

This is a Navigant Consulting white paper about Rule 23 class certification and expert testimony in light of recent rulings including *In re Hydrogen Peroxide* and *In re IPO Securities*.

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Recent Trends in Rule 23 Class Certification Expert Analyses

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Almost a decade into the new millennium, the right of parties to a rigorous class-certification contest is increasingly entrenched in most Federal circuits and many states, and indeed is appearing in other countries, such as Canada. It is also spreading to new causes of action. To the surprise of experienced litigators, key judicial rulings on the certification of class are arising in such unexpected quarters as antitrust and securities fraud. For some such causes of action, the new rulings might well be game changers, and in other cases the rulings at least move the certification goal posts. Legal teams will be looking at the class certification strategies and analytical tools deployed in a wide variety of causes of action, in case an approach taken in employment class actions (for example) might be germane to antitrust. In doing so, key questions will emerge:

- » Which lessons are transferable between quite different case law and fact patterns?
- » Is there a need for a new kind of expert or is it simply a matter of using the same kinds of expert analyses in new ways?
- » Which questions can be addressed by experts that provide rigor at the certification stage but remain separate from the merits?

This white paper addresses these and related questions.

Background

The reader will appreciate we are asking these questions in the wake of key appellate court decisions – for example, the 2008 ruling *In re Hydrogen Peroxide*, in the Third Circuit, and *In re IPO Securities Litigation*, in the Second Circuit in 2006.¹ The rulings in both cases endorsed the role of expert analysis and testimony at the certification hearing, and did so in general language seemingly intended to offer wider guidance unrestricted to a particular cause of action. Interesting reading in their own right, the rulings also show further convergence in judicial thinking.

Of the two cases, *In re Hydrogen Peroxide* appears likely to have immediate widespread effect, simply because the fact pattern is similar to many antitrust cases. A growing consensus of federal appellate courts now requires a stricter legal standard to govern requests for antitrust class certification. Historically, courts have certified classes more freely in antitrust cases than in certain other class actions because claims based on harm from antitrust violations were *assumed* to satisfy Rule 23.² In the past, courts have granted class certification based on lit-

¹ See *In re Hydrogen Peroxide Antitrust Litig.*, 552 F.3d 305 (3d Cir. 2008); *In re Initial Pub. Offerings Sec. Litig.*, 471 F.3d 24, 40 (2d Cir. 2006). These are not the only important recent rulings, but serve well in a discussion of changes and trends.

² The class certification ruling for direct purchasers by the District Court in *In re Hydrogen Peroxide* notes: "It should come as no surprise that courts, both in this Circuit and elsewhere, have regularly certified as class actions suits alleging a horizontal price-fixing conspiracy. ... Because litigation in price-fixing cases will usually focus on the existence, scope, and effect of the alleged conspiracy, the goals of judicial economy and fairness in such cases will very often be well served by Rule 23's tools." See *In re Hydrogen Peroxide Antitrust Litig.*, 240 F.R.D. 163, 175 (E.D. Pa. 2007). Rule 23 of course is a Federal rule, but class actions under State law frequently follow closely upon the Federal guidelines and rules.

“First, the requirements set out in Rule 23 are not mere pleading rules.”¹

In re Hydrogen Peroxide Antitrust Litig.;
In re Initial Pub. Offerings Sec. Litig.

tle more than the pleadings.³ As a result, plaintiffs could realistically succeed so long as the opinions of their experts were “not fatally flawed.”

Following a broader trend, however, a review of antitrust class certification requirements suggests this position may no longer be acceptable. As of April 2009, six of the 12 circuits have made class certification rulings requiring “rigorous” analysis. These include the Second Circuit (in 2006), the Third Circuit (in 2008), the Fourth Circuit (in 2004), the Fifth Circuit (in 2007), the Seventh Circuit (in 2001), and the Eleventh circuit (in 2004).

