Class Action

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Expert Analysis

The Curious Case of 'Merits' and Class Certification

By Ugo Colella, Esq., and Michael T. Korns, Esq.

There are many oddities in law, such as indulging legal fictions — treating corporations as "persons," for example. A truly curious case, however, is presented when a problem that seems complex actually is not because its complexity is based upon an interpretation error that inexplicably took root and multiplied over the course of roughly three decades. Such it is with the question of whether a court may examine the merits of class claims when deciding whether to certify a class action under state or federal law.

The Ubiquity of Class Actions

Perhaps, like death and taxes, the third certainty in today's turbulent environment is the threat of litigation, particularly class actions. With the economic downturn in full swing, the class mechanism is becoming the weapon of choice for people and institutions that believe they have been swindled by Wall Street, Ponzi schemes (such as Bernard Madoff's) or, dare we say, "traditional" run-of-the-mill financial wrongdoing. And, with the U.S. Supreme Court's recent and widely publicized preemption decision, a wave of tobacco-related class actions is spreading through state courts like wildfire.[1]

Looking for ever-larger paydays, enterprising class counsel are becoming more creative and aggressive about turning ordinary individualized disputes into large-scale class actions. As a result, despite Congress' attempt to rein in class actions through the Class Action Fairness Act of 2005 and the Supreme Court's recent attempts to limit the ability of plaintiffs to bring federal securities class actions, class-action suits are being filed at a fairly uninterrupted and brisk pace, with securities class actions rising by roughly 19 percent in 2008.[2]

Although policymakers and economists are predicting, or perhaps hoping, that the current recession will begin to subside sometime in 2009, the class-action landscape looks much different. Class complaints arising from the financial crisis, combined with the standard assortment of consumer-related class actions, which include an ever-growing number of tobacco cases, require the

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usual targets of class claims — large private and publicly traded companies — to ensure they are well positioned to defend against these actions efficiently and with minimal fanfare or public scrutiny.

There are many tools in a class defendant's arsenal that may be effective in securing an early dismissal of a class action. Although there are efficiencies and fairness issues that no doubt can benefit class defendants, it is well known that the class action has been and remains a moneymaker for counsel representing a class against a defendant with deep pockets. As such, pulling the proverbial plug on the class action by defeating certification essentially ends the litigation because the amount in dispute in any individual case normally is so small that the dispute is settled or otherwise litigated without the significant exposure and expense of a class action.[3]

Further, a class defendant can take control of the certification process and potentially reduce the exposure and expense of a full-blown class action by going on the offensive and filing a motion to deny certification fairly soon after a class complaint is filed.[4] Equally, challenges can be made to expert testimony that can quickly eliminate a class that is stitched together using "junk science."[5]

Courts have held that the rules of evidence — governing relevance, authenticity, hearsay, and expert testimony — do not apply at the class-certification stage.

Unfortunately, even if a class defendant went on the offensive or simply waited for the plaintiffs to move for certification, courts have erected various rules that can make defeating class certification early and at the lowest possible cost challenging. For instance, some courts have established a presumption that, in close cases, courts should err on the side of certifying a class.[6] Other courts have held that the rules of evidence — governing such important issues as relevance, authenticity, hearsay and expert testimony — simply do not apply at the certification stage.[7]

The Role of Merits Issues in Certification Determinations

Perhaps the most curious limitation on the party opposing certification at the class-certification stage is that the trial court supposedly cannot examine the merits of class claims in making a certification determination. So, if a class action is premised, in whole or in part, on a cause of action that may be bogus or otherwise questionable as a matter of fact or law, a court's hands may be tied at the certification stage, such that the merits (or lack thereof) of the claims being made cannot be considered at all. To be sure, a class defendant can move to dismiss on the merits pursuant to Federal Rule of Civil Procedure 12(b)(6), or its state equivalent, on the grounds that the complaint fails to state a claim as a matter of law.

