House of Representatives Committee on the Judiciary
Subcommittee on the Constitution

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The Fraudulent Joinder Prevention Act of 2015

Thank you, Mr. Chairman and distinguished Committee members for inviting me to provide testimony on fraudulent joinder and the impact that it has on small businesses in America today. My name is Elizabeth Milito and I serve as Senior Executive Counsel of the National Federation of Independent Business (NFIB) Small Business Legal Center. The NFIB Small Business Legal Center (NFIB Legal Center) is a nonprofit, public interest law firm established to provide legal resources and be the voice for small businesses in the nation's courts through representation on issues of public interest affecting small businesses.

The National Federation of Independent Business (NFIB) is the nation's leading small business association, representing members in Washington, D.C., and all 50 state capitals. Founded in 1943 as a nonprofit, nonpartisan organization, NFIB's mission is to promote and protect the right of its members to own, operate and grow their businesses.

NFIB represents 325,000 member businesses nationwide, and its membership spans the spectrum of business operations, ranging from sole proprietor enterprises to firms with hundreds of employees. While there is no standard definition of a "small business" the typical NFIB member employs 10 people and reports gross sales of about $500,000 a year. The NFIB membership is a reflection of American small business.

Although federal policy makers often view the business community as a monolithic enterprise, it is not. Small business owners have many priorities and often limited resources. Being a small business owner means, more times than not, you are responsible for everything – NFIB members, and hundreds of thousands of small businesses across the country, do not have human resource specialists, compliance officers, or attorneys on staff. Because of their size and limited resources, uncertainty continues to be the enemy of small business owners. Small-business owners continue to rank "Uncertainty Over Economic Conditions" as a serious problem. And for a small business owner being served with lawsuit generates significant trepidation, disgust, and yes, uncertainty.

Because litigation entails angst and great expense for small businesses, NFIB is pleased to see this Committee's attention focused on the issue of fraudulent joinder. Fraudulent joinder remains a source of confusion and unnecessary litigation in our courts and impacts far too many innocent small businesses. The situation unfolds as follows: plaintiffs' attorneys will name a small business – such as a local pharmacy or insurance agent – with little connection to the complaint in order to deny the federal courts of jurisdiction. In many instances, the plaintiff has no intention of imposing liability on the fraudulently joined party. With courts divided over the standard for finding that a defendant is fraudulently joined, the small business is forced to engage in protracted litigation when all they want is to be dismissed from the case entirely.

Congress should address this problem by passing the Fraudulent Joinder Prevention Act, which would slightly amend 28 U.S.C. § 1447(c), the federal statute governing diversity jurisdiction in the federal courts. A short and straightforward bill, the Act, would require plaintiffs to show a "plausible claim for relief" against a nondiverse defendant. In evaluating fraudulent joinder, judges would be able to consider affidavits or other evidence beyond the pleadings submitted by the plaintiff, as well as whether the plaintiff has shown a good-faith intent to pursue a judgment against the nondiverse defendant. Adoption of this bill would help protect local small businesses from becoming pawns in high-stakes and high-dollar civil litigation.

Perverse Incentives for Fraudulent Joinder

While most attorneys comply with the highest ethical standards, there are instances, unfortunately, where small businesses are named as defendants because they represent convenient targets for the purpose of forum shopping. In the paradigmatic fraudulent joinder case, a plaintiff sues a nominal nondiverse/in-state defendant along with a diverse foreign defendant in an effort to make sure that its claims against its true target, the diverse defendant, stay in state court. At the time of removal, the diverse defendant is already a party, and the only question is whether the court can disregard the nondiverse/in-state defendant for purposes of assessing jurisdiction.

For instance, in the world of pharmaceutical litigation, a familiar strategy by plaintiffs is to target a local pharmacy as the diversity-destroying pawn to be a roadblock to the drug manufacturer's removal efforts.[1] Plaintiffs in these circumstances rarely intend in good faith to pursue the local independently-owned pharmacy. Rather, they usually dismiss the pharmacy once the case is remanded to state court. Some plaintiffs will even offer to dismiss the pharmacy in exchange for the drug manufacturer's stipulation to forgo removal.

In these cases, small business owners are forced to incur substantial financial costs in defending their business, they must dedicate their time and energy to the case, and they must deal with the heavy emotional toll that a wrongful suit may cause—all because they have been named as a defendant for an improper reason. Public policy should encourage plaintiffs' attorneys to prudently assess the viability of their clients' potential claims *before* initiating a lawsuit and discourage plaintiffs from taking unfounded or improvidently cavalier positions.

