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SHIFTING SANDS IN CLASS ACTION LITIGATION

Last November 5, the Supreme Court Justices spent the morning listening to two important class action cases that may offer the opportunity for the Court to impose stricter standards for the certification of class actions.

Comcast Corp. v. Behrend is a Sherman antitrust claim brought by cable subscribers in the Philadelphia market asserting that they paid too much for cable.[1] The plaintiffs alleged a conspiracy to "cluster" licenses in geographical areas where the company could then more effectively control cable prices. At the outset of the case, the plaintiffs advanced four theories to support their damages claim. The lone theory found creditable by the district court was that Comcast's clustering deterred "overbuilders"—companies that can offer a competitive alternative where a cable company already operates—from entering the Philadelphia market. On the basis of that theory of damages, the district court certified the class under Fed. R. Civ. P. 23(b)(3).

On appeal to the Third Circuit, Comcast argued that the plaintiffs had not satisfied Rule 23(b)(3)'s predominance requirement. According to Comcast, the plaintiffs' expert relied on a damages model tied to all four theories but could not measure damages under the sole remaining theory credited by the district court. A divided panel affirmed class certification. It did so on the heels of *Wal-Mart Stores, Inc. v. Dukes*, where the Supreme Court suggested that Daubert's standards for the admission of expert testimony applied in class certification proceedings.[2] The Third Circuit, however, refused to fault the district court for not scrutinizing the expert's damages model under *Daubert* standards. The panel stated, "We understand the Court's observation to require a district court to evaluate whether an expert is presenting a model which *could* evolve to become admissible evidence, and not requiring a district court to determine if a model *is perfect* at the certification stage." (Emphasis supplied.) Rather, according to the Third Circuit, expert opinions need only be "plausible" at the class certification stage.

1 *Comcast Corp. v. Behrend*, No. 11-864 (U.S. June 25, 2012). For the decision below, *see Behrend v. Comcast Corp.*, 655 F.3d 182 (3d Cir. 2011).

2 *Wal-Mart Stores, Inc. v. Dukes*, 131 S. Ct. 2541, 2553–54 (2011) (discussing *Daubert v. Merrell Dow Pharm.*, 509 U.S. 579 (1993)).

The majority's rationale elicited a strong dissent from Judge Jordan. He found the evidentiary standard which had been applied to be deficient, noting that "simple logic indicates that a court may consider the admissibility of expert testimony at least when considering pre-dominance [under Rule 23(b)(3)]." In the dissent's view, a "court should be hard pressed to conclude that the elements of a claim are capable of proof through evidence common to a class if the only evidence proffered would not be admissible as proof of anything."

Thus, *Comcast* raises the critical question of whether the "plausible" prospect that admissible evidence will be admitted at trial can satisfy the standards for class certification, or whether admissible evidence, including competent expert opinion, must be advanced at the time certification is considered by the district court.

In the second case, *Amgen Inc. v. Connecticut Retirement Plans and Trust Funds*, the plaintiffs claimed to be representatives of a class of securities holders suing under Section 10(b) of the Exchange Act and Rule 10b-5. They alleged that false and misleading public statements made by an officer of the company fraudulently inflated its stock price.[3] The plaintiffs sought class certification under Rule 23(b)(3) partly on the basis of the fraud-on-the-market theory of reliance. This theory, accepted by the Supreme Court in *Basic Inc. v. Levinson*, 485 U.S. 224 (1988), relieves plaintiffs of the need to show actual reliance where there is a public market for the stock, a so-called "efficient market," and where the offending statements or misrepresentations were made into that market. The assumption implicit in the theory is that the market takes account of such statements and that their impact is reflected in the price of the stock.

Amgen argued that, in addition to proving that an efficient market existed and the alleged misstatements were public, plaintiffs must also prove—at the certification stage—that those misrepresentations were material. According to Amgen, *immaterial* statements do not affect stock price. Thus, there is no basis for presuming that investors relied in common on immaterial misstatements when they bought or sold the stock. The district court rejected that argument, refused Amgen's attempt to offer admissible evidence of immateriality, and certified the class.

