DEFINING THE LIMITS OF SUPPLEMENTAL JURISDICTION UNDER 28 U.S.C. § 1367: A HEARTY WELCOME TO PERMISSIVE COUNTERCLAIMS

by
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In 1990, Congress passed 28 U.S.C. § 1367, which combined the judge-made doctrines of ancillary and pendent jurisdiction into a new category, "supplemental jurisdiction." Supplemental jurisdiction allows federal district courts with original jurisdiction to also have jurisdiction over all other claims that form part of the "same case or controversy under Article III of the United States Constitution." This Article analyzes supplemental jurisdiction over both permissive and compulsory counterclaims, before and after the codification of § 1367, by looking at the meaning of "same case or controversy." It then examines two Circuit Court opinions that have held permissive counterclaims may be subject to supplemental jurisdiction as part of the "same case or controversy" as the claim over which the court has original jurisdiction. The author concludes that recent opinions from the Second and Seventh Circuit Courts of Appeal have correctly recognized federal courts' ability to hear permissive counterclaims without independent jurisdiction.

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I. INTRODUCTION

In 1990, Congress added § 1367 to Title 28 of the United States Code,[1] which codified the judge-made doctrines of ancillary and pendent jurisdiction into a newly created category, "supplemental jurisdiction."[2] Under § 1367, in any civil action where the district courts have original jurisdiction, the courts can have supplemental jurisdiction "over all other claims that are so related to claims in the action within such original jurisdiction that they form part of the same case or controversy under Article III of the United States Constitution."[3]

Federal Rule of Civil Procedure 13(a) states the rule for compulsory counterclaims.[4] A defendant must plead any counterclaim that "arises out of the transaction or occurrence" that forms the basis of the plaintiff's claims.[5] Although the rule does not state the consequences of a defendant's failure to plead a compulsory counterclaim, courts have held that the failure to plead results in claim preclusion in a later lawsuit.[6] Courts have also held that if a claim satisfies the test for a compulsory counterclaim by "arising out of the same transaction or occurrence," then the claim naturally falls within the "same case or controversy" language of 28 U.S.C. § 1367(a).[7] Therefore, § 1367 provides a jurisdictional basis for compulsory counterclaims.[8]

Federal Rule of Civil Procedure 13(b) states the rule for permissive counterclaims.[9] Under the rule, "[a] pleading may state as a counterclaim any claim against an opposing party not arising out of the transaction or occurrence that is the subject matter of the opposing party's claim."[10] Before the existence of § 1367, many courts determined that because permissive counterclaims did

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[1] Judicial Improvements Act of 1990, Pub. L. No. 101-650, § 310(a), 104 Stat. 5089, 5113 (codified as amended at 28 U.S.C. § 1367 (2000)).

[2] 28 U.S.C. § 1367 (2000).

[3] 28 U.S.C. § 1367(a) ("Such supplemental jurisdiction shall include claims that involve the joinder or intervention of additional parties.").

[4] FED. R. CIV. P. 13(a).

[5] *Id.*

[6] Cleckner v. Republic Van & Storage Co., 556 F.2d 766, 769 n.3, 772 (5th Cir. 1977) (inferring a bar to a later claim under the alternative theories of *res judicata*, waiver, or equitable estoppel); *see also* Baker v. Gold Seal Liquors, Inc., 417 U.S. 467, 469 n.1 (1974); Pipeliners Local Union No. 798 v. Ellerd, 503 F.2d 1193, 1198 (10th Cir. 1974); Fagnan v. Great Cent. Ins. Co., 577 F.2d 418, 420 (7th Cir. 1978), *cert. denied*, 439 U.S. 1004 (1978). *But see* Bristol Farmers Mkt. & Auction Co. v. Arlen Realty & Dev. Corp., 589 F.2d 1214, 1220 (3d Cir. 1978) (holding that while a claim not raised may be barred from consideration in litigation it is not also barred in later arbitration proceedings).

[7] Saglioccolo v. Eagle Ins. Co., 112 F.3d 226, 233 (6th Cir. 1997) (holding that a claim which arose out of the same transaction or occurrence formed part of the same Article III case or controversy); *see also* Baer v. First Options of Chicago, Inc., 72 F.3d 1294, 1299 (7th Cir. 1995) (citing the Report of the Federal Courts Study Committee 47 (April 2, 1990) and finding that the statutory language proposed by the Committee would have allowed supplemental jurisdiction only for claims arising out of the same "transaction or occurrence"; noting the significance of the language of the statute as adopted that authorized supplemental jurisdiction as "coextensive with the 'case or controversy' requirement of Article III").

[8] *Saglioccolo*, 112 F.3d at 233; *Baer*, 72 F.3d at 1301.

[9] FED. R. CIV. P. 13(b).

[10] *Id.*

not "arise from the same transaction or occurrence," they required independent subject matter jurisdiction in order to be heard by the federal district court.[11] However, § 1367 explicitly extended the federal courts' authority to "all other claims" that are "so related . . . that they form part of the same case or controversy under Article III of the United States Constitution."[12] The statute expands supplemental jurisdiction to its constitutional limits. As a result, it is no longer clear that permissive counterclaims require independent jurisdiction. Even if the counterclaim does not "arise out of the same transaction or occurrence" as the opposing party's claim, it still may fall within the broader constitutional requirement of "same case or controversy."[13]

The Seventh Circuit, in *Channell v. Citicorp National Services, Inc.*,[14] and more recently the Second Circuit in *Jones v. Ford Motor Credit Co.*,[15] have addressed this issue, holding that permissive counterclaims may be subject to supplemental jurisdiction under § 1367.[16] This Article will examine these opinions by looking at the scope of § 1367, the purposes of supplemental jurisdiction, and the meaning of "same case or controversy" within the statute. The Article will specifically analyze supplemental jurisdiction over both permissive and compulsory counterclaims before and after the codification of § 1367 by looking at the meaning of "same transaction or occurrence." Finally, the Article will analyze the opinions in *Channell* and *Jones*, and will conclude that the courts correctly found that "same transaction or occurrence" is narrower than the constitutional limits of "case or controversy."

II. THE NEED FOR SUPPLEMENTAL JURISDICTION

The federal courts are courts of limited jurisdiction.[17] The federal courts only have subject matter jurisdiction over claims where there is both constitutional and congressional authority.[18] Situations frequently arise where

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[11] *But see* Ambromovage v. United Mine Workers, 726 F.2d 972, 990–91 (3d Cir. 1984).

