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3rd Circuit Case Illustrates Certification Procedure's Efficiency

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Special to the Legal

Recently, the 3rd U.S. Circuit Court of Appeals invoked the little used procedure of "certification" of questions to the state Supreme Court to clarify an important issue of state law. The use of the certification procedure had the dual effect of providing the court and parties to the action an efficient method for resolution of pivotal and undecided state law issues while simultaneously reminding practitioners of the procedure's practical utility in litigation.

The story begins in 2008, when the 3rd Circuit reviewed a district court order granting summary judgment to PricewaterhouseCoopers (PwC) in a case alleging accounting malpractice. The district court ruling rested on an underdeveloped area of state law. Recognizing the uncertain state of Pennsylvania law on this issue, and likely considering the importance of clarifying the liability of auditors in a commercial world beset with financial fraud, the 3rd Circuit petitioned the Pennsylvania Supreme Court to certify questions of state law relating to the appeal. After accepting the certification, the Supreme Court of Pennsylvania issued what amounts to an advisory opinion to the 3rd Circuit. In May 2010, the 3rd Circuit, acting upon that opinion, issued its own and reversed the district court's grant of summary judgment.

The 3rd Circuit's decision in *Official Committee of Unsecured Creditors of Allegheny Health, Education and Research Foundation v. PricewaterhouseCoopers* closes the certification loop in the long-running bankruptcy appeal, which made



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its debut before the 3rd Circuit nearly two years ago. The case against PwC, asserted under Pennsylvania law, was premised on PwC's alleged malpractice and cooperation with officers of the debtor, Allegheny Health, Education and Research Foundation, to misstate AHERF's finances in the years leading up to its bankruptcy.

In July 2008, Judge Thomas Ambro, writing on behalf of a panel that included Judge Kent Jordan and then-chief judge of the Federal Circuit, Paul Michel, concluded that the appeal raised "important and unresolved questions" with regard to the Pennsylvania common law defenses of *in pari delicto* and imputation. Specifically, the case raised the question of whether a third party, PwC, that allegedly colludes with or assists the agents of a principal may impute the fraud of those agents to the principal and then invoke the doctrine of *in pari delicto* as a shield against liability. The importance of that question, and the ambiguity in Pennsylvania law governing

its answer, led the circuit court to invoke the rarely used certification procedure.

In *Erie Railroad Co. v. Tompkins*, the U.S. Supreme Court in 1938 required federal courts to apply state substantive law in diversity jurisdiction cases. Since then, lawyers practicing in federal court, and the courts themselves, have had to cope with uncertainty where reference to state substantive law yields indeterminate or nonexistent results. As a general rule, the absence of state authority does not relieve a federal court from determining how a state's highest court would likely decide a given issue were it squarely presented to that court. Where the federal court is unable to predict with confidence the nature of the state court's ruling, it may be appropriate for the court to seek guidance from the state's highest court through the certification procedure.

Although familiar in the context of seeking review from the U.S. Supreme Court, the certification procedure for seeking discretionary review from a state's highest court is more obscure. Both the federal courts and nearly all of the state supreme courts have little used, but complementary, procedures that allow for the federal court to certify questions of law to the state Supreme Court. In Pennsylvania, the rules for certification are set forth in Section 10 of the Supreme Court of Pennsylvania Internal Operating Procedures. While some states permit petitions for certifications from any federal court, Pennsylvania limits certification petitions to requests from the U.S. Supreme Court or the U.S. Courts of Appeal. The range of issues on which certification can be sought is not precisely defined, although the certification rules specifically identify the following as viable bases for petition:

- The question of law is one of first impression and is of such substantial public importance as to require prompt and definitive resolution by this court.

- The question of law is one with respect to which there are conflicting decisions in other courts.

- The question of law concerns an unsettled issue of the constitutionality, construction, or application of a statute of this commonwealth.