In *In re IPO Securities Litigation*, the fact pattern is somewhat unusual, because the case does not involve publicly listed securities. The need to prove reliance in securities litigation has often been finessed by the fraud-on-the-market doctrine. But in a few cases – *Cammer* comes to mind, and now most recently *In re IPO Securities Litigation* – the market efficiency argument fails and the burden on plaintiffs to establish another form of reliance looms commensurately greater. Thus *In re IPO Securities Litigation* is not a typical “stock drop” 10(b)-5 shareholder suit, but it may have great influence in a broader array of class action cases. This is apparent in the variety of prior rulings it cites, *e.g.*, complex employment and antitrust litigation, and in the ruling’s stated objective of clarifying prior case law in the Second Circuit: “our Court has been less than clear as to the applicable standards for class certification.”⁴

Where expert testimony is embraced at the class certification stage, it can have a profound effect on the outcome of the ruling. A related Navigant Consulting white paper by Dr. Timothy Savage discusses the evolution of class certification case law specifically in antitrust, and the reader is referred there for more details about the legal framework. Here, we review the purpose of expert analysis at the certification stage, and offer some examples of specific questions an expert might be asked to address in a wide variety of cases.

The Elements of a Class Certification Analysis

The experienced antitrust or securities lawyer may be surprised to learn that there is no “canonical form” of expert analysis for class certification. This is so, in spite of the courts’ acknowledgement that “the ultimate issue as to each requirement [for certification under Rule 23] is really a mixed question of fact and law.”⁵ This state of affairs stands in sharp contrast to the experiences of each. In civil securities litigation, the efficient-markets finance theory holds sway and the event study methodology is often *de rigueur* (especially following *In re Dura Pharmaceuticals*). Similarly in antitrust litigation, with its intellectual linkage to

³ For example, allowing plaintiffs to make a presumption of antitrust impact in class certification by invoking the *Bogosian* short-cut. The “*Bogosian* short-cut” presumes that all buyers of a product are injured if the price has been unlawfully increased. See *Bogosian v. Gulf Oil Corp.*, 561 F.2d 434, 455 (3d Cir. 1977).

⁴ *In re Initial Pub. Offerings Sec. Litig.*, 471 F.3d at 20.

⁵ *Id.* at 38.

“It is incorrect to state that a plaintiff need only demonstrate an ‘intention’ to try the case in a manner that satisfies the predominance requirement.”²

In re Hydrogen Peroxide Antitrust Litig.

microeconomics and the theory of industrial organization, certain types of economic analyses are received orthodoxies, such as econometric analyses of prices. But just as there is no economic theory of intellectual property *per se*, there is no economic theory of class membership *per se*.

That said, the Rule 23 requirements for certification certainly suggest a number of themes for experts to explore, which can lead to “statistical dueling” between opposing experts.⁶ Some of these themes are discussed later in this article. The weak linkage with any one academic discipline therefore invites a multi-disciplinary viewpoint; lateral thinking about the case fact pattern is the natural starting point for many a class certification analysis. The legal team will be doing just that kind of case assessment in order to identify the qualities it is looking for in an expert, but the expert team should also be wide enough and deep enough to follow where the case facts lead. In what follows, we focus on how experts might be used to shed light on some of the key issues in a certification hearing.

The class certification hearing is where the court examines the case facts in light of the requirements of Federal Rule of Civil Procedure 23. In the federal courts and in many state courts, this examination goes beyond the legal pleadings of the case; it includes a “rigorous” analysis that is increasingly likely to include the testimony of the opposing parties’ experts as to whether the Rule 23 requirements can be met. While this rigorous analysis is intended not to pre-judge the ultimate merits of the case, the analysis is permitted to touch on the merits to the extent that is required to rule on the existence of a proper class.⁷