[12] 28 U.S.C. § 1367(a) (2000).

[13] *See* Jones v. Ford Motor Credit Co., 358 F.3d 205, 212–13 (2d Cir. 2004); Channell v. Citicorp Nat'l Servs., Inc., 89 F.3d 379, 385–86 (7th Cir. 1996)*; see also* Thomas F. Green, Jr., *Federal Jurisdiction over Counterclaims*, 48 NW. U. L. REV. 271, 283 (1953).

[14] 89 F.3d at 385.

[15] 358 F.3d at 213.

[16] *Channell*, 89 F.3d at 385. The court in *Channell* relied on its decision in *Baer*, 72 F.3d at 1298–1301, where it held that "§ 1367 has extended the scope of supplemental jurisdiction, as the statute's language says, to the limits of Article III—which means that '[a] loose factual connection between the claims' can be enough, quoting from *Ammerman v. Sween*, 54 F.3d 423, 424 (7th Cir.1995)."

[17] *See* Aldinger v. Howard, 427 U.S. 1, 15 (1976) (noting the established principle that federal courts are courts of limited jurisdiction).

[18] Constitutional authority comes from U.S. CONST art. III, § 2, which enumerates categories over which there is federal judicial power. These categories are the outer limits of jurisdiction, and it is up to Congress to grant the federal courts specific subject matter jurisdiction. The most common statutes are 28 U.S.C. § 1331 (2000), which gives the court jurisdiction over cases involving federal questions, and 28 U.S.C. § 1332 (2000), which gives the court subject matter jurisdiction over cases involving diversity.

there is a claim that is related to the main claim, but over which there is no subject matter jurisdiction.[19] In order to enable the federal courts to hear those related claims, the courts created the doctrine of supplemental jurisdiction to allow litigants to resolve all aspects of a controversy in a single proceeding.[20]

Without supplemental jurisdiction, a plaintiff in federal court could not assert an additional related state law claim if that state law claim did not have an independent basis of subject matter jurisdiction. Similarly, a defendant would not be able to assert counterclaims or third party claims unless there was independent subject matter jurisdiction for those claims, even if those claims were related to the plaintiff's original claim. The court-created doctrine, and the subsequent codification of that doctrine, permits those claims to be heard. In addition, supplemental jurisdiction promotes fairness and judicial economy, and complements the liberal joinder rules of the Federal Rules of Civil Procedure.[21]

A. Supplemental Jurisdiction Under 28 U.S.C. § 1367

On December 1, 1990, Congress enacted the supplemental jurisdiction statute as part of the federal Judicial Improvements Act of 1990.[22] In so doing, Congress codified and changed the court-created doctrine. Supplemental jurisdiction under 28 U.S.C. § 1367 permits the federal courts to exercise subject matter jurisdiction over additional claims against existing parties, as well as claims against new parties to the action, where there is no original subject matter jurisdiction.[23] Subject to certain specific exceptions,[24] a district court hearing claims over which there is original jurisdiction shall have supplemental jurisdiction over all other claims that "form part of the same case or controversy under Article III of the United States Constitution" as the original claim.[25] In codifying the common law of supplemental jurisdiction, the

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[19] *See* Washington Int'l Ins. Co. v. Victoria Sales Corp., No. 87 Civ. 7110 (RJW), 1989 U.S. Dist. LEXIS 8306, at *10–11 (S.D.N.Y. July 19, 1989); Alumax Mill Prods., Inc. v. Cong. Fin. Corp., 912 F.2d 996, 1002–07 (8th Cir. 1990); Carey v. E.I. duPont de Nemours & Co., 209 F. Supp. 2d 641, 649 (M.D. La. 2002); Soranno v. N.Y. Life Ins. Co., No. 96 C 7882, 2000 U.S. Dist. LEXIS 7539, at *4–5 (N.D. Ill. May 31, 2000).

[20] *See* United Mine Workers v. Gibbs, 383 U.S. 715, 725 (1966). *See also infra* note 101.

[21] Denis F. McLaughlin, *The Federal Supplemental Jurisdiction Statute—A Constitutional And Statutory Analysis*, 24 ARIZ. ST. L.J. 849, 864 (1992).

[22] Pub. L. No. 101-650, § 310(a), 104 Stat. 5089, 5113 (codified as amended at 28 U.S.C. § 1367 (2000)); *see also* McLaughlin, *supra* note 21 (a comprehensive examination of the supplemental jurisdiction statute).

[23] 28 U.S.C. § 1367(a) (2000) codified the authority for the extension of jurisdiction that the Court believed was lacking in *Finley v. United States*, 490 U.S. 545, 556 (1989). It overrules *Finley* by expressly providing that supplemental jurisdiction will include pendent party claims.

[24] Supplemental jurisdiction is available except as restricted by § 1367(b) or § 1367(c), or as expressly negated by another federal statute. Section 1367(b) codified the holding in *Owen Equipment & Erection Co. v. Kroger*, 437 U.S. 365, 377 (1978), which prohibits courts from exercising jurisdiction over parties joined by the plaintiff when it would defeat diversity jurisdiction.

[25] 28 U.S.C. § 1367(a).

legislature did away with the doctrines of pendent party jurisdiction,[26] pendent claim jurisdiction,[27] and ancillary jurisdiction,[28] and created the term supplemental jurisdiction. In addition, § 1367 codified the Supreme Court's holding in *United Mine Workers v. Gibbs*,[29] by giving the federal court the discretion[30] to hear a state law claim if the state claim arises out of the same case or controversy [31] as a claim that has original subject matter jurisdiction.

B. The Meaning of "Same Case or Controversy" in § 1367(a)

Section 1367(a) provides that a district court hearing claims over which it has original jurisdiction shall have supplemental jurisdiction over all other claims that "form part of the same case or controversy under Article III of the United States Constitution"[32] as the original claim. The meaning of "same case or controversy" is somewhat unsettled. The text of the statute is unambiguous and extends jurisdiction to the limits of Article III.[33] The legislative history of the section demonstrates that Congress viewed the test enunciated by the Supreme Court in *United Mine Workers v. Gibbs*[34] as expressing those constitutional limits.[35] In *Gibbs*, the Court held that federal courts have jurisdiction over state law claims that "derive from a common nucleus of operative fact" such that "the relationship between . . . [the federal] claim and the state claim permits the conclusion that the entire action before the court

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[26] Pendent party jurisdiction allowed additional parties to enter the lawsuit where there was no independent subject matter jurisdiction. The United States Supreme Court essentially eliminated pendent party jurisdiction in *Finley*, 490 U.S. at 556, where the Court held that federal courts could not entertain claims over additional parties without an independent basis of subject matter jurisdiction over the claim.

