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Controversy Over 'Amount in Controversy'

Courts are split on the efficacy of affirmative defenses raised to defeat diversity jurisdiction.

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THE "AMOUNT in controversy" requirement for federal court jurisdiction, while not as frequently litigated as diversity issues, has led to a circuit split that the U.S. Supreme Court has yet to resolve. Practitioners should be mindful of the courts' differing interpretations of this requirement, which can provide a basis for a motion to dismiss for lack of subject matter jurisdiction.

Pursuant to 28 U.S.C. §1332(a), a federal court may exercise subject matter jurisdiction only if there is complete diversity and the amount in controversy exceeds \$75,000.¹ A defendant who seeks to dismiss on grounds that the amount in controversy falls below the statutory minimum will commonly do so based on an affirmative defense, such as a statutory or contractual limitation on damages. The circuits are divided as to what extent such defenses may be considered.

In *Paul Mercury Indemnity Company v. Red Cab Company*, 303 U.S. 283, 289 (1938),² the Supreme Court set forth the "legal certainty" test to determine whether the statutory minimum amount in controversy is satisfied. In that case, the Court found that

the sum claimed by the plaintiff 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.

The Court further held that the plaintiff's inability "to recover an amount adequate to give the court jurisdiction does not show his bad faith or oust the jurisdiction," nor did the fact that the complaint disclosed the existence of a valid defense to the claim limiting recovery to less

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than the requirement amount in controversy mandate dismissal.³

Courts applying *Red Cab* have split as to whether the plaintiff's "good faith" allegation that the amount in controversy exceeds the jurisdictional minimum is sufficient to allow the case to proceed when a defense may exist that would limit any potential recovery to an amount less than the required amount. The issue largely turns on how far beyond plaintiff's initial pleading the court is inclined to look.

The Second Circuit has staked out a minority position on this issue, taking the pro-plaintiff

approach that courts should generally look no further than the plaintiff's own good faith basis to allege that the jurisdictional minimum is satisfied.

Tales of Two Hotel Rooms

The circuit split is dramatically illustrated in two cases with essentially identical facts but with diametrically opposed results: *Zacharia v. Harbor Island Spa, Inc.*, 684 F.2d 199 (2d Cir. 1982) and *Pachinger v. MGM Grand Hotel-Las Vegas, Inc.*, 802 F.2d 362 (9th Cir. 1986).

In *Zacharia*, plaintiff hotel guest entrusted defendant hotel with jewelry to be placed in the hotel's deposit box.⁴ The plaintiff signed a registration card and two "statement of value" forms that stated that the hotel's liability was limited to \$1,000. Plaintiff's jewelry was stolen from the deposit box and the Eastern District of New York dismissed the subsequent complaint for lack of subject matter jurisdiction, on grounds that plaintiff's damages were limited to below the threshold jurisdictional minimum.

Plaintiff appealed and the Second Circuit reversed, finding that by considering the contractual limitation on damages, the district court "did more in this case than assess the allegations of [plaintiff's] complaint."⁵ The panel reasoned that affirmative defenses should not be considered and adjudicated in jurisdictional motions:

[W]ere the law otherwise, the orderly progress of litigation would be disrupted, and doubt and ambiguity would surround the jurisdictional base of most diversity litigation from complaint to final judgment. Issues going to a federal court's power would be hopelessly confused with the merits themselves.⁶

The Ninth Circuit's *Pachinger* decision stands in stark contrast. There, as in *Zacharia*, plaintiff brought a claim against a hotel over lost jewelry.⁷ The hotel's claim check purported to limit liability to \$250 and the Nevada innkeeper statute limited a hotel's liability for theft to \$750.⁸

The district court dismissed for lack of subject matter jurisdiction, holding that plaintiff could not possibly recover the statutory minimum amount in controversy because the hotel's liability was limited by statute.⁹ The Ninth Circuit affirmed, holding that "in the few cases involving a rule or measure of damages that limits liability, we may go beyond the pleadings for the limited purpose of determining the applicability of the rule or measure of damages."

In *Pachinger*, the Ninth Circuit expressly acknowledged, but declined to follow, the Second Circuit's *Zacharia* decision.¹⁰

Faith or Certainty?

Because the Second Circuit relies on the Supreme Court's enunciation in *Red Cab* that "the sum claimed by the plaintiff controls if the claim is apparently made in good faith,"¹¹ Second Circuit courts maintain that even if a limitation on damages provision exists, the defendant may opt not to rely on the limiting provision or the court might later find that provision to be unenforceable.

In a 2003 decision, the Second Circuit reiterated the rule and created an almost impossible bar to defendants seeking dismissal, holding that "[t]he legal impossibility of recovery must be so certain as to virtually negate plaintiff's good faith in asserting the claim."¹² Courts in the Fifth Circuit have also held that an affirmative defense cannot be used to defeat jurisdiction.¹³

On the other hand, the Third, Seventh, Ninth and Tenth Circuits endorse a more rigorous examination of a plaintiff's basis to allege the existence of a sufficient amount in controversy.¹⁴ These circuits encourage federal courts to act as

gatekeepers to ensure that they are not burdened by claims that do not merit federal subject matter jurisdiction. As the Seventh Circuit explained in *Pratt Central Park Ltd. Partnership v. Dames & Moore, Inc.*, 60 F.3d 350 (7th Cir. 1995),

it does not follow that the court must accept the plaintiff's perspective and proceed to adjudicate on the merits every case in which the lawyers can keep straight faces when making their presentations.... To adjudicate a case fully just because the plaintiff has something of an argument may be the cheapest way to dispose of the current dispute, but it has costs for other litigants, who must wait in a longer queue.¹⁵