A key entry point to the class certification analysis is “ascertainability”, meaning a reasonable and reliable method exists for identifying all potential class members and excluding non-members. Plaintiffs sometimes must modify the definition of their proposed class several times before ascertainability is deemed likely, and in fact this initial hurdle has proven occasionally fatal to proposed classes. But assuming the proposed class is deemed ascertainable by the court in principle, the emphasis merely shifts to another set of hurdles. Taken in combination, Rules 23(a) and 23(b) set forth a total of seven criteria that must be met for the successful certification of a class. As a first-step Rule 23(a)’s four well-known criteria must be met. These consist of numerosity; common questions of law and fact; typicality; and adequacy of representation. If satisfied that the Rule 23(a) requirements are met, the plaintiff must also show that the lawsuit qualifies under Rule 23(b), owing to either: the risk of inconsistent or impaired adjudication; the defendant acted on grounds generally applicable to the class; or common questions of law or fact predominate and class resolution is superior to other available methods.

⁶ The Second Circuit has “condemned” what it terms “statistical dueling” in *Caridad* and elsewhere, but with *In re IPO Securities Litigation*, is evidently receptive to the appropriate use of expert analysis. Both opinions share the same author. It was *Caridad* that coined the confusing language requiring a low threshold of “some showing” that the Second Circuit sought to overturn with *In re IPO Securities Litigation*, *Id.*

⁷ *Id.*

This final, two-legged criterion of predominance and superiority is often fact-dependant and therefore one of the issues likely to benefit from expert opinion. We will focus on this aspect in what follows.

Superiority

A commonly encountered starting point in class certification analyses is with the central judicial issue of whether economy can be gained by combining plaintiffs into a single class. “Economy” of course refers to judicial economy, and we will use the term interchangeably with the Rule 23(b) superiority requirement for forming the class, as stated earlier. In a fact-based analysis, the line between superiority or economy and the predominance of facts in common can be somewhat blurry; some of the comments made in this section could also be covered in the “Predominance” section which follows.

One line of analysis related to superiority is the question as to whether, in principle, it will be possible to generate the information set necessary to adjudicate the matter as a class action through common proof. The “knowability” and the “measurability” of loss causation and damages must be established in principle, along with the ability to account for differences among class members without violating judicial economy. In this undertaking, the tension between the rigor of the class hearing and the need not to prejudge merits can be acutely felt. However, the expert can perform a rigorous analysis from the point of view of the class-wide aspect without straying too far into “merits.”⁸

Plaintiffs may seek to show that the requisite knowledge is easily obtained without undue discovery burdens. Plaintiffs may employ a sampling or statistical expert to show that a small sample will suffice to establish loss causation and class-wide damages. But a sample of what, exactly? Depending upon the nature of the case, the sample may be of human subjects, responding to a questionnaire or interview. Respondents might be current or former employees, or consumers. In some cases respondents are members of the putative class, however in other cases they emphatically must not be in the putative class but must be satisfactory stand-ins for the class members. In still other cases, the sample is not of human subjects, but instead consists of files or records in an accounting system. While this would seem to simplify things, it can be easier to administer a survey than to compile all information about a given customer’s account (for example).

In short, Plaintiffs may approach the “economy” aspect of certification by emphasizing a “small-sample” view of the world: the necessary facts are knowable, and available in a short time frame at reasonable cost by recourse to a small sample. Moreover, the information being acquired through the small sample consists of a few key facts that can be reliably obtained via the sampling process,

“It would seem to be beyond dispute that a district court may not grant class certification without making a determination that all of the Rule 23 requirements are met.”³

Bogosian v. Gulf Oil Corp.

⁸ Many of the rulings cited herein, e.g., *In re Initial Pub. Offerings Sec. Litig.*, address this demarcation. *Id.*

“Defendants are likely to argue that class certification is not about how many balls are white or red; certification hinges on whether it is possible to place the white and red balls into separate urns, without having to inspect each ball individually.”

whether that involves human subjects’ recall of past events; billing, medical, personnel, or other official records; or other case-relevant objective information.