[27] Pendent claim jurisdiction was generally limited to the ability of a plaintiff to bring a state law claim as "pendent" to a claim that arose under federal law, usually under federal question jurisdiction. Such claims were allowed even when there was no independent subject matter jurisdiction over the state claims if the state and federal claims "derive[d] from a common nucleus of operative fact." United Mine Workers v. Gibbs, 383 U.S. 715, 725 (1966).

[28] The doctrine of ancillary jurisdiction was usually used to support claims interposed by parties other than the plaintiff, and was usually used in diversity of citizenship suits, where there was no independent subject matter jurisdiction over those claims. *See* Owen Equip. & Erection Co., 437 U.S. at 377.

[29] 383 U.S. 715 (1966).

[30] 28 U.S.C. § 1367(c) (2000) codifies the discretionary step in *Gibbs*, 383 U.S. at 726. Courts may refuse to exercise supplemental jurisdiction on a case-by-case basis.

[31] 28 U.S.C. § 1367(a).

[32] *Id.*

[33] *Id.*

[34] 383 U.S. 715 (1966).

[35] *See* H.R. REP. NO. 101-734, at 29 n.15 (1990), *reprinted in* 1990 U.S.C.C.A.N. 6860, 6375 n.15 ("In so doing, [§ 1367] subsection (a) codifies the scope of supplemental jurisdiction first articulated by the Supreme Court in *United Mine Workers v. Gibbs*, 383 U.S. 715 (1966).").

comprises but one constitutional 'case.'"[36] The federal courts have consistently interpreted "case or controversy" by applying the *Gibbs* test.[37]

There have been commentators, however, who have suggested that the meaning of "case or controversy" may be broader than the *Gibbs* test.[38] These commentators urge that the constitutional test of a "case or controversy" under Article III does not require the factual connection between the underlying claim and the joined claim delineated in *Gibbs*.[39] Therefore, Congress could not, by creating § 1367(a), provide an independent limitation on supplemental jurisdiction.[40]

For a federal court to exercise supplemental jurisdiction under § 1367(a) the supplemental claim must fall within the same "case or controversy" as the main claim. But it remains unclear whether the *Gibbs* "common nucleus of operative facts" test provides the outer limits of an Article III "case or controversy" or whether the test is broader and does not require such a factual relationship. The issue involving supplemental jurisdiction over permissive counterclaims arises when the counterclaim arises from the same "case or controversy" as the underlying claim, but the relationship between the joined claim and the underlying claim does not rise to the level that would make the counterclaim compulsory. Even if the outer limits of "case or controversy" are

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[36] *Gibbs*, 383 U.S. at 725.

[37] *See* Carnegie-Mellon Univ. v. Cohill, 484 U.S. 343, 349 (1988); Republic of the Philippines v. Marcos, 862 F.2d 1355, 1359 (9th Cir. 1988); Arnold v. Kimberly Quality Care Nursing Serv., 762 F. Supp. 1182, 1186 (M.D. Pa. 1991); Am. Foresight of Philadelphia, Inc. v. Fine Arts Sterling Silver, Inc., 268 F. Supp. 656, 662 (E.D. Pa. 1967); Trs. of the Colo. Pipe Indus. Employee Benefit Funds v. Colo. Springs Plumbing & Heating Co., 388 F. Supp. 71, 74 (D. Colo. 1975).

[38] *See* William A. Fletcher, *"Common Nucleus of Operative Fact" and Defensive Set-Off: Beyond the* Gibbs *Test*, 74 IND. L.J. 171 (1998); Richard A. Matasar, *Rediscovering "One Constitutional Case": Procedural Rules and the Rejection of the* Gibbs *Test for Supplemental Jurisdiction*, 71 CAL. L. REV. 1401, 1463 (1983).

[39] Matasar, *supra* note 38 at 1463. "[S]everal courts, including the Supreme Court, have upheld supplemental jurisdiction in many ancillary jurisdiction cases that do not meet the *Gibbs* fact relationship requirements. . . . Their existence undermines the conclusion that *Gibbs* sets any constitutional limits on supplemental jurisdiction based upon fact relatedness of claims." After analyzing the role of supplemental jurisdiction in a diverse range of cases addressing issues such as property, receiverships, aggregation of claims to meet amount in controversy, and set-off defenses, Professor Matasar concludes that "[a] review of well-established supplemental jurisdiction cases reveals that the only constitutional limit to supplemental jurisdiction is the presence of a nonfederal claim in the same 'case' or 'controversy' as a federal claim, and that a 'case' or 'controversy' is measured by federal procedural rules." *Id.* at 1463–75, 1491; *see also* Fletcher, *supra* note 38, at 177 (Citing the myth of the factual relationship in the historical context, Professor Fletcher offers that "[i]t is quite clear that civil cases and controversies in the then-contemporary practice could involve adjudication of claims arising out of unrelated facts, both in English and American courts, as they did in entertaining unrelated counterclaims for defensive set-off beginning in the early 1700s.").

[40] Congress cannot give the federal courts broader subject matter jurisdiction than is allowed by the United States Constitution. It can only regulate subject matter jurisdiction. 13 CHARLES ALAN WRIGHT, ARTHUR R. MILLER & EDWARD H. COOPER, FEDERAL PRACTICE AND PROCEDURE § 3522 (2d ed. 1984); Bender v. Williamsport Area Sch. Dist., 475 U.S. 534, 541 (1986).

broader than the *Gibbs* test, the counterclaim may fall within the more narrow view.

III. SUPPLEMENTAL JURISDICTION OVER COUNTERCLAIMS

Among other things, the Federal Rules of Civil Procedure provide procedural authorization for the joinder of claims[41] and parties[42] in federal court. This is different from jurisdictional authorization—Federal Rule of Civil Procedure 82 specifically states that "[t]hese rules shall not be construed to extend . . . the jurisdiction of the United States district courts."[43] Therefore, for a federal court to hear a joined claim, there must be a procedural rule that allows the joinder, as well as a jurisdictional basis through independent jurisdiction or through supplemental jurisdiction.