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[1] *See, e.g.*, *In re Rezulin Products Liability Litigation*, 133 F. Supp. 2d 272, 289 (S.D.N.Y. 2001) (local pharmacies and salespeople held fraudulently joined in prescription drug action against manufacturers); *Negrin v. Alza Corp.*, 1999 WL 144507 at *5 (S.D.N.Y. Mar. 17, 1999) (local pharmacy held fraudulently joined in prescription drug case against manufacturer); *Strickland v. Brown Morris Pharmacy, Inc.*, 1996 WL 537736 at *2 (E.D. La. Sept. 20, 1996) (local pharmacy held fraudulently joined in over-the-counter drug case against manufacturer); *see also Johnson v. Parke-Davis*, 114 F. Supp. 2d 522, 525–26 (S.D. Miss. 2000) (resident sales representatives held fraudulently joined in action against prescription drug manufacturer).

Along these lines, we should aim to create strong disincentives against naming a small business as a defendant in a case where the claim against the business is particularly weak, especially where the plaintiff's apparent motive is to use the defendant as "body-shield" against invocation of federal jurisdiction. But unfortunately, as the law currently stands, plaintiffs actually have perverse *incentive* to bring weak or attenuated claims against small business defendants for the sake of defeating federal jurisdiction.[2]

The plaintiffs' bar knows that suits are much more likely to be dismissed in federal court.[3] Accordingly, plaintiffs' attorneys usually seek to file in state court and they draft their complaints with an aim to prevent defendants from removing to federal court.[4]

On the other side of the equation, defendants prefer to be in federal court because federal courts tend to have a better grasp on the issues and the proper procedures, and because there is more predictability in federal courts.[5] Thus out-of-state defendants often seek to remove tort cases from state to federal court. They are entitled to do so under federal law, provided that there is "complete diversity" between the defendants and the plaintiff.[6] In other words, removal is allowed only where *all* of the defendants are from a different state than the plaintiff.[7] For example, a case may be removed from Kentucky state court where plaintiff is a resident and where the defendant corporations are based in New York and California.

Accordingly, an aggressive plaintiff's attorney—always employing new and ingenious forum-shopping games—has a strong incentive to find someone else to name as a defendant in the plaintiff's home state. In the foregoing example, the Kentucky plaintiff has a much better chance of prevailing if he or she can add a Kentucky defendant to the suit because this will most likely ensure that the case will remain in state court.

Knowing that the plaintiff is more likely to prevail in state court, the plaintiff's attorney has an incentive to name another defendant, even if he or she can only muster a weak or attenuated claim. And this is often going to be a local small business that had only a tangential or peripheral role in the case or controversy

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[2] *See* Melissa R. Levin and Heather K. Hays, *Fraudulent Joinder: Successful Removal of Actions to Federal Court*, Pharmaceutical & Medical Device Law Bulletin, Vol. 4, No. 4 (April, 2004).
[3] Plaintiffs' success rate is only 34 percent in federal court after removal. Matthew J. Richardson, *Clarifying and Limiting Fraudulent Joinder*, 58 Fla. L. Rev. 119, 183 (2006)
[4] John Merrill Gray, III, *Motions—Refining the Standard in Motions in Alleging Fraudulent Joinder*, 36 Am. J. Trial Advoc. 225, 231 (2012) ("Joining an in-state defendant to defeat diversity is a common tool used by parties seeking to remain in state court.").
[5] *See* Levin and Hays, *supra* at 2.
[6] *See* 28 U.S.C. § 1332(a)(1) (2005) (stating that the district courts have original jurisdiction over all cases and controversies between citizens of different states).
[7] Richardson, *supra,* at 166.

at issue because they are convenient target.[8] For example, in a typical products liability case, the plaintiff will be suing an out-of-state manufacturer on the theory that the manufacturer was negligent in designing the product. In such a case, the local merchant who sold the product is a convenient defendant—not necessarily because the plaintiff intends to hold the merchant liable so much as because the plaintiff wants to prevent the manufacturer from removing the case to federal court. But, once more, we maintain that the plaintiff should not be incentivized to drag a small business owner into litigation for such a Machiavellian purpose.

In theory, the out-of-state manufacturer in such a case could seek to remove the case to federal court on the ground that the plaintiff fraudulently joined the local merchant as a defendant simply for the purpose of defeating federal jurisdiction.[9] But, this is an uphill battle for the defendant.[10] To avoid remand back to state court, the defendant must demonstrate that the plaintiff falsely or fraudulently misstated facts in adding the in-state defendant or that there is no chance of the plaintiff stating a viable claim against that defendant in state court.[11]

While the federal courts vary in how they approach this issue, the differences between the circuits pertain to deference provided to the plaintiff.[12] This means that, in the best case scenario, it is going to be hard for a defendant to prevail. Indeed, plaintiffs predominantly succeed in getting federal courts to remand these cases back to state court.[13] Courts generally remand any case if the plaintiff has a remote possibility of recovery against the in-state defendant.[14] This plaintiff-friendly standard only emboldens plaintiffs to aggressively name local defendants even when there are serious questions as to their likelihood of success in the end.

