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Civil Procedure—Supplemental Jurisdiction

Federal Law Includes Permissive Claims Within Supplemental Jurisdiction Definition

A federal district court properly exercised supplemental jurisdiction over counterclaims asserted by Verizon New England concerning access fees related to ''dial-up'' internet usage by its customers, the U.S. Court of Appeals for the First Circuit held April 29 (*Global NAPs Inc. v. Verizon New England Inc. d/b/a Verizon Massachusetts,* 1st Cir., No. 09-1308, 4/29/10).

The counterclaims, which sought enforcement of the company's 2003 interconnection agreement (ICA) with Global NAPs Inc. (GNAPs), as well as alter ego liability and disregard of the corporate form, were both covered by 28 U.S.C. § 1367's grant of supplemental jurisdiction because both claims were inherently related to the same dispute, Chief Judge Sandra L. Lynch said; namely, ''what fees the carriers owe each other.''

While the court found the matter of the ICA's enforcement ''more than sufficiently related'' to the original complaint to warrant supplemental jurisdiction, it took a much harder look at the alter-ego counterclaim and whether the traditional ''judge-made'' rule allowing compulsory counterclaims into federal court, but barring permissive counterclaims, was still applicable.

In a matter of first impression, the court joined the Second and Seventh circuits by holding that some permissive counterclaims may fall within the purview of the supplemental jurisdiction established by Section 1367. While it refused to define the outer limits of Section 1367's ''same case or controversy'' language, the court said that Verizon's alter-ego counterclaim was safely within the boundaries of the statute.

Civil procedure experts told BNA that the court's decision was generally a straightforward application of Section 1367. However, it remains unclear just what the practical effect of the new standard will be.

Remember Dial-Up? Under the 1996 Telecommunications Act, local and long-distance carriers are required to share fees based on the interconnectivity of their networks. For local calls, an originating carrier must share part of the fees it collects with the terminating carrier. For long-distance calls, a long-distance carrier pays ''access charges'' to both the originating and terminating carriers.

In this case, Verizon's customers were connecting to the internet via a dial-up connection. GNAPs' customers were the internet service providers (ISPs) who received the call and connected the Verizon customers to the web.

Because GNAPs' customers never originated any calls and the connections lasted for significant periods of time, GNAPs was entitled to large reciprocal fees from Verizon, but never owed any in return. GNAPs compounded the discrepancy by assigning its ISP customers virtual phone numbers that appeared to Verizon and its customers to be local, but were in fact long distance.

Eventually, the Massachusetts Department of Telecommunications and Energy (DTE) ruled that Verizon was entitled to reciprocal fees for calls placed to these virtual phone numbers and ordered the companies to enter into an ICA—signed in 2003—which required GNAPs to pay access charges to Verizon for these calls.

GNAPs filed suit in federal district court, asserting that an FCC order issued in 2001, and another in 2008, preempted the state agency's authority to regulate ISP traffic. Verizon counterclaimed, asking for enforcement of the ICA and payment of the access charges mandated by the agreement. Later Verizon added the alter-ego counterclaim because it suspected that GNAPs was transferring its assets to avoid paying any future judgment against it.

The district court ruled in favor of Verizon on both counterclaims, and awarded $57,716,714 in damages.

Enforcement of ICA. GNAPs argued that no federal jurisdiction existed for either of Verizon's two counterclaims. With regard to Verizon's claim seeking enforcement of the ICA, GNAPs asserted that Verizon should have asked the DTE to interpret and enforce the agreement first.

The court pointed out that the law regarding the proper role of state agencies and federal courts in interpreting and enforcing ICAs remains unsettled. According to the court, most circuits have held that state commissions like the DTE do have the authority to deal with matters involving ICAs. On the other hand, the court noted that neither it nor the Supreme Court has weighed in on the issue.

The court concluded that it was not necessary to address the role of the DTE in this case because the counterclaim was already ''properly in federal court.'' ''At a minimum,'' the court said, ''there is supplemental jurisdiction under § 1367 over Verizon's counterclaim to enforce the ICA.''