A. The Difference Between Compulsory and Permissive Counterclaims

Federal Rule of Civil Procedure 13(a) is the compulsory counterclaim rule. It requires a defendant to plead any counterclaim that "arises out of the transaction or occurrence" that forms the basis of the plaintiff's claim.[44] A party who fails to plead a compulsory counterclaim cannot raise that claim in a subsequent action.[45] If the counterclaim does not arise out of the same "transaction or occurrence" then it is a permissive counterclaim and is governed by Federal Rule of Civil Procedure 13(b).[46] The failure to plead a permissive counterclaim will not bar the defendant from asserting it in a later action. Whether a counterclaim is compulsory or permissive, therefore, depends on interpretation of the phrase "same transaction or occurrence."

The courts have not specifically defined this phrase, but have instead created tests to determine if a counterclaim is compulsory or permissive.[47] In the most common test, courts have held that the requirement of "same transaction or occurrence" is met when there is a "logical relationship" between

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[41] FED. R. CIV. P. 18.

[42] FED. R. CIV. P. 19.

[43] FED. R. CIV. P. 82.

[44] FED. R. CIV. P. 13(a).

[45] The rule itself does not explain the consequences of failure to plead a compulsory counterclaim. The courts have generally held that the failure to plead results in a bar under the doctrine of res judicata. 6 CHARLES ALAN WRIGHT, ARTHUR R. MILLER & MARY KAY KANE, FEDERAL PRACTICE AND PROCEDURE § 1417 (2d ed. 1990).

[46] FED. R. CIV. P. 13(b).

[47] *See, e.g.*, Adamson v. Dataco Derex, Inc., 178 F.R.D. 562, 564 (D. Kan. 1998) (holding that "a counterclaim is compulsory if: (1) the issues of fact and law raised by the claim and counterclaim are largely the same; (2) res judicata would bar a subsequent suit on defendant's claim absent the compulsory counterclaim rule; (3) substantially the same evidence supports or refutes plaintiff's claims as well as defendant's counterclaim; and (4) there is a logical relation between the claim and the counterclaim."); *see also* Fox v. Maulding, 112 F.3d 453, 457 (10th Cir. 1997); Pipeliners Local Union No. 798 v. Ellerd, 503 F.2d 1193, 1198 (10th Cir. 1974).

the counterclaim and the main claim.[48] In applying this test, courts look to see if the essential facts of the claims are so related that "considerations of judicial economy and fairness dictate that all the issues be resolved in one lawsuit."[49]

Some courts have held that the test is whether the issues of fact and law on the counterclaim are the same.[50] This test has been criticized as unworkable, because it is impossible to know what the issues will be until after the plaintiff has replied to the counterclaim.[51] A third test in distinguishing a permissive counterclaim from a compulsory counterclaim is whether the counterclaim would be barred by res judicata if there were no compulsory counterclaim rule.[52] Absent a compulsory counterclaim rule, however, a pleader is never barred from suing independently on a claim that he refrained from pleading in a prior action.[53] A fourth test suggested by some courts is whether the same evidence will support both the original claim and the counterclaim.[54] Although it is easy to see why a counterclaim would be compulsory if the same evidence supports it and the original claim, it is not as easy to see why a counterclaim would not be compulsory when it arises from the same facts even if the evidence supporting it is different.[55]

A permissive counterclaim, therefore, is a counterclaim that does not satisfy the compulsory counterclaim tests enunciated by the courts. Such is the case when the essential facts for proving the counterclaim and the underlying claim are not so closely related that resolving the issues in one lawsuit is integral to judicial economy.[56] The relationship between the main claim and the

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[48] The phrase "logical relationship," in the context of counterclaims, was first used by the Supreme Court in *Moore v. N. Y. Cotton Exchange.*, 270 U.S. 593, 610 (1926). In *Moore*, the Court was dealing with former Equity Rule 30, the predecessor to Federal Rule of Civil Procedure 13(a). The Court stated that when a counterclaim arises out of a transaction which is the subject matter of the suit, "'[t]ransaction' is a word of flexible meaning. It may comprehend a series of many occurrences, depending not so much upon the immediateness of their connection as upon their logical relationship." *Id.*; *see also* United States v. Aquavella, 615 F.2d 12, 22 (2d Cir. 1979); Xerox Corp. v. SCM Corp., 576 F.2d 1057, 1059 (3d Cir. 1978); Valencia v. Anderson Bros. Ford, 617 F.2d 1278, 1291 (7th Cir. 1980), *rev'd on other grounds*, 452 U.S. 205 (1981).

[49] Critical-Vac Filtration Corp. v. Minuteman Int'l, Inc., 233 F.3d 697, 699 (2d Cir. 2000).

[50] Nachtman v. Crucible Steel Co. of Am., 165 F.2d 997, 999 (3d Cir. 1948).

[51] CHARLES ALAN WRIGHT & MARY KAY KANE, LAW OF FEDERAL COURTS 568 (6th ed. 2002).

[52] Big Cola Corp. v. World Bottling Co., 134 F.2d 718, 723 (6th Cir. 1943).

[53] Painter v. Harvey, 673 F. Supp. 777, 781 (W.D. Va. 1987); RESTATEMENT (SECOND) OF JUDGMENTS § 22 cmt. a (1982).

[54] Non-Ferrous Metals Inc. v. Saramar Aluminum Co., 25 F.R.D. 102, 105 (N.D. Ohio 1960).

[55] For example, in a suit to void an insurance policy for fraud with a counterclaim for the amount of the loss, the evidence of the fraud will be different from the evidence of the loss and the amount, yet there should only be one suit to settle this controversy between the parties.

