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SECOND CIRCUIT REVIEW

BY MARTIN FLUMENBAUM AND BRAD S. KARP

Merit-Based Class Cert Determinations

In this month's column, we discuss the U.S. Court of Appeals for the Second Circuit's notable decision in *Heerwagen v. Clear Channel Communications*, in which the court held that a district court, in determining whether to certify a class action, may consider the merits of the case.[1]

In reaching this conclusion, the Second Circuit distinguished a prior precedent that most commentators had believed placed the court at odds with many of its sister circuits.[2]

For years, the federal courts of appeals have struggled to reconcile two seemingly conflicting Supreme Court commands. In *General Telephone Co. v. Falcon*, the Supreme Court held that a district court may not certify a class action without first conducting a "rigorous analysis" as to whether the prerequisites have been met.[3]

But the Supreme Court also has stressed that class certification does not provide a district court with license to embark on a preliminary assessment of the action's underlying merits.[4] Several courts of appeals have taken the view that a merits inquiry is permissible to the extent necessary to determine whether the Rule 23 requirements for class certification have been met.[5]

Seven years ago, in *Caridad v. Metro-North Railroad Co.*, however, the Second Circuit appeared to take a different view, holding that it was "not appropriate" for the district court to "weigh[] conflicting expert testimony" because doing so would constitute an impermissible inquiry into the merits.[6]

But in *Clear Channel*, an opinion authored by Judge Richard J. Cardamone and joined by Judges Joseph M. McLaughlin and José A. Cabranes, the court decisively retreated from its position in *Caridad*, now holding that a merits inquiry is prohibited only if the class certification issue is "effectively identical" to the underlying merits. The *Clear Channel* decision thus sharply limits, if not overrules, *Caridad*, and brings the Second Circuit largely (though not completely) in line with its sister circuits.

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'Clear Channel' Litigation in District Court

In *Clear Channel*, plaintiff Malinda Heerwagen brought a putative nationwide class action against Clear Channel Communications and its subsidiaries, alleging that Clear Channel "used its national presence to set nationally uniform concert ticket prices for certain tours." In so doing, plaintiff alleged, Clear Channel maintained an illegal monopoly in violation of §2 of the Sherman Act.

A pivotal issue at the class certification stage was whether issues of fact common to all class members predominated over individual issues, as required by Rule 23(b)(3).[7] The predominance inquiry "boiled down to one pivotal question: whether the relevant market for assessment of plaintiff's §2 claim was national, thus justifying a national class."[8] In arguing against the existence of a national market, defendants relied on expert testimony that there was little cross-elasticity of demand for concert tickets across geographic areas. Defendants further pointed out that testimony from plaintiff herself and her expert bolstered their argument that markets were local, not national.[9]

After a three-day evidentiary hearing on the class certification question, District Judge John Sprizzo issued an order, holding: "[I]n light of the expert testimony adduced at the hearing, the Court concludes that the relevant market for concert tickets at the retail level is local, not national."[10] Accordingly, Judge Sprizzo ruled that plaintiff had failed to satisfy the predominance requirement in Rule 23(b)(3).

On appeal, plaintiff argued that the district court's predominance holding was erroneous in multiple respects. Plaintiff argued that the holding was erroneous insofar as the court had wrongly concluded that plaintiff had failed to establish a national market. Plaintiff also asserted that the district court had improperly considered the merits of her claim, relying on several of Judge Sprizzo's remarks during the hearing, including his observations that plaintiff was "required to make a predominance showing by a preponderance of the evidence," and that he was "weighing the weight" of conflicting expert testimony.[11] These and other comments on the record demonstrated, according to plaintiff, that the district court's denial of class certification was the result of an improper inquiry into the merits.

Establishing the Relevant Market

Plaintiff also argued that the district court had erred in two respects in determining that plaintiff had failed to prove the existence of a national market for concert ticket sales. First, plaintiff noted that in *Tops Markets, Inc. v. QualityMarkets, Inc.*, the Second Circuit had stated that monopoly power "may be proven directly by evidence of control of price or exclusion of competition, or it may be inferred from one firm's large percentage share of the relevant market."[12] According to plaintiff, because she could prove her antitrust claims with direct evidence of market power that is not dependent on reference to a specific geographic market, she was not required to prove separately the existence of a national market.[13] The *Clear Channel* court squarely rejected this argument, holding that "[p]laintiff's argument that she need not delineate a geographic market is one we cannot adopt." As the court observed, "the power to control prices or exclude competition only makes sense with reference to a particular market."[14]

Plaintiff also argued that, contrary to the district court's conclusion, she had established a national market because "Clear Channel's national course of alleged anticompetitive conduct alone is sufficient to render the relevant market national." Plaintiff relied on *United States v. Grinnell Corp.*, in which the Supreme Court had found a national market in a monopolization claim against suppliers of fire and burglar alarm services. Despite the fact that defendants could only sell the product within 25 miles of regional central service stations, the court affirmed the district court's holding that the market was national.[15]

The Second Circuit in *Clear Channel* held that "*Grinnell* is plainly distinguishable from the case before us." The Second Circuit explained that "there are no claims that Clear

Channel entered into any horizontal agreements, sold concert tickets pursuant to national contracts or marketed manufactured goods on a national basis."[16] The court went on to note that "[t]he Supreme Court's method of determining relevant geographic markets generally reference both the 'area in which the seller operates, and to which the purchaser can practicably turn for supplies.'"[17] Accordingly, the *Clear Channel* court held, "[l]ocal markets for tickets sales are not transformed into a national market simply because concert tours are coordinated nationally."