Specifically, ''Both parties' claims ultimately arise from a dispute over the same agreement and involve the same basic factual question: what fees the carriers owe each other,'' the court said.

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Compulsory, Permissive, or Both. The more ''complicated argument'' was whether supplemental jurisdiction existed for Verizon's alter-ego counterclaim, the court said. GNAPs argued that ''at most this counterclaim is permissive, not compulsory,'' and therefore requires an independent basis for jurisdiction.

Having not yet ''considered the scope of statutory supplemental jurisdiction over counterclaims,'' the court first looked at the case law regarding supplemental jurisdiction that existed prior to Section 1367's enactment in 1990.

For ancillary claims, including counterclaims, ''Courts drew the line . . . at the transaction-or-occurence test,'' meaning that counterclaims ''had to arise from the same transaction or occurrence'' as the underlying claim.

This was done ''for practical reasons,'' the court said. Counterclaims that met this test were generally compulsory, and ''needed to be raised to avoid preclusion in a later proceeding.'' Because the courts were hesitant to expand federal judicial power more than necessary, supplemental jurisdiction was extended just far enough to include claims that would otherwise be lost, and did not include so-called ''permissive'' claims, the court said.

Section 1367, on the other hand, extended supplemental jurisdiction to claims that ''form part of the same case or controversy under Article III of the [U.S.] Constitution.''

Concluding that the ''same case or controversy'' language of Section 1367 was at least broader in scope than the transaction-or-occurrence test, the court held that the statute ''abolishes the conceptual framework underpinning the old compulsory-permissive counterclaim distinction.''

Rather than ''define the outer boundary of the phrase,'' the court reasoned that because the underlying litigation involved the ''fees the parties owe each other'' and the ''efforts by both parties to collect claimed fees,'' the counterclaim was sufficiently related because it ''was part of Verizon's effort to collect those fees when GNAPs attempted to avoid payment.''

Further, because the case had already taken up so much time, and the district court was already intimately familiar with the facts and the issues involved, it would have been impractical to send the case to state court, the court said.

Judges Michael Boudin and Jeffrey R. Howard joined the opinion.

How Much Overlap? Adam Steinman, a professor at the University of Cincinnati College of Law specializing in civil procedure and federal courts, told BNA in a May 6 email that the First Circuit's decision was ''a correct and straightforward application of 1367 to counterclaims.'' He added that ''the conventional wisdom is that the 'same case or controversy' standard is at least as broad as, if not broader than, the 'same transaction or occurrence' standard.''

Scott Dodson, William & Mary Law School, Williamsburg, Va., who also focuses on civil procedure and federal courts, said that the statutory language trumps the common law standard, ''So, the court is right to discard the old language in favor of the new.''

However, in a May 6 email to BNA, Dodson said it is still unclear ''whether there is any meaningful difference between the two.'' Courts have ruled both ways, he said. ''As a practical matter, though, even if there is a difference, the percentage of counterclaims that would meet one but not the other is going to be very small,'' he added.

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Steinman agreed, focusing on the inherent flexibility of both standards. ''[F]rankly, they're both vague enough that in close cases courts will have a fair amount of leeway under either test.''

Andrew Good and Philip Cormier, Good & Cormier, Boston, Joel Davidow, Kile Goekjian Reed & McManus, Washington, D.C., and Eric Osterberg, Fox Rothschild, Stamford, Conn., represented GNAPs. Scott H. Angstreich and Gegory G. Rapawy, Kellogg, Huber, Hansen, Todd, Evans & Figel, Washington, D.C., Robert L. Weigel and Jason W. Myatt, Gibson, Dunn & Crutcher, New York, Richard P. Owens, Verizon New England Inc., Boston, and Paul J. Larkin Jr., Verizon Communications Inc., Washington, D.C., represented Verizon. James C. Schroeder, Christian F. Binnig, Hans J. Germann, and Stephen Sanders, Mayer Brown, Chicago, represented amici curiae in support of Verizon AT&T ILEC Companies.

BY TOM P. TAYLOR

Full text at http://pub.bna.com/lw/091308.pdf.