[56] *See, e.g.*, Whigham v. Beneficial Fin. Co. of Fayetteville, 599 F.2d 1322, 1323 (4th Cir. 1979) (looking at the differences between permissive and compulsory counterclaims).

joined claim is not "logical" or is not supported by the same evidence.[57] Yet, a permissive counterclaim may still have facts in common with the main claim.[58]

B. Supplemental Jurisdiction over Counterclaims Before 28 U.S.C. § 1367

Prior to the codification of 28 U.S.C. § 1367, permissive counterclaims clearly needed independent subject matter jurisdiction, while compulsory counterclaims did not. In *Moore v. New York Cotton Exchange*,[59] the Supreme Court held that a compulsory counterclaim that arose out of the transaction or occurrence that was the subject matter of the opposing claim could be heard by the federal court even if it did not have independent subject matter jurisdiction. This continued to be the law throughout the development of the court-created doctrine of supplemental jurisdiction.[60] A counterclaim that arises out of the same transaction or occurrence as the main claim, and is therefore compulsory,[61] also falls within the "common nucleus of operative facts" test enunciated in *Gibbs.*

A permissive counterclaim, however, required independent jurisdiction. The origin of this doctrine is in *Marconi Wireless Telegraph Co. of America v. National Electric Signaling Co.*,[62] which involved Equity Rule 30, the predecessor to Federal Rule of Civil Procedure 13(a) and 13(b).[63] In *Marconi*, the Court stated in dictum that independent jurisdiction was necessary for permissive counterclaims.[64]

Most of the early cases coming out of the federal courts observed that "it seems to be accepted that a permissive counterclaim . . . is not ancillary and

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[57] *See generally* 3 JAMES WM. MOORE ET AL., MOORE'S FEDERAL PRACTICE §§ 13.01–13.33 (3d ed. 2004); 6 CHARLES ALAN WRIGHT, ARTHUR R. MILLER & MARY KAY KANE, FEDERAL PRACTICE AND PROCEDURE §§ 1401–1430 (2d ed. 1990); John E. Kennedy, *Counterclaims Under Federal Rule 13*, 11 HOUS. L. REV. 255 (1973); Charles Alan Wright, *Estoppel by Rule: The Compulsory Counterclaim Under Modern Pleading*, 38 MINN. L. REV. 423 (1954).

[58] *See* Michael D. Conway, Comment, *Narrowing the Scope of Rule 13(a)*, 60 U. CHI. L. REV. 141, 152 (1993); Plant v. Blazer Fin. Servs., Inc., 598 F.2d 1357, 1360 (5th Cir. 1979) (discussing a split among the courts about whether the relationship between a truth-in-lending claim and a debt counterclaim pose different issues of law and fact).

[59] 270 U.S. 593, 609 (1926).

[60] United States v. Eastport S.S. Corp., 255 F.2d 795, 805 (2d Cir. 1958); Chemetron Corp. v. Cervantes, 92 F.R.D. 26, 29 (D.P.R. 1981); Hosp. Bldg. Co. v. Trs. of Rex Hosp., 86 F.R.D. 694, 695 (E.D.N.C. 1980).

[61] *Eastport S.S. Corp.*, 255 F.2d at 804 ("A counterclaim is compulsory under Rule 17(a) of the Court of Claims only if 'it arises out of the transaction or occurrence that is the subject matter of the petition.'").

[62] 206 F. 295 (E.D.N.Y. 1913) (involving former Equity Rule 30, the predecessor to Federal Rule of Civil Procedure 13(a) and 13(b)); *see also* Green, *supra* note 13, at 283.

[63] The second paragraph of Equity Rule 30 had two parts, one dealing with what we would now call compulsory counterclaims, which "aris[e] out of the transaction which is the subject matter of the suit," and one dealing with what we would now call permissive counterclaims, which "might be the subject of an independent suit in equity." *Marconi Wireless Tel. Co.*, 206 F. at 297.

[64] 206 F. at 299–301. For a discussion on *Marconi* and how later courts just adopted this dictum, see Green, *supra* note 13, at 283.

requires independent grounds of jurisdiction."[65] In 1974, the Supreme Court stated that "if a counterclaim is compulsory, the federal court will have ancillary jurisdiction over it even though ordinarily it would be a matter for state court."[66] Other courts have inferred from this statement that if a counterclaim is permissive, ancillary jurisdiction is not available.[67] Although commentators challenged the independent jurisdiction requirement,[68] it remained the law for permissive counterclaims.[69] In 1990, however, the court-created doctrine was displaced by 28 U.S.C. § 1367, and a new interpretation of supplemental jurisdiction over permissive counterclaims was born.

IV. THE CIRCUIT COURTS SPEAK: *CHANNELL v. CITICORP NATIONAL SERVICES, INC.* AND *JONES v. FORD MOTOR CREDIT CO.*

In 1996, the Seventh Circuit decided *Channell v. Citicorp National Services, Inc*.[70] In *Channell*, the plaintiffs were a certified class comprised of persons whose automobile leases had been assigned and terminated by the defendant. There was also a sub-class of lessees where the terminations were involuntary.[71] The plaintiffs brought an action in district court against the defendant for violating the Consumer Leasing Act by charging a substantial early termination charge.[72] The defendant counterclaimed, seeking a judgment for the contractual termination payments.[73] The district court determined that this was a permissive counterclaim,[74] and because there was no independent

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[65] Lesnik v. Pub. Indus. Corp., 144 F.2d 968, 976 n.10 (2d Cir. 1944); *see also* Princess Fair Blouse, Inc. v. Viking Sprinkler Co., 186 F. Supp. 1, 4 (M.D.N.C. 1960); McKnight v. Halliburton Oil Well Cementing Co., 20 F.R.D. 563, 564 (N.D.W. Va. 1957); Tel. Delivery Serv. v. Florists Tel. Serv., 12 F.R.D. 342, 343 (S.D.N.Y. 1952).

[66] Baker v. Gold Seal Liquors, Inc., 417 U.S. 467, 469 n.1 (1974).

[67] Maddox v. Ky. Fin. Co., 736 F.2d 380, 382 (6th Cir. 1984); *see also* Hartford Accident & Indem. Co. v. Sullivan, 846 F.2d 377, 381 (7th Cir. 1988).

[68] *See* Green, *supra* note 13, at 283 (arguing that the doctrine emerged from dicta and did not make sense in terms of saving court time); *see also* United States v. Heyward-Robinson Co., 430 F.2d 1077, 1088 (2d Cir. 1970) (Friendly, J., concurring) (rejecting the independent jurisdiction doctrine, being persuaded by Professor Green's article, and noting that the doctrine does not serve judicial efficiency).

[69] *But see* Ambromovage v. United Mine Workers, 726 F.2d 972, 990 (3d Cir. 1984) (rejecting the view that independent jurisdiction is required for all permissive counterclaims, and instead finding that "the determination that a counterclaim is permissive within the meaning of Rule 13 is not dispositive of the constitutional question whether there is federal jurisdiction over that counterclaim").