But suppose a class defendant has no viable early motion to dismiss on the merits, perhaps because further fact development is necessary or the standard for early dismissal is difficult to meet. Suppose further that certain merits issues overlap or otherwise are inextricably intertwined with the certification decision. Can a class defendant raise those types of merits issues in an effort to defeat the critical certification decision? Many state courts say no.[8]

Although originally aligning themselves with state courts, federal courts now subscribe to a different rule. After much confusion, virtually every federal circuit has concluded that trial courts have an obligation to examine the merits of class claims if, and only to the extent that, such an examination is necessary to determine whether the class representative has met her burden of meeting all requirements imposed by Rule 23.[9] The federal rule makes eminent sense in those areas in which a merits issue *must* be established in order to certify a class.[10] After all, just because a trial court at the certification stage evaluates merits to render a Rule 23 decision does not mean that the ultimate trier of fact is bound by that holding.[11]

Federal courts largely have relied on a fairly straightforward rationale to support this conclusion. Relying on the long-standing principle that courts must conduct a "rigorous analysis" of, or otherwise take a "close look" at, whether a class representative has complied with Rule 23, federal appellate courts have required trial courts to examine all facts necessary to render a definitive and factually reliable class certification decision — a requirement that includes an assessment of the merits of claims that overlap with Rule 23 requirements.[12] As such, Congress' 2003 amendments to Rule 23 encourage limited "merits" discovery if such discovery will aid the trial court in making a well-informed certification decision.[13]

Although federal circuit courts now largely appear to agree that merits issues intertwined with Rule 23 requirements can be examined at the class-certification stage, it has not always been so. That has produced the following anomaly in class-certification jurisprudence: Although state courts regularly rely on federal class-action precedent in interpreting their own class-action statutes, state courts continue to subscribe to the rule that merits issues are off-limits at the certification stage.[14]

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This anomaly is not academic. It has had real-world consequences for class defendants in state courts, prohibiting, for example, a full examination of the reliability of expert testimony at the certification stage.[15] This inconsistency between state and federal class decisions is readily susceptible to a fix because it is traceable to a 1974 U.S. Supreme Court decision that has been widely misinterpreted.

The Eisen Myth: Divorcing the 'Merits' From Class Certification

The question in *Eisen v. Carlisle & Jacquelin,* 417 U.S. 156 (1974), was whether the defendant or the plaintiff (class representative) should pay the cost of providing putative class members notice of the class action. Rather than answer this question with reference to the commands of Rule 23, the trial court instead asked whether the class representative more likely than not would succeed at trial on the merits of the underlying claims. After conducting a preliminary evidentiary hearing on the merits of the claims, the court answered that question in the affirmative, certified the class and imposed 90 percent of the notice costs on the defendant.

The U.S. Supreme Court reversed and dismissed the class action, finding no support in Rule 23 or elsewhere for the lower court's reasoning or ultimate conclusions.[16] The high court said, "[N]othing in either the language or history of Rule 23 … gives a court any authority to conduct a preliminary inquiry into the merits of a suit in order to determine whether it may be maintained as a class action."[17]

This language has been taken out of context repeatedly and ultimately assumed a life of its own. *Eisen*, courts subsequently said, supported the notion that Rule 23 put merits and class-certification issues in separate, hermetically sealed boxes, precluding trial courts from addressing the merits of class claims at the certification stage.[18]

As a result, lower courts began drawing bright lines in class actions, prohibiting defendants from delving into the merits of class claims even in those cases in which the merits were directly relevant to, and intertwined with, the requirements for class certification.

Eisen *Properly Understood*

Eisen was an effort by the court to rein in the lengthy (eight years), dizzying (three trips to the court of appeals) and ultimately wasteful (endorsing the trial court's original decision in the third appeal) proceedings in the lower courts.[19] In fact, *Eisen* did not resolve a circuit split, construe an obscure question of federal procedural law or ultimately break any new ground. *Eisen* , it seems, was an exercise in case management.