A unanimous panel of the Ninth Circuit affirmed the certification, reasoning that materiality is an "element of the merits of [a] securities fraud claim," whereas the efficient-market and public-statement predicates to the fraud-on-the-market theory are not. Because materiality is an element of a claim, the panel reasoned, its merits can be addressed only "at trial or by summary judgment motion."[4]

Each of these cases raises the question as to the quantum of proof required at the class certification stage. Each challenges the pre-existing practice of certifying a class with something less than admissible evidence. The Court's decisions in *Comcast* and *Amgen* could dramatically modify the class action landscape. What is troubling to certain of the Justices is the fact that class certification becomes the defining moment in class action cases because the act of certification can increase risk monumentally and exert unwarranted pressure on defendants to settle claims that may have little chance of success on the merits. In many high-stakes class actions, including both antitrust and securities class actions, certification hinges on expert testimony. Permitting class certification on the basis of plausible but *inadmissible* expert opinions and/or alleged misrepresentations that may be *immaterial* to market price serves

3 *Amgen Inc. v. Conn. Ret. Plans & Trust Funds*, No. 11-1085 (U.S. June 11, 2012). For the decision below, *see Conn. Ret. Plans & Trust Funds v. Amgen Inc.*, 660 F.3d 1170 (9th Cir. 2011).

4 Reflecting the Supreme Court's recent focus on class action litigation, Comcast and Amgen are only two of the class action cases under review this Term. Another important case is *Standard Fire Insurance Co. v. Knowles*, No. 11-1450 (U.S. Aug. 31, 2012), a breach-of-contract case brought as a putative class action in Miller County, Arkansas, labeled by some as a plaintiff-friendly "magnet jurisdiction." After the defendant removed the case under the Class Action Fairness Act of 2005 ("CAFA"), the plaintiff obtained a remand on the basis of a "stipulation" purportedly for the absent class that the class damages were less than $5 million, the threshold for federal jurisdiction. The question presented in *Knowles* is whether such a stipulation can defeat a defendant's right of removal under CAFA. Jones Day filed an amicus brief in *Knowles* on behalf of the National Association of Manufacturers suggesting reversal. For a copy of that amicus brief, *see* http://www.americanbar.org/content/dam/aba/publications/supreme_court_preview/briefs/111450_reversal_amcu_nam.authcheckdam.pdf (all web sites herein last visited January 23, 2013).

as an obvious opportunity for what Judge Henry Friendly described as "blackmail settlements."[5]

The class certification issues raised by *Comcast* and *Amgen* have split the circuits. In *Comcast*, the Third Circuit's decision itself created the split. The emerging trend, both pre- and especially post-*Dukes*, has been to apply *Daubert* in class certification proceedings, although the circuits differed as to the level of scrutiny required. For example, in *American Honda Motor Co. v. Allen*, the Seventh Circuit held that when expert testimony is critical to class certification, "the district court must perform a full *Daubert* analysis before certifying the class."[6] The Eleventh Circuit subsequently adopted that approach.[7] And the Ninth Circuit, after tinkering with a contrary view, ultimately agreed with the Seventh and Eleventh Circuits.[8]

Other circuits have been less exacting but still apply *Daubert* in some form or another. The Eighth Circuit, for instance, has endorsed a "focused Daubert inquiry." According to the panel, "an exhaustive and conclusive *Daubert* inquiry before the completion of merits discovery cannot be reconciled with the inherently preliminary nature of pretrial evidentiary and class certification rulings."[9] And, although the First Circuit has not addressed this precise question, it has held that when predominance turns on "a novel or complex theory as to injury . . . the district court must engage in a searching inquiry into the viability of that theory and the existence of the facts necessary for the theory to succeed."[10]

In *Amgen*, the Ninth Circuit compounded the pre-existing circuit split. Its decision aligned the Ninth Circuit with the Seventh and Third Circuits, both of which view materiality as a merits element of a securities fraud claim that has no place in the certification inquiry.[11] In doing so, the Ninth Circuit disapproved of contrary holdings in the Second and Fifth Circuits (and contrary *dictum* in a First Circuit decision).[12] Those circuits require a plaintiff to prove materiality at the certification stage on the basis of a footnote in the Supreme Court's decision in *Basic*,[13] which they have read as suggesting a materiality criterion for the fraud-on-the-market theory. The Ninth, Seventh, and Third Circuits, however, say that reading *Basic* in that way is unwarranted.