[70] 89 F.3d 379 (7th Cir. 1996).

[71] *Id.* at 381.

[72] *Id.*

[73] *Id.* at 384.

[74] *Id.* at 384–85 (basing its finding that the counterclaim was permissive on *Valencia v. Anderson Bros. Ford*, 617 F.2d 1278 (7th Cir. 1980), *rev'd on other grounds*, 452 U.S. 205 (1981), which held that an attempt to collect the balance of a consumer loan is a permissive counterclaim).

subject matter jurisdiction over the permissive counterclaim,[75] the court dismissed the counterclaim.[76]

The Seventh Circuit vacated the judgment dismissing the counterclaim, holding that the codification of § 1367 requires courts to use the language of the statute to define the extent of their powers.[77] The court found that § 1367 extends the scope of supplemental jurisdiction to the limits of Article III, which means that a "loose factual connection between the claims can be enough."[78]

The court opined that the distinction between compulsory and permissive counterclaims served an important function when every assertion of ancillary jurisdiction was of doubtful propriety because the parties were afraid not to assert a counterclaim and risk its forfeiture.[79] In applying § 1367(a), the court found that the facts of the counterclaim were closely related enough to bring it within the outer limits of "same case or controversy."[80] Therefore, the court found that the permissive counterclaim fell within the reach of supplemental jurisdiction. The court noted that § 1367(c) allows the courts to decline to exercise supplemental jurisdiction under certain circumstances.[81] Because the application of those factors involves the discretion of the district court, the court ultimately remanded the case.[82]

In *Jones v. Ford Motor Credit Co.*,[83] plaintiffs, both individually and as a class, brought an action against the defendant for racial discrimination under the Equal Credit Opportunity Act (ECOA).[84] The defendant counterclaimed for the amount of the plaintiffs' unpaid car loans.[85] The plaintiffs moved to dismiss the counterclaim, and the district court granted the motion on the ground that the counterclaims were permissive, and as state law claims, had no independent subject matter jurisdiction.[86]

The Second Circuit agreed with the district court that the counterclaims were permissive, finding that "[t]he essential facts for proving the counterclaims and the ECOA claim are not so closely related that resolving

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[75] *Channell*, 89 F.3d at 384 (finding that there was no independent subject matter jurisdiction over the permissive counterclaim because some of the plaintiff class members were not of diverse citizenship from the defendant, and therefore the complete diversity rules were not satisfied).

[76] *Id.* at 385.

[77] *Id.*

[78] *Id.* (citing Baer v. First Options of Chicago, Inc., 72 F.3d 1294, 1298–1301 (7th Cir. 1995)) (internal quotations omitted).

[79] *Id.*

[80] *Id.* at 386.

[81] *Id.*

[82] *Id.* at 387.

[83] 358 F.3d 205 (2d Cir. 2004).

[84] *Id.* at 207.

[85] *Id.*

[86] *Id.* at 208. The district court did express some uncertainty as to whether permissive counterclaims still required independent subject matter jurisdiction under § 1367(a). The court ruled that if there were supplemental jurisdiction, the court would still dismiss the counterclaims under the discretionary elements available in § 1367(c).

both sets of issues in one lawsuit would yield judicial efficiency."[87] Agreeing with the rationale of the Seventh Circuit, the Second Circuit held that "[a]fter section 1367, it is no longer sufficient for courts to assert, without any reason other than dicta or even holdings from the era of judge-created ancillary jurisdiction, that permissive counterclaims require independent [subject matter] jurisdiction."[88] The court found that the facts surrounding the defendant's counterclaims and the main ECOA claim had enough of a loose factual connection to satisfy the "same case or controversy" requirement of Article III, and therefore § 1367, even if the relationship was not enough to make the counterclaim compulsory.[89] That loose factual connection was that both the ECOA claim and the debt collection claims arose from the plaintiffs' decisions to purchase the defendant's cars.[90] After holding that the permissive counterclaim was subject to supplemental jurisdiction under § 1367(a), the court then remanded the case to the district court so that it could consider the discretionary factors in § 1367(c).

V. 28 U.S.C. § 1367 ALLOWS SUPPLEMENTAL JURISDICTION OVER PERMISSIVE COUNTERCLAIMS

The circuit courts are correct in their conclusions that permissive counterclaims can be subject to supplemental jurisdiction under 28 U.S.C. § 1367. When Congress codified pendent claim, pendent party, and ancillary jurisdiction, the resulting statute displaced the existing case law.[91] The new statute extended supplemental jurisdiction to the constitutional limitation of "case or controversy" under Article III.[92] Therefore, the line of decisions holding that a permissive counterclaim requires independent jurisdictional grounds is no longer good law.

In creating § 1367(a), Congress gave district courts supplemental jurisdiction over all claims that are so related to the original jurisdiction claims that they form part of the same case or controversy within Article III. Congress neither defined the constitutional limit of Article III[93] nor provided a definition of the relationship that is needed between the original claim and the supplemental claim for jurisdiction to attach. The Federal Courts Study Committee[94] proposed that Congress adopt a "same transaction or occurrence"

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[87] *Id.* at 210.

[88] *Id.* at 212–13.

[89] *Id.* at 213–14.

[90] *Id.* at 214.

[91] *See infra* Part II.A.

[92] 28 U.S.C. § 1367(a) (2000).

[93] It is the function of the Supreme Court, and not Congress, to define the limits of Article III power. *See* Marbury v. Madison, 5 U.S. (1 Cranch) 137, 173–75 (1803).