In response, the Defendants may engage an expert to evaluate whether the optimistic small-sample view of the world put forward by Plaintiffs and their experts is realistic. Depending upon the case fact pattern, one or more kinds of experts might be involved. An expert may form an opinion that much more extensive scientific sampling of the population of potential class members is indicated. Plaintiff’s proposed reliance on a small sample may have been driven by approaching the problem as one of so-called “Bernoulli trials” in which a homogeneous population is sampled with respect to a single, readily determined yes-or-no condition. The textbook analogy is one of drawing a sample of red and white balls from an urn, in sufficient quantity to estimate the proportion of balls that are red and the proportion that are white. Defendants are likely to argue that class certification is not about how many balls are white or red; certification hinges on whether it is possible to place the white and red balls into separate urns, without having to inspect each ball individually.

Defendants may envision a world in which there is not one homogeneous population, but many distinct sub-populations, each heterogeneous within itself and certainly different than other sub-populations. This hypothesis will demand a more elaborate and extensive sampling approach. And the problem would be compounded if the population naturally decomposes into multiple distinct populations, but there is no sampling frame available that identifies in advance which subject or case file belongs in which sub-population. Moreover, while it may be easy to distinguish a white ball from a red one in bright daylight, the information needed in real-world litigation may be much more problematical to extract and verify. In some cases, for example where the object is to ask employees to spontaneously recall minutiae from their daily work experiences from several years ago, experts might opine as to the limits of reliability of the information generated in the investigation, even if the sampling is flawless.

Preponderance

If and when the Court authorizes discovery, the day will come when Plaintiffs and Defendants have developed data drawn from their samples. But what then? Since this is the class certification stage, the information is used to determine whether each potential class member’s situation is sufficiently similar to make it desirable to proceed collectively.

From the Plaintiffs’ point of view, the worst outcome might be clear and convincing evidence that there is a conflict of interest within the proposed class.⁹ One possible remedy would involve bifurcating the proposed class into “winners” and “losers” (under the assumption liability is proven and class-wide damages awarded or at least bad behavior enjoined). Winners could be ex-

⁹ Rodriguez-Feliciano v. Puerto Rico Electric Power Authority, KDP 2005-1591 (P.R. Super. Ct. June 28, 2007).

cluded, though logic might also suggest that winners could conceivably be obliged to compensate losers, and then some method adopted to apportion any remaining award “fairly” (whatever that might mean). The reader will appreciate how difficult it could be to persuade the Court to proceed in such a case. Class actions do indeed arise where an “average” amount of harm disguises the fact that some putative class members were actually better off as a result of Defendants’ actions. This scenario might well arise in an antitrust case, and indeed this can also easily arise in many other class actions, such as billings related. In securities fraud cases, there is an academic literature devoted to winners and losers among shareholders.¹⁰

Another scenario arises in class certification challenges, when the evidence supports the conclusion that there is no homogeneous class, but rather multiple subclasses. In principle, this can sometimes be accommodated within a class action framework, so long as each individual can be properly assigned to the right subclass, and the proper remedy worked out in the abstract for each subclass. The issue there then reverts to “superiority.” Presumably a Plaintiffs’ expert might use multiple regression analysis or other statistical technique to differentiate the financial award or other intervention appropriate to each subclass. But what if there is almost as much heterogeneity and variation within any one subclass, as there is between any two subclasses? Should this arise – and Defendants’ experts are likely to have a close look at the possibility – it becomes hard to argue a preponderance of facts in common. Rule 23(b) also envisions different issues arising in this respect, depending upon whether an “injunctive class” or “damages class” is at issue.¹¹

Finally, in some cases it is possible to formulate rigorous tests of the hypothesis that named plaintiffs are or are not like other members of the proposed class. This should not be confused with the Rule 23(a) requirements, which address different issues about the representativeness (and commonality and typicality) of the case. An expert analysis of whether the facts appear to support similar experiences and impact within the class and between one representative class member (whether a named plaintiff or not) and other class members, is instead a legitimate subject for statistical or other expert analysis.

