983) with FED. R. CIV. P. 68.

139. *See, e.g.*, NEV. R.C.P. 68.

140. Guaranty Trust Co. v. York, 326 U.S. 99 (1945) (emphasis in original).

141. *Id.* at 99 (noting that an amount recovered is included within the meaning of outcome).

apply the state rule would thwart the purpose of the federal rule and would create more litigation in federal courts.

In *Byrd v. Blue Ridge Rural Electric*,[142] the Supreme Court balanced the state interest in having its law followed against the federal interest in administering justice as an independent system.[143] The federal interest must be related to a "strong federal policy" to outweigh the state interest.[144] Here, these states went to great lengths to enact and amend these rules. They have a great interest in reducing protracted litigation and maintaining control over their court systems. They also have a great interest in making sure their residents are not subjected to discrimination just because they are in federal court (as with a diverse plaintiff) or because they cannot get to federal court (as with a non-diverse defendant). Furthermore, the application of these state rules does not diminish the federal court's interest in maintaining practice and pleading in its court. If anything, the application of these rules is more likely to encourage settlement prior to litigation, thereby keeping the parties out of federal court and the federal docket clear. Encouraging settlement is in accord with the federal policy behind FRCP 68. Applying a state's offer of judgment rule will not thwart the purpose underlying the federal rule if the state's rule promotes settlement.

VI. CONCLUSION

Following the two prong analysis set out in *Walker*, the Seventh and Eleventh Circuits' handling of the Wisconsin and Florida rules, and the analysis outlined above, a federal court, sitting in diversity in a state with an amended Rule 68 or similar statute must apply the state rule. Application of the state rule is the only way to avoid disparate outcomes between state and federal judgments, forum-shopping, favoring out-of-state defendants to the detriment of in-state defendants, and to effectuate the stated purposes of both the state and federal offer of judgment rules—that of encouraging settlement and avoiding protracted litigation. If removal can be used as a tactic whereby defendants can avoid settling and shift costs, the purpose behind FRCP 68 will be thwarted.

Louisiana has a rule that allows plaintiffs to make offers of judgment. To date, the issue of its application in diversity has not been litigated in Louisiana federal courts. Currently Mississippi is considering adopting a rule similar to those addressed in this article. This issue will eventually find its way to the Fifth Circuit Court of Appeals. Without the Supreme Court stepping in to clean up the obvious discrepancies among the Circuits, the Fifth Circuit will have to address this issue. The District Courts of Mississippi and Louisiana, as well as the Fifth Circuit, should look to the aims of *Erie* and its progeny to avoid forum-shopping, discrimination, and disparate outcomes by applying the state's rule in diversity.

142. Byrd v. Blue Ridge Rural Electric Coop. Inc., 356 U.S. 525 (1958).
143. *Id.* at 537.
144. *Id.* at 538.