[94] Congress created this Committee in 1988 to conduct a comprehensive study of the federal judicial system. The Committee was directed to examine problems and issues currently facing the courts of the United States and develop a long-range plan for the future of the federal judiciary. Judicial Improvement and Access to Justice Act, Pub. L. No. 100-702, § 102(b)(1), (2), 102 Stat. 4626, 4644 (codified as amended at 28 U.S.C. § 331 (2000)).

test to define that relationship,[95] but Congress did not. Instead, a plain reading of the statute extends supplemental jurisdiction to the full constitutional limit of Article III.[96]

The legislative history of the statute does state, however, that § 1367(a) codifies the "scope of supplemental jurisdiction first articulated by the Supreme Court in *United Mine Workers v. Gibbs*."[97] In *Gibbs*, the Court found that for supplemental jurisdiction to attach, "the state and federal claims must derive from a common nucleus of operative fact."[98] As a result, many courts and commentators have determined that this test is the constitutional limit of supplemental jurisdiction.[99] Others have argued, however, that the constitutional limit is even broader, and that a single case or controversy consists of all claims that bear a loose factual relationship to the claim on which there is original subject matter jurisdiction.[100] Either way, it is clear that there is no need for an identical factual relationship between the two claims in order for the courts to have the power to entertain supplemental jurisdiction.[101]

The Federal Rules of Civil Procedure do not explain the rationale for the difference between permissive and compulsory counterclaims. The word "shall" in Rule 13(a) was used to indicate that a failure to plead the counterclaim would result in its loss in a later lawsuit.[102] Therefore, if the defendant's counterclaim arises out of the same transaction or occurrence, it must be pleaded as long as it is within the jurisdiction of the court. Federal Rule of Civil Procedure 13(a) provides the procedure, but it does not address the courts' jurisdictional power to hear the claim.[103] The purpose of distinguishing between permissive and compulsory counterclaims is to make

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The Committee recommended over 100 changes to the federal courts, including the recommendation that Congress formally authorize supplemental jurisdiction.

[95] FED. COURTS STUDY COMM., REPORT OF THE FEDERAL COURTS STUDY COMMITTEE 47 (April 2, 1990).

[96] *See* Conn. Nat'l Bank v. Germain, 503 U.S. 249, 253–54 (1992) (plain meaning of the statute has priority in interpreting the statutory language).

[97] H.R. REP. NO. 101-734, at 29 (1990), *reprinted in* 1990 U.S.C.C.A.N. 6860, 6875.

[98] United Mine Workers v. Gibbs, 383 U.S. 715, 725 (1966).

[99] Mendoza v. Zirkle Fruit Co., 301 F.3d 1163, 1174 (9th Cir. 2002); CFSC Consortium, LLC v. Ferreras-Goitia, 198 F. Supp. 2d 116, 124 (D.P.R. 2002); *see also* Carnegie-Mellon Univ. v. Cohill, 484 U.S. 343, 349 (1988); Deena Godshall Roth, Note, Finley v. United States*: Is Pendent Party Jurisdiction Still A Valid Doctrine?* 39 AM. U. L. REV. 811, 818 (1990).

[100] Fletcher, *supra* note 38, at 171 (citing the example of an unrelated defensive set-off claim and arguing "that the constitutional test for supplemental jurisdiction is broader than the 'common nucleus of operative fact' test of *United Mine Workers v. Gibbs*").

[101] *See* Moore v. N.Y. Cotton Exch., 270 U.S. 593, 610 (1926) (finding that it does not matter that the facts supporting the supplemental and original claims are not identical because "[t]o hold otherwise would be to rob this branch of the rule of all serviceable meaning, since the facts relied upon by the plaintiff rarely, if ever, are, in all particulars, the same as those constituting the defendant's counterclaim"); *see also Gibbs*, 383 U.S. at 724–25 (requiring that supplemental and original jurisdiction "be little more than the equivalent of different epithets to characterize the same group of circumstances" is "unnecessarily grudging") (internal quotations omitted).

[102] FED. R. CIV. P. 13, Notes of Advisory Committee on Rules—1937.

[103] Green, *supra* note 13, at 286.

sure that compulsory counterclaims are pleaded, not to deal with jurisdiction.[104] There is no basis to conclude that the test that differentiates a compulsory counterclaim from a permissive counterclaim is the same test that differentiates jurisdiction from lack of jurisdiction. Rather, Congress specifically chose not to use the same "transaction or occurrence" language of Federal Rule of Civil Procedure 13(a) in defining the limits of § 1367(a).[105]

Under the rules of statutory interpretation, a court may not engage in a wholly creative process when it interprets a statute. Rather, it must determine and give effect to the intent of the legislature by examining the statutory language, the purpose of the legislation, and the legislative history.[106] Under the plain meaning rule of statutory interpretation,[107] the language in § 1367 specifically states "same case or controversy." This language must be interpreted the same way it is interpreted in Article III of the United States Constitution. There is nothing in the legislative history or in the Federal Rules of Civil Procedure that would lead to the conclusion that the language excludes permissive counterclaims. Therefore, statutory construction supports the courts' decisions in *Channell v. Citicorp National Services, Inc.*[108] and *Jones v. Ford Motor Credit Co.*[109]

The purpose of supplemental jurisdiction is to ensure judicial economy, convenience, and fairness to litigants.[110] It avoids piecemeal litigation and the unnecessary litigation of federal questions in federal courts while duplicative litigation occurs in state courts as a result of plaintiffs having to split their actions. It also promotes the protective purposes of federal jurisdiction by giving the plaintiff unimpeded access to the federal courts.[111] Additionally, it permits the federal courts to give full relief by hearing claims that might be lost if forced into a different forum.[112] Allowing permissive counterclaims, which by definition are not part of the same transaction or occurrence as the main claim, to fall within the "case or controversy" limit of § 1367(a) fosters those purposes. Supplemental jurisdiction is also consistent with the underlying philosophy of the Federal Rules of Civil Procedure to "entertain[] the broadest

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[104] FED. R. CIV. P. 82.

[105] H.R. REP. NO. 101-734, at 27–28 (1990), *reprinted in* 1990 U.S.C.C.A.N. 6860, 6873–74.

[106] Hon. Judith S. Kaye, *Things Judges Do: State Statutory Interpretation*, 13 TOURO L. REV. 595, 605–07 (1997); Jackson Transit Auth. v. Local Div. 1285, Amalgamated Transit Union, 457 U.S. 15, 22–24 (1982); Mohasco Corp. v. Silver, 447 U.S. 807, 815 (1980).

[107] *See* Conn. Nat'l Bank v. Germain, 503 U.S. 249, 253–54 (1992) (plain meaning of the statute has priority in interpreting the statutory language).

[108] 89 F.3d 379 (7th Cir. 1996).

[109] 358 F.3d 205 (2d Cir. 2004).

[110] United Mine Workers v. Gibbs, 383 U.S. 715, 726 (1966) ("Its justification lies in considerations of judicial economy, convenience and fairness to litigants."); *see also* Wright v. Associated Ins. Cos., 29 F.3d 1244, 1252 (7th Cir. 1994) (stating general rule is to relinquish pendent claims to state courts unless, in an exercise of discretion, the court determines that the balance of judicial economy, convenience, fairness, and comity justify retention).