Evaluating the Expert Analysis

It was in 1966 when revisions to Rule 23 first accommodated monetary damages to unnamed members of the proposed class, and it was in 1966, too, that the

¹⁰ A widespread academic sentiment is that well-diversified investors tend, on average, to have inflated sales offset inflated purchases, across hundreds of 10(b)-5 cases. An entry point to this literature is A. Thakor, J. Nielsen, & D. Gulley, [The Economic Reality of Securities Class Action Litigation](#), Research Paper issued by the U.S. Chamber Institute for Legal Reform, October 2005. Innocent shareholders who sell at inflated prices are not expected to disgorge their gains; the point is that the legal system comprehends there may well be “winners” among a proposed class, and the remedy will need to accommodate this. *Id.*

¹¹ Rule 23(b)(2) focuses on injunctive relief, while Rule 23(b)(3) focuses on actions primarily involving the awarding of damages.

“... there is no basis for thinking that a specific Rule 23 requirement need not be fully established just because it concerns, or even overlaps with, an aspect of the merits.”⁴

In re Initial Pub. Offerings Sec. Litig.

Second Circuit issued its *Eisen* ruling, that henceforth was invoked to limit fact-finding and expert analysis at the certification stage. Since that time, most courts¹² have moved decisively in the direction of more rigorous analyses in class certification, while striving to avoid prejudging the merits of the case. Over time, the courts spread out on a continuum between an *Eisen*-inspired no-merits stance, eschewing expert testimony and relying solely upon pleadings; to a middle ground in which the court considers primarily the plaintiffs’ factual presentation and expert analyses (since the plaintiff carries the burden of proof); and finally to a rigorous view of both plaintiffs’ and defendants’ expert analyses, wherein the court will likely have to consider the appropriate weight to assign experts on both sides. This final task seems a responsibility the courts have taken upon themselves, at the certification stage, reluctantly. But logic does seem to have propelled many courts to accept this as necessity, in the interests of unnamed plaintiffs and defendants alike.¹³ Indeed, this is why the Second Circuit’s own journey from *Eisen* to *In re IPO Securities Litigation* is so noteworthy.

Whether or not the parties seek formally to exclude the other party’s expert testimony, the reliability of all such testimony will be weighed by many courts today. Accordingly, there are pro’s and con’s to a formal Daubert-style motion to exclude. Of course, the original intent of Daubert and related rulings was to shield juries from so-called “junk science.” There being no jury at the certification hearing, legal teams make expert challenges when they wish to drill-down more deeply into the methodological issues in the expert reports.

This may come about in part as a matter of timing, depending upon whether the experts had the opportunity to rebut opposing experts in either their affirmative or rebuttal report. Or the legal teams may seek additional, focused opportunities to rebut. This might arise when the expert analyses are extremely technical.

It might also arise in the exact opposite context. For example, some Defendants will characterize a simple Plaintiff expert report as a “trust-me” report. The Plaintiff’s expert may have submitted a report or declaration simply enumerating the expert’s qualifications along with a brief discussion that a small sample addressing two or three key questions can easily and inexpensively be conducted. Defendants will seek to show that this is completely inadequate as a “rigorous” determination of certification issues.

Such Daubert challenges have been known to succeed, and where they have not led to the exclusion of all or part of an expert’s opinion, they may still undermine the veracity of the expert. On the other hand, Daubert challenges are sometimes welcomed by a legal team, who believe their expert has done fine

¹² The Ninth Circuit is regarded by at least one authority as the last *Eisen* holdout among the Federal districts, particularly since certifying *Dukes, et al. v. Wal-Mart Stores, Inc.*, 474 F.3d 1214 (9th Cir. 2007) in the aftermath of *In re IPO Securities Litigation*.

¹³ See H. P. Scribner, *Rigorous Analysis of the Class Certification Expert: The Role of Daubert and the Defendant’s Proof*, 28 Rev. Litig. 71 (2008).

work. In such a case, the Daubert challenge may result in focusing judicial scrutiny on the work and confirming the rigor of the analysis. Even when the Daubert challenge exposes flaws in an expert’s work, the Daubert challenge may have the unintended consequence of convincing the court that it will be possible to correct these errors after certification.¹⁴

How Applicable are these Methods for Antitrust and Securities Class Actions?