Rule 110.1 of the 3rd Circuit Local Appellate Rules sets forth the procedure to petition for certification to a state's supreme court. The petition may be filed with the state supreme court on a sua sponte basis by the 3rd Circuit — as in *PricewaterhouseCoopers* — or a party may move the 3rd Circuit to file such a petition. After the petition is filed in state court, the Pennsylvania rules provide that the Pennsylvania Supreme Court has 60 days to determine whether it will accept the petition. Once accepted, certification has the effect of staying the appeal before the federal court.

As *PricewaterhouseCoopers* demonstrates, certification has practical benefits to litigants and institutional benefits to the federal courts. Certification, as a general rule, is less costly to litigants — with regard to time and economic expense — than the associated doctrine of federal abstention. Rather than remanding the case to a state court for a full trial, by certifying the questions regarding in pari delicto and imputation, the 3rd Circuit permitted the parties to have direct access to the Pennsylvania Supreme Court. In addition to saving litigants a significant amount of time by streamlining the litigation process, certification provides parties the opportunity to save the substantial legal fees that are often incurred during the course of litigation from trial through final appeal.

In addition to the benefits that certification has for parties, the process also has advantages for the courts. It is an efficient use of state resources both financially and with regard to judicial economy; only the state's highest court is required to address the novel or uncertain legal issue. Further, deferring to a state's highest court on open issues not only avoids further muddying of the judicial waters but may prevent the development of inconsistent bodies of law between the federal and state forum. As the *PricewaterhouseCoopers* court observed, in pari delicto is a “murky

area” of law and one where there is already inconsistent precedent within Pennsylvania. Not only is encouraging consistency in the development of such legal doctrine beneficial, because it serves the expectations of litigants, but it discourages forum shopping by utilizing the highest court of the state whose substantive law applies.

Perhaps most notably, because certification allows the authoritative court to interpret a statute or resolve an unclear area of decisional law in the first instance, it has the clear benefit of ensuring that

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federal courts do not err in their best efforts to guess as to the proper result under the applicable state law. In addressing the novel application of in pari delicto suggested by the committee, Ambro noted that “[e]xtending in pari delicto to a breach-of-fiduciary-duty action without guidance from the Supreme Court of Pennsylvania gives us pause.” Although the court's statement may have tipped its hand with regard to its leanings prior to certification, it also revealed the panel's hesitancy to create rules of conduct or conventions of liability unacceptable to the Pennsylvania Supreme Court.

This is not to suggest that every disputed question of state law presents an appropriate basis for the court to seek certification or for the parties to request it. Certification is not a method by which federal courts may abdicate decision-making responsibilities regarding state law issues; nor should it be used by parties seeking to circumvent a federal ruling that they foresee to be unfavorable. However, as the 3rd Circuit *PricewaterhouseCoopers*

panel noted, certain unresolved questions of state law are particularly ripe for judicial determination by state courts, particularly where resolution of the questions requires a policy judgment.

The question of whether a non-innocent third party may impute fraud to a principal where the third party has aided or abetted the agent in committing the fraud does more than reveal an existing tension in the law of imputation between the federal courts and Pennsylvania courts. It also implicates a state's policy judgment with regard to the incentives created by a rule that allows or disallows non-innocent third parties to insulate themselves from liability where the adverse party is also non-innocent. As the 3rd Circuit concluded in *PricewaterhouseCoopers*, where “it would be inappropriate for [the court] to make this policy judgment in the first instance, particularly in light of the magnitude and importance” of a given case to a state, a petition for certification is an appropriate remedy to be sua sponte employed by the court or requested by a party.

On May 28, 2010, armed with the opinion of the Pennsylvania Supreme Court, the 3rd Circuit handed the committee a victory and reversed the lower court ruling in PwC's favor. Adopting the answers of the Pennsylvania Supreme Court to the certified questions, the circuit remanded the case to the district court, directing that it resolve the factual questions regarding PwC's conduct — particularly whether it acted in good faith in the conduct of its audit. Although the case will have important implications for imputation and in pari delicto defenses, particularly in auditor liability cases governed by Pennsylvania law, it serves as an equally important illustration of the certification process and provides a helpful reminder of both the procedure's importance to our federalist system and its potential as a tool for practitioners. •