It thus is quite exceptional that *Eisen* 's answer to the unexceptional question of who pays the costs of class notice would cause so much confusion for so many years in federal *and* state dispositions of class determinations. *Eisen* itself strongly suggests that a merits inquiry is inappropriate only when that inquiry is *wholly separate* from the certification decision.[20] And, if the words of *Eisen* aren't enough, the court just four years later made it crystal clear that "the class determination generally involves considerations that are 'enmeshed in the factual and legal issues comprising the plaintiff's cause of action.'"[21]

Don't Be Deceived by Eisen

Federal courts, mainly at the appellate level, are only now getting around to decisively clearing up the confusion caused by *Eisen* . Nevertheless, some federal district courts continue to adhere to *Eisen* despite binding circuit precedent to the contrary.[22] While *Eisen*-friendly precedent may remain on the books, those decisions likely will have to be re-examined and ultimately rejected in light of the 2003 amendments to Rule 23 and the now prevailing view of the overwhelming majority of federal circuit courts. The 2nd U.S. Circuit Court

of Appeals recently conducted such a house-cleaning exercise in *In re Initial Public Offerings Securities Litigation*, 471 F.3d 24 (2006), disapproving of prior decisions that suggested merits issues were off-limits at the class certification stage.[23]

State courts that look to federal courts for guidance in this area likewise should re-examine their class-action jurisprudence and ensure that they remain consistent with the evolving view of the federal judiciary. Some state courts have caught the drift of federal courts, while others continue to rely on *Eisen* and turn away from merits issues when addressing certification determinations.[24]

The failure of federal and state courts to examine merits issues that overlap with certification requirements can be harmful. A class action may be certified on the basis of incomplete or inaccurate information, only later to be either reversed on appeal or decertified based on complete and accurate information. Members of the class lose in this scenario. Equally, assuming a class defendant hangs in there for the duration, the costs of such an error could be devastating, both in terms of litigation fees and publicity. Other defendants may just settle for the sake of avoiding that publicity or those costs. In either case, the class defendant loses, and the efficiencies that are supposed to be advanced by the class mechanism are defeated.

In the end, when the merits of class claims overlap with certification requirements, courts must decide the merits to ensure that the class is certified on the basis of facts that survive the adversarial process. In this way, the parties to class actions can have at least some level of assurance that the certification decision will stick, rather than be subject to change based on the passage of time and the vagaries of "merits" discovery. Any other approach would make the class-action process — which purports to be efficient and fair to all parties — inefficient and unfair.