The preceding discussion gives an impressionistic flavor for the range of analyses encountered in many class certification contests. One of the seeming paradoxes of Rule 23 proceedings is that as a practical matter, antitrust and securities fraud cases have had a relatively easy time achieving certification, yet there is more case law specifically concerned with certification in these causes of actions than in most other types of cases. The question for the practicing class action attorney, therefore, is whether a handful of new rulings will appreciably change either the manner or the success rate in achieving or contesting certification. Time will tell, but legal teams may feel compelled to litigate as though the trend is firmly established. And acting as though it is so will help make it so.

Several themes seem promising either in antitrust or securities or both. Testing for conflicts within the class might very well be indicated in an antitrust class action, for some firms (or individuals depending on the case) might benefit relative to others, under the allegedly anticompetitive behavior of Defendants. And perhaps surprisingly, in some antitrust class actions, the required information simply cannot be readily obtained. For example, in some antitrust actions the “class” may well consist of downstream competitors, fiercely antagonistic toward one another, and not at all inclined to share sensitive financial or operating information. If the court can learn this fact at the certification stage rather than at trial, judicial economy might be advanced.

The issue of class suitability in securities fraud is likely to come up in the context of reliance. This would appear to invite close scrutiny of the “knowability” dimension, and raises a host of issues about the limits of autobiographical recall and cognition. How many of us are really sure as to what parts of the argument or fact pattern persuaded us to adopt our course of action? Even if that decision was reached today, and especially if it was years ago? And will our recall be colored by whether we think it was a good decision or bad? Issues such as these are similar to those that may arise in many class certification battles, including billing-related and employment-related class actions. They illustrate how and why behavioral scientists might supplement experts in statistics, sampling, economics, or finance. A court may well conclude that plaintiffs’ testimony based upon personal knowledge, *i.e.*, their autobiographical recall of past events, ought to be deemed reliable – if unchallenged. Depending in part upon the legal

“Weighing conflicting expert testimony at the certification stage is not only permissible; it may be integral to the rigorous analysis Rule 23 demands.”⁵

In re Initial Pub. Offerings Sec. Litig.

¹⁴ *In re Wal-Mart Stores, Inc. Wage and Hour Litig.*, 2008 WL 413749 (N. D. Cal.).

issues involved, the court might be more skeptical of this proposition, if presented expert analysis to the contrary.

Conclusions

In summary, there appears to be growing momentum toward more rigorous class certification hearings. This is seemingly so, across jurisdictions and causes of action. Given this trend, experts have an ever-increasing role to play in Rule 23 hearings, and many times a key role at that. The nature of the expert analysis will naturally vary with the fact pattern being analyzed. Some of the questions that may be suitable for expert analysis include:

1. Are there reasons to believe, *a priori*, that class members were affected by the allegations in a systematic and generalized manner? Are there reasons to believe, *a priori*, that these systematic influences were stronger or weaker than individual differences?
2. Are there reasons to believe, *a priori*, that such influences can be detected and measured using a general means of analysis?
3. Were any one class member's experiences uniform or systematic throughout the class period, and if not, can the differences over time be properly identified and studied?
4. Is there reason to believe that the class is ascertainable? Is there reason to believe the class naturally decomposes into multiple sub-classes? If so, can we properly assign individual plaintiffs to the appropriate sub-class?
5. Does a given class member's experiences predict or stand-in for another class member's experiences? How can we confirm that the experiences of the named plaintiffs, in particular, can be generalized to others in the proposed class?
6. Is there reason to believe that the situations among class members extend to actual conflicts as to remedies?
7. Can we properly identify the nature and extent of differences among the class to devise a fair outcome within the constraints of judicial economy and suitability?

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