[111] *See* Matasar, *supra* note 38, at 1404–07 n.6.

[112] *See* Note, *A Closer Look at Pendent and Ancillary Jurisdiction: Toward a Theory of Incidental Jurisdiction*, 95 HARV. L. REV. 1935, 1945 (1982).

possible scope of action consistent with fairness to the parties."[113] Finally, it represents the concept of federal judicial power enunciated by the United States Supreme Court in *Osborn v. Bank of the United States*[114] that a federal court must be empowered to decide all aspects of an entire controversy if it is to function effectively.[115]

Finally, allowing permissive counterclaims to fall within § 1367(a) is further supported by § 1367(c). Section 1367(c) sets out four grounds under which the district court may decline to exercise supplemental jurisdiction even if the claim falls within § 1367(a).[116] In exercising its discretion, the district court must undertake a case specific analysis.[117] As both the Second[118] and Seventh[119] Circuits have recognized, even if a permissive counterclaim is subject to supplemental jurisdiction, the court still has the discretionary power to decline to exercise jurisdiction under § 1367(c). Therefore, if the court determines that the lawsuit has become unwieldy, or that there are considerations of federalism or efficiency that warrant dismissal, it can decide to decline supplemental jurisdiction over the permissive counterclaim.[120]

Thus, permissive counterclaims may fall within the broad constitutional authority of "case or controversy" under Article III under the canons of statutory interpretation and under the policies underlying supplemental jurisdiction. They fall within that authority whether the courts apply the *Gibbs* "common nucleus of operative fact" test or read "case or controversy" more broadly. After determining that permissive counterclaims fall within § 1367(a), the district courts then have statutory discretion to either dismiss or hear the counterclaim under § 1367(c). This approach makes much more sense than imposing constitutional restrictions on permissive counterclaims without any precedent or authority.

VI. CONCLUSION

Even before the creation of the Federal Rules of Civil Procedure, the federal courts have always required independent subject matter jurisdiction for permissive counterclaims before those counterclaims could be heard.[121] Unlike

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[113] *Gibbs*, 383 U.S. at 724.

[114] 22 U.S. (9 Wheat.) 738 (1824).

[115] McLaughlin, *supra* note 21, at 911.

[116] The section states that the district court may decline to exercise supplemental jurisdiction over a claim under subsection (a) if the claim raises a novel or complex area of state law, the claim substantially predominates over the claim over which the district court has original jurisdiction, the district court has dismissed all claims over which it has original jurisdiction, or there are other compelling reasons for declining jurisdiction. 28 U.S.C. § 1367(c) (2000). For an in-depth discussion of this section, see M. Ashley Harder, *Making a Federal Case Out of It: Supplemental Jurisdiction Under 28 U.S.C. § 1367*, 22 U. BALT. L. REV. 67, 103–10 (1992).

[117] Carnegie-Mellon Univ. v. Cohill, 484 U.S. 343, 350 n.7 (1988).

[118] Jones v. Ford Motor Credit Co., 358 F.3d 205, 214 (2d Cir. 2004).

[119] Channell v. Citicorp Nat'l Servs., Inc., 89 F.3d 379, 386–87 (7th Cir. 1996).

[120] Harder, *supra* note 116, at 103–10.

[121] *See* Fletcher, *supra* note 38, at 172–73.

compulsory counterclaims, permissive counterclaims did not arise out of the same "transaction or occurrence" as the main claim.[122] The courts concluded that, by definition, permissive counterclaims did not fall within the "common nucleus of operative fact" relationship required for supplemental jurisdiction to attach.

In 1990, Congress enacted 28 U.S.C. § 1367, displacing years of court created doctrine in the area of supplemental jurisdiction.[123] In the last several years, two circuit courts have examined the issue of whether, under the new statute, supplemental jurisdiction may be extended to permissive counterclaims. These two courts, in *Jones v. Ford Motor Credit Co.*[124] and *Channell v. Citicorp National Services, Inc.*,[125] correctly held that § 1367(a) allows supplemental jurisdiction to attach to permissive counterclaims.

This reading of 28 U.S.C. § 1367 is correct. Under the rules of statutory interpretation, "case or controversy" in § 1367 includes the full reach of Article III of the United States Constitution.[126] Therefore, if a counterclaim is permissive—in that it does not fall within the same transaction or occurrence as the underlying claim, but it still has a loose factual relationship to the underlying claim—it can be subject to supplemental jurisdiction. In addition, allowing supplemental jurisdiction to attach to permissive counterclaims fosters the purposes of judicial economy and fairness to litigants.[127] It cuts down on litigation by allowing all claims that are loosely factually related to be heard in one lawsuit.[128] Finally, the federal courts retain the discretionary power to not hear the permissive counterclaim under § 1367(c) if the courts determine that it would be too confusing.[129]

Supplemental jurisdiction is a complex area of the law, and § 1367 has been criticized as being "poorly drafted, creating ambiguity for cases that formerly were clear and creating numerous problems in others."[130] In the area of supplemental jurisdiction and permissive counterclaims, however, the codification has simplified years of confusing and inaccurate judge-made law. By not requiring permissive counterclaims to have independent subject matter jurisdiction, Congress is continuing the progress of streamlining the litigation process embraced by the Federal Rules of Civil Procedure.

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[122] FED. R. CIV. P. 13(b).

[123] *See supra* Part II.A.

[124] 358 F.3d 205, 213–14 (2d Cir. 2004).

[125] 89 F.3d 379, 385 (7th Cir. 1996).

[126] Jones v. Ford Motor Credit Co., 358 F.3d 205, 212 (2d Cir. 2004).

[127] *See* Ambromovage v. United Mine Workers, 726 F.2d 972, 991 (3d Cir. 1984) (stating that exercising jurisdiction over permissive counterclaims should occur when it would improve the judicial economy, be fair to the parties, and further the interests of federalism).

[128] *See Jones*, 358 F.3d at 210–11.

[129] 28 U.S.C. § 1367(c).

[130] Thomas C. Arthur & Richard D. Freer, *Grasping at Burnt Straws: The Disaster of the Supplemental Jurisdiction Statute*, 40 EMORY L.J. 963, 964 (1991).