Notes

1. *See Altria Group Inc. v. Good*, 129 S. Ct. 538 (2008); Chris Rizo, *Expert: Supreme Court Ruling Could Spur Class Actions Against Cigarette Makers*, Legal Newsline (Dec. 16, 2008), *available at* http://www.legalnewsline.com/news/218036-expert-supreme-court-ruling-could-spur-class-actions-against-cigarette-makers.
2. *Stoneridge Inv. Partners v. Scientific-Atlanta*, 128 S. Ct. 761, 769-70 (2008); Securities Class Action Filings 2008: A Year in Review, Cornerstone Research (2009).
3. *See, e.g., Eisen v. Carlisle & Jacquelin*, 417 U.S. 156, 161 (1974) ("A critical fact in this litigation is that petitioner's individual stake in the damages award he seeks is $70. No competent attorney would undertake this complex antitrust action to recover so inconsequential an amount. Economic reality dictates that petitioner's suit proceed as a class action or not at all.").
4. *See* Ugo Colella & Michael T. Korns, Managing the Credit Crisis in Court: Defense Control of the Class Certification Process, 9 (21) Class Action Litig. Rep. 937 (Nov. 14, 2008).
5. *See* Ugo Colella, 'Daubert Lite' at the Class Certification Stage: Great Taste, But Ultimately Less Filling (forthcoming, For the Defense, 2009).
6. *See, e.g., Burgess v. Farmers Ins. Co.,* 151 P.3d 92, 98 (Okla. 2006); *Davis v. Am. Home Prods. Corp.*, 844 So. 2d 242, 249 (La. Ct. App., 4th Cir. 2003). *But see In re Hydrogen Peroxide Antitrust Litig.*, – F.3d –, 2008 WL 5411562, at *11, *15 (3d Cir. Dec. 30, 2008) (holding that presumptions in favor of class certification are prohibited).
7. *See, e.g., Ammons v. La-Z-Boy Inc.,* No. 04-67, 2008 WL 5142186, at *12 (D. Utah Dec. 5, 2008) (collecting cases).
8. *See, e.g., Burgess,* 151 P.3d at 100; *Sav-On Drug Stores v. Super. Ct.*, 96 P.3d 194, 199-200 (Cal. 2004); *In re S.D. Microsoft Antitrust Litig.*, 657 N.W.2d 668, 673, 677, 680 (S.D. 2003); *Howe v. Microsoft Corp.,* 656 N.W.2d 285, 291, 293-94 (N.D. 2003); *Mayho v. Amoco Pipeline Co.,* 750 So. 2d 278, 283-84 (La. Ct. App., 5th Cir. 1999).
9. *See In re Hydrogen Peroxide,* 2008 WL 5411562, at *8 ("An overlap between a class certification requirement and the merits of a claim is no reason to decline to resolve relevant disputes when necessary to determine whether a class certification requirement is met."); *Oscar Private Equity Invs. v. Allegiance Telecom,* 487 F.3d 261, 268 (5th Cir. 2007) ("A district court … must give full and independent weight to each Rule 23 requirement, regardless of whether that requirement overlaps with the merits."); *Dukes v. Wal-Mart Inc.,* 509 F.3d 1168, 1177-78 n.2 (9th Cir. 2007) ("Of course, we recognize that courts are not only at liberty to but *must* consider evidence which goes to the requirements of Rule 23 even if the evidence may also relate to the underlying merits of the case" [original emphasis; internal quotations and citation omitted].); *In re Initial Public Offering Sec. Litig.,* 471 F.3d 24, 33-39 (2d Cir. 2006) (collecting cases; "We thus align ourselves with [other circuits] that have required [a] definitive assessment of Rule 23 requirements, notwithstanding their overlap with merits issues.").
10. *See, e.g., Oscar Private*, 487 F.3d at 267-68 (holding that class representative must establish loss causation to satisfy Rule 23 requirements; loss causation an essential element of class claim of violations of securities laws).
11. *In re Hydrogen Peroxide*, 2008 WL 5411562, at *8.
12. *See Amchem Prods. v. Windsor*, 521 U.S. 591, 615 (1997) ("close look"); *Gen. Tel. Co. of the Sw. v. Falcon*, 457 U.S. 147, 161 (1982) ("rigorous analysis"); *In re Hydrogen Peroxide*, 2008 WL 5411562, at *10 ("[B]ecause each requirement of Rule 23 must be met, a district court errs as a matter of law when it fails to resolve a genuine legal or factual dispute relevant to determining the requirements.").
13. *See In re Hydrogen Peroxide*, 2008 WL 5411562, at *9 & n.20 (quoting Advisory Committee Notes to 2003 amendments to Rule 23: "[I]t is appropriate to conduct controlled discovery into the 'merits,' limited to those aspects relevant to making the certification decision *on an informed basis*" [emphasis added].).

[14] *See Medrazo v. Honda of N. Hollywood*, 166 Cal. App. 4th 89, *95 (Cal. Ct. App., 2d Dist. 2008) ("The certification question is 'essentially a procedural one that does not ask whether an action is legally or factually meritorious."); Cruz v. Unilock Chicago, 892 N.E.2d 78 (Ill. App. Ct., 2d Dist. 2008) ("Thus, the trial court is not to determine the merits of the complaint, but only the propriety of class certification, and its factual inquiry and resolution of factual issues is to be limited solely to that determination."); *But see GEICO v. Bloodworth,* 2007 WL 1966022, at *21 (Tenn. Ct. App. 2007) (recognizing that "[a] majority of [federal] circuits now agree that a trial court is required to perform a rigorous analysis of the class certification requirements and to make such findings as are necessary to that analysis, regardless of whether a Rule 23 requirement overlaps with the merits").

[15] *See, e.g., Burgess*, 151 P.3d at 100; *In re S.D. Microsoft,* 657 N.W.2d at 673, 677, 680; *Howe*, 656 N.W.2d at 291, 293-94.

[16] *Eisen*, 417 U.S. at 177-79.

[17] *Id.* at 177.