Moreover, plaintiffs are further incentivized to proceed with questionable claims—and for the purpose of avoiding federal jurisdiction—by naming local small business defendants because federal statutes prevent defendants from appealing when a federal court remands a case back to state court.[15] And, conversely, courts give plaintiffs an unfair advantage over defendants because

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[8] *See e.g.*, Gray, *supra* at 225-27 (discussing the facts of a case where out-of-state defendants were prevented from removing their case to federal court because the plaintiff also named a local landlord was as a defendant).
[9] *See* Levin and Hays, *supra* at 2.
[10] *See* Richardson, *supra* at 133-34.
[11] *Id*.
[12] *Id*.
[13] *Id*. at 134 ("The removing defendant bears a heavy burden to show fraudulent joinder, and the burden is heavy in large part because issues of both law and fact are to be resolved in favor of the plaintiff.").
[14] *Id*.
[15] *Id*. at 134 -35 (If defendants lose on the motion to remand, they are left without a remedy because the order cannot be appealed, pursuant to federal statute.) (citing 28 U.S.C. § 1447(d) (2005)).

the plaintiff can appeal if the federal court holds that the in-state defendant was inappropriately joined.[16]

Finally, federal statutes discourage defendants from challenging fraudulent joinder because the plaintiff can collect attorney's fees if the challenge fails.[17] Here again, plaintiffs are given an unfair advantage over defendants because defendants *are not* entitled to seek attorney's fees if they prevail in convincing the federal court that the in-state defendant was fraudulently joined.[18] Accordingly, plaintiffs have little to lose and much to gain from naming another defendant—even if they are climbing out on a limb in doing so. Federal statutes have thus created all of the wrong incentives here.

The Fraudulent Joinder Prevention Act – A Solution for Small Business

To fulfill our role in representing the interests of the small business community in the nation's courts, the NFIB Legal Center filed about 70 amicus briefs on a wide spectrum of issues last year, including in cases where aggressive plaintiffs sought to set a precedent that would have exposed small business owners to new or greater liabilities in civil litigation. And we anticipate the need to continue filing in these sort of cases to defend small business interests because the plaintiffs' bar continues to push the proverbial envelop in encouraging courts to adopt expansive tort liability rules. Personal injury attorneys advocate rules that will open small businesses up to new and expanded liabilities because they are looking for more parties to hold liable and to make it easier to prevail in their cases.

For these reasons, the NFIB Legal Center encourages policy makers to mitigate and eliminate incentives driving our litigious culture. This may be accomplished to some extent through substantive reforms limiting tort liabilities or setting evidentiary and recovery standards. But, we should remember that the fundamental problem facing small business owners in these cases is a lack of financial resources necessary to successfully fend off implausible claims.

Given the tremendous costs of litigation, and the inevitable risk that a plaintiff might prevail if the case goes before a sympathetic jury or an errant judge, we must also address the reality that small business defendants are rationally discouraged from vindicating their rights. And so long as this remains true, plaintiffs' attorneys will inevitably weigh the benefits of pursuing a questionable claim or a questionable defendant as outweighing the risks.

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[16] *Id*. at 138 ("If the motion is denied, then the order may be appealed after final judgment, and the district court may proceed to dismiss the non-diverse defendants under Rule 21.").
[17] *Id*. at 134 ("Even worse, if defendants lose on the motion to remand, the district court is empowered by federal statute to award costs to the plaintiffs.") (citing 28 U.S.C. § 1447(c)).
[18] *See* 28 U.S.C. § 1447(c) (stating that "[a]n order remanding the case may require payment of just costs and any actual expenses, including attorney fees, incurred as a result of the removal").

Accordingly, NFIB supports "The Fraudulent Joinder Prevention Act," which would discourage plaintiffs' attorneys from taking cavalier and abusive positions in litigation, provide greater clarity in the law on removal, and reduce litigation. It would accomplish these things by requiring that a federal court considering a motion for remand determine whether the complaint states a "plausible claim for relief" against the nondiverse defendant. This language would eliminate the current standards - "no possibility of recovery," "no reasonable possibility of recovery," and "reasonable basis for the claim" – that strongly favor plaintiffs' motions for remand. The court would also consider whether the plaintiff has a good faith intention to prosecute the action against the nondiverse defendant or to seek judgment against the nondiverse defendant. The bill is straightforward and offers a simple and commonsense fix for a problem that has generated much confusion and unnecessary litigation in federal courts at the expense of small business.

Conclusion

On behalf of America's small business owners, I thank this Committee for holding this hearing and providing a forum to highlight the problems associated with fraudulent joinder. Lawsuits hurt small business owners, new business formation, and job creation. The cost of lawsuits for small businesses can prove disastrous, if not fatal, and threaten the growth of our nation's economy by hurting a very important segment of that economy, America's small businesses. We must work together to find and implement solutions that will stop this wasteful trend

We believe that "The Fraudulent Joinder Prevention Act" strikes the appropriate balance to protect those who are truly harmed and the many unreported victims of our nation's civil justice system – America's small businesses.

Sincerely,

Elizabeth Milito, Esq.
NFIB Small Business Legal Center