If oral argument is any gauge of how the Court will rule, the defendants in both *Comcast* and *Amgen* have reason for cautious optimism.[14] In *Comcast*, the defense counsel argued that the plaintiffs' model for determining damages could not pass muster under *Daubert*, adding that the

5 *In re Rhone-Poulenc Rorer*, 51 F.3d 1293, 1298 (7th Cir. 1995) (Posner, J.) ("Judge Friendly, who was not given to hyperbole, called settlements induced by a small probability of an immense judgment in a class action 'blackmail settlements.' ") (quoting Henry J. Friendly, Federal Jurisdiction: A General View 120 (1973)). *Accord In re New Motor Vehicles Canadian Export Antitrust Litig.*, 522 F.3d 6, 26 (1st Cir. 2008) (recognizing the "irresistible pressure to settle" on the part of defendants in high-stakes class actions).

6 *Am. Honda Motor Co. v. Allen*, 600 F.3d 813, 815–16 (7th Cir. 2010).

7 *Sher v. Raytheon Co.*, 419 F. App'x 887, 890–91 (11th Cir. 2011).

8 *Ellis v. Costco Wholesale Corp.*, 657 F.3d 970, 982 (9th Cir. 2011).

9 *In re Zurn Pex Plumbing*, 644 F.3d 604, 610 (8th Cir. 2011).

10 *New Motor Vehicles*, 522 F.3d at 25–26. District courts in the First Circuit have read *New Motor Vehicles* to require a *Daubert*-like inquiry when class certification depends on expert testimony. *See, e.g., In re Neurontin Mktg., Sales Practices & Products Liab. Litig.*, 257 F.R.D. 315 (D. Mass. 2009); *Natchitoches Parish Hosp. Serv. Dist. v. Tyco Intl., Ltd.*, 262 F.R.D. 58 (D. Mass. 2008).

11 *Schleicher v. Wendt*, 618 F.3d 679, 685 (7th Cir. 2010); *see In re DVI, Inc. Sec. Litig.,* 639 F.3d 623, 631 (3d Cir. 2011).

12 *In re Salomon Analyst Metromedia Litig.*, 544 F.3d 474, 481 (2d Cir. 2008); *Oscar Private Equity Invs. v. Allegiance Telecom, Inc.*, 487 F.3d 261, 264 (5th Cir. 2007), abrogated on other grounds, *Erica P. John Fund v. Halliburton*, 131 S. Ct. 2179, 2183, 2186 (2011); *see also In re PolyMedica Corp. Sec. Litig.*, 432 F.3d 1, 8 n.11 (1st Cir. 2005) (noting in a dictum that to invoke fraud-on-the-market presumption at class certification stage, plaintiff must prove materiality).

13 *Basic*, 485 U.S. at 248 n.27 ("The Court of Appeals held that in order to invoke the presumption, a plaintiff must allege and prove . . . that the misrepresentations were material . . . .").

14 For the transcript of the oral argument in *Comcast*, *see* http://www.supremecourt.gov/oral_arguments/argument_transcripts/11-864.pdf. For the transcript of the oral argument in *Amgen*, *see* http://www.supremecourt.gov/oral_arguments/argument_transcripts/11-1085.pdf.

certified class covered subscribers in hundreds of franchise areas facing different competitive conditions. "If you drop a stone in the water, you're going to have ripples all the way out," *Comcast* argued. "That doesn't mean all the ripples are the same." Justice Kennedy, who often casts the deciding vote in close cases, appeared sympathetic to this line of reasoning, stating, "The judge has to make a determination that in his view the class can be certified. And that includes some factual inquiries as to the damages alleged." The plaintiffs' counsel responded with a procedural argument, namely, that Comcast had waived the *Daubert* issue by failing to raise it below. Chief Justice Roberts, however, suggested that the Court could simply answer the admissibility question and then remand for a finding on the waiver issue.

Later that same morning, in *Amgen*, the defense counsel argued that the fraud-on-the-market theory does not make sense without materiality: "Absent materiality, the market price cannot be presumed to reflect the statement in question." That argument drew pointed questions from Justices Ginsburg and Kagan, who appeared reluctant to require plaintiffs to prove materiality before trial. Justice Ginsburg in particular said that she was "nonplussed" by Amgen's argument because a finding of immateriality at the class certification stage would be dispositive of the merits: "Of course, [the finding is] going to bind the class representative. So if it's immaterial, the case ends." But the plaintiffs' counsel was subject to harsher treatment when he took the podium. Indeed, Justice Scalia told the plaintiffs' counsel that there is "good reason" to decide the question of materiality before a class is certified: "The reason is the enormous pressure to settle once the class is certified. In most cases, that's the end of the lawsuit"—an observation that applies equally to the question of materiality in *Amgen* and the question of admissibility in *Comcast*.

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