[18] *See, e.g., Castillo v. Envoy Corp.*, 206 F.R.D. 464, 468 (M.D. Tenn. 2002) ("However, courts cannot make a preliminary inquiry into the merits of the proposed class action," citing ***Eisen***.); *Reel v. Clarian Health Partners,* 855 N.E.2d 343, 347 (Ind. Ct. App. 2006) ("[F]or the purpose of allocating the burdens of giving notice, the Supreme Court in *Eisen IV* resolved the problem by placing the burden upon the party asserting class status and expressly rejecting consideration of the ultimate merits at this stage as inimical to both the purpose of subsection (C)(1) and the substantial rights of the defendant," citing *Eisen*).

[19] *See Eisen*, 417 U.S. at 169 (agreeing with the appeals court's observation that "this litigation has lived up to … [the] characterization of it as a Frankenstein monster posing as a class action" [internal quotations and citation omitted]).

[20] *See Eisen*, 417 U.S. at 177 ("Indeed, such a procedure [ruling on the probable success on the merits] contravenes the rule by allowing a representative plaintiff to secure the benefits of a class action without first satisfying the requirements for it."); *id.* at 177-78 ("He is thereby allowed to obtain a determination on the merits of the claims advanced on behalf of the class without any assurance that a class action may be maintained.").

[21] *Coopers & Lybrand v. Livesay*, 437 U.S. 463, 469 (1978) (quoting *Mercantile Nat'l Bank v. Langdeau,* 371 U.S. 555, 558 [1963]).

[22] *Compare, e.g., In re Live Concert Antitrust Litig.*, 247 F.R.D. 98, 106 (C.D. Cal. 2007) (citing ***Dukes*** and holding that the 9th Circuit prohibits inquiry into the merits at the class certification stage), *with Dukes*, 509 F.3d at 1177-78 n.2 (holding that district courts "*must*" examine the merits if they overlap with Rule 23).

[23] *See In re IPO*, 471 F.3d at 42 (declining to follow contrary holdings in three prior 2nd Circuit decisions).

[24] Compare *Bloodworth*, 2007 WL 1966022, at *21) (recognizing change in federal law on this point), with *Ameriquest Mortgage Co. v. Scheb,* 2008 WL 4568383, 2 (Fla. 2d Dist. Ct. App. 2008) (adhering to Eisen).

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Katten Muchin Rosenman LLP

Ugo Colella is a litigation partner in the Washington, D.C. office of **Katten Muchin Rosenman LLP**, concentrating his practice on commercial litigation, with a particular emphasis on class actions. He practices at the trial and appellate levels in state and federal courts across the United States, and advises clients on a variety of matters involving contracts and other commercial instruments. Mr. Colella has extensive experience with the complexities associated with class actions and multidistrict litigation, having participated in cases involving multiple actions and class actions consolidated before a single federal district judge.

Mr. Colella is widely published, having written about class actions, federal sovereign immunity, burdens of proof, contract defenses to tort claims, statutes of limitations, and privacy and discovery. State and federal courts have relied on select publications of Mr. Colella in deciding questions of state and federal law.

Before joining Katten, Mr. Colella spent three years as a trial attorney for the Civil Division of the U.S. Department of Justice. Admitted through the Attorney General's Honors Program, he handled toxic-tort claims as well as a wide variety of other civil litigation issues at the federal trial and appellate levels. While at the Department, Mr. Colella represented various agencies of the federal government, including the Department of the Army, the Small Business Administration, and the Department of Energy.

Mr. Colella earned a B.A., with honors and distinction, from Stanford University, and his J.D. from Tulane Law School, where he served as the editor-in-chief of the Tulane Law Review. After graduating from law school, Mr. Colella served as a law clerk for the Honorable Carl E. Stewart, United States Court of Appeals for the Fifth Circuit.

Michael T. Korns is an associate in the Washington, D.C. office of **Katten Muchin Rosenman LLP**, who concentrates his practice in litigation matters.

Mr. Korns received his B.A., summa cum laude, in political science from the University of Pittsburgh, and his J.D. from Harvard Law School, where he was assistant articles editor for the Harvard Journal of Law and Public Policy. He is admitted to practice in the District of Columbia and Pennsylvania.