The majority of circuits, unlike the Second Circuit, follow this approach. As one federal court in the Tenth Circuit recently noted in deciding that it was obligated to determine the enforceability of a damages limitation clause before conferring subject matter jurisdiction, "[t]he Second Circuit's views on this issue represents the minority approach."¹⁶ The same court found, among other things, that because (1) the limitation of liability provision at issue was valid and enforceable against the plaintiff and (2) plaintiff's tortious interference claim was insufficiently pleaded, there was a "legal certainty" that the amount in controversy was below the statutory minimum.

It is well settled that a plaintiff's ultimate recovery of less than the jurisdictional minimum does not establish that a federal court should not have asserted subject matter jurisdiction in the first place. Nevertheless, in a few cases, judgments have been vacated on grounds that plaintiff at the outset never had a basis to allege the minimum amount in controversy.

When to Vacate a Judgment?

For example, in *Jimenez Puig v. Avis Rent-A-Car Sys.*, 574 F.2d 37 (1st Cir. 1978), the First Circuit vacated an award of damages for defamation on grounds that there was no colorable basis for subject matter jurisdiction because of an insufficient amount in controversy. The case concerned the alleged humiliation of plaintiff by defendant's employee.

Reviewing exhibits and testimony from trial, the panel found that the "evidence in [the] case, viewed most favorably to plaintiff, established that he suffered a brief embarrassment... The defamation was not serious... Even the \$2500 which the court below awarded seems to us excessive."¹⁷ Because the claim could not be "objectively" viewed as "worth" the jurisdictional minimum, the court held that subject matter jurisdiction was lacking.

In a Second Circuit case that may appear anomalous given the Circuit's lenient approach, *Tongkook v. Shipton Sportswear Co.*, 14 F.3d 781 (2d Cir. 1994), the panel reversed a district court's decision denying defendant's motion to dismiss for lack of subject matter jurisdiction. The Circuit held that the amount in controversy was insufficient, notwithstanding that both parties at the outset of the case apparently believed in good faith that it exceeded the jurisdictional minimum.

The plaintiff in *Tongkook* had sued on an unpaid balance that was believed to be over \$100,000 at

the time the suit was initiated. However, both parties came to recognize during pretrial discovery that the amount in dispute was actually less than one-third that amount. The Second Circuit explained that regardless of plaintiff's beliefs when the suit began, "good faith has an objective element and we cannot ignore what pretrial discovery revealed—that from the outset, [plaintiff], to a 'legal certainty,' could not recover the statutory jurisdictional amount."

Conclusion

Until the Supreme Court resolves this issue, the fate of a motion to dismiss for lack of subject matter jurisdiction based on an affirmative defense to the amount in controversy will depend largely on the circuit in which the action is commenced.

For plaintiffs appearing in the Second Circuit, satisfying the statutory minimum appears to be relatively straightforward: The plaintiff needs only a good faith basis to bring a claim. A defendant seeking to dismiss such an action on grounds that the amount in controversy is insufficient should recognize that a contractual limitation on damages will almost certainly not prevent the plaintiff from prosecuting his case.

However, in those circuits in which courts conduct a more scrutinizing examination, a motion predicated on the existence of a defense limiting plaintiff's recovery to less than the statutory minimum is much more likely to succeed.



1. A federal court has diversity jurisdiction over the subject matter of a civil action "where the matter in controversy exceeds the sum or value of \$75,000, exclusive of interests and costs, and is between...citizens of different States [or] citizens of a State and citizens or subjects of a foreign state..." 28 U.S.C. §1332(a).

2. At the time, the amount in controversy was required to exceed \$3,000.

3. 303 U.S. at 289 (1938).

4. 684 F.2d at 201.

5. *Id.* at 202.

6. *Id.*

7. 802 F.2d at 363.

8. *Id.*

9. *Id.*

10. *Id.* at 365.

11. 303 U.S. at 289.

12. *Scherer v. Equitable Life Assurance Soc. of the U.S.*, 347 F.3d 394, 395-6 (2d Cir. 2003) quoting *Chase Manhattan Bank, N.A. v. Am. Nat. Bank & Trust Co. of Chicago*, 93 F.3d 1064, 1070-71 (2d Cir. 1996).

13. *Anderson v. Moore*, 372 F.2d 747 (5th Cir. 1967) (defense of *res judicata* on claim could not be used to reduce the amount in controversy to below the jurisdictional minimum); *McKorkel v. Exxon Corp.*, 1976 WL 1568 (S.D. Ga. 1976).

14. See, e.g., *Valhal Corp. v. Sullivan Assoc., Inc.*, 44 F.3d 195 (3d Cir. 1995); *Pratt Central Park Ltd. Partnership v. Dames & Moore, Inc.*, 60 F.3d 350 (7th Cir. 1995); *City of Boulder v. Snyder*, 396 F.2d 853 (10th Cir. 1968).

15. 60 F.3d at 352.

16. *LD Circuit, LLC v. Sprint Communications Co., L.P.*, 364 F. Supp. 2d 1246, 1253 (D. Kan. 2005).

17. 574 F.2d at 40.