Predominance

• ***Proving Predominance by a Preponderance of the Evidence.*** The Second Circuit also rejected plaintiff's argument that the district court erred in holding plaintiff to a preponderance-of-the-evidence standard in demonstrating predominance of common issues. The court observed at the outset that, based on Judge Sprizzo's remarks during the hearing, "it is not evident that the trial court mandated a Rule 23(b)(3) showing by a preponderance of the evidence."[18]

But the Second Circuit reasoned that even if the district court had applied such a standard, it would have been appropriate because "[c]omplying with Rule 23(b)(3)'s predominance requirement cannot be shown by less than a preponderance of the evidence." Under a more permissive standard, the Second Circuit explained, a district court could certify a class "despite the motion judge's belief that it is more likely than not that individual issues would predominate." Such a result would run counter to the "express language of Rule 23(b)(3)," which requires that a court affirmatively "find[]" that common issues predominate. It would also frustrate the underlying purpose of Rule 23(b)(3) by permitting class actions to proceed without "ensur[ing] that the class is 'sufficiently cohesive to warrant adjudication by representation.'"[19]

Weighing the Evidence

The Second Circuit also rejected plaintiff's argument that the district court erred by weighing competing expert testimony on the proper definition of the market for retail concert ticket sales.

The Second Circuit noted that "Judge Sprizzo did in fact make comments suggesting that he compared the relative weight of the experts' testimony." The court also acknowledged that "[t]he district court is not permitted to conduct a preliminary inquiry into the merits of plaintiff's case at the class certification stage." Nevertheless, the Second Circuit held, "[e]ven assuming these comments [by Judge Sprizzo] amount to weighing the experts' testimony," the district court had not engaged in an impermissible inquiry into the merits.

In reaching this conclusion, the Second Circuit revisited its prior decision in *Caridad*, where the court had reversed a district court's denial of class certification on the grounds that the district court's weighing of conflicting expert testimony constituted an impermissible merits inquiry. In *Caridad*, plaintiffs, several African-American present and former employees of the Metro-North Commuter Railroad, alleged that the company's policy of delegating to supervisors the discretion to discipline and promote employees amounted to an organization-wide pattern of racial discrimination in violation of Title VII.

Plaintiffs sought to show that the Rule 23(a) requirements of commonality and typicality were satisfied through company-wide statistical data and sociological opinion, which evidenced a meaningful statistical disparity according to race. The district court, however, denied class certification, holding that "defendant has satisfied the Court that the plaintiffs' statistics, even taken most favorably to plaintiffs, cannot carry their burden here, because they fail to take account of the fact that different Metro-North positions have materially different individual rates of discipline and of promotion associated with them."[20]

On appeal, the Second Circuit acknowledged that "class certification would not be warranted absent some showing" that the requirements in Rule 23 had been met. But the *Caridad* court held that the district court had erred in "credit[ing] Metro-North's expert evidence over that of the Class Plaintiffs." "Such a weighing of the evidence," the Second Circuit held, "is not appropriate at this stage in the litigation."[21]

In *Clear Channel*, the Second Circuit gutted its holding in *Caridad*, reading it to prohibit a district court from weighing conflicting evidence only in that narrow band of cases where the class certification issue is "effectively identical" to the underlying merits issue. By contrast, in *Clear Channel*, the court held that "[w]hether Clear Channel is liable for monopolization on the one hand, and whether issues common to the class are likely to predominate, on the other hand, are sufficiently distinct that the district court did not prematurely rule on the merits by weighing the experts' testimony."[22] The Second Circuit further explained that, in finding that individual issues were likely to predominate,

> the district court resolved an independent fact question concerning the expected forms of proof in light of the specific factual allegations contained in the amended complaint. Some overlap with the ultimate review on the merits is an acceptable collateral consequence of the 'rigorous analysis' that courts must perform when determining whether Rule 23's requirements have been met, so long as it does not stem from a forbidden preliminary inquiry into the merits.[23]

The court thus found *Caridad* to be inapposite because the class certification and merits issues in the *Clear Channel* case are not "effectively identical." Accordingly, the Second Circuit held that the district court did not err in examining conflicting expert testimony on the market definition issue.

Class Certification

The Second Circuit in *Clear Channel* acknowledged that "[a] number of our sister circuits have determined more broadly that an inquiry into the merits of a claim is appropriate to the extent necessary to determine whether the requirements of Rule 23 have been met."[24] The *Clear Channel* plaintiff argued that the Second Circuit had adopted the contrary rule in *Caridad*,[25] but the *Clear Channel* court declined to read *Caridad* as setting forth a general rule prohibiting district courts from considering merits issues at the class certification stage. Instead, in *Clear Channel*, the Second Circuit has ruled that *Caridad* presents the exceptional case where there exists an extreme degree of overlap between the class certification and merits issues; as a general rule, the *Clear Channel* court has adopted the position of its sister circuits that merits issues are not off-limits to district courts grappling with whether or not to certify a class.

Clear Channel thus permits district courts to evaluate the evidence proffered by putative class action plaintiffs in support of class certification, to engage in a "rigorous analysis" as to whether the Rule 23 requirements have been satisfied and look beyond the pleadings and examine conflicting evidence. If, at the conclusion of its inquiry, plaintiff has failed to demonstrate, by a preponderance of the evidence, that the requirements for class certification have been met, then district courts in the Second Circuit should decline to certify the class, on the authority of *Clear Channel*.

Clear Channel looms as an enormously powerful weapon for defendants opposing class certification.

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1. No. 04-0699-CV, 2006 WL 45849, at *11 (2d Cir. Jan. 10, 2006).
2. See, e.g., David S. Evans, "Class Certification, the Merits, and Expert Evidence," 11 GEO. MASON L. REV. 1, 1-2 (2002).
3. 457 U.S. 147, 156 (1982).
4. *Eisen v. Carlisle & Jacquelin*, 417 U.S. 156, 177 (1974).
5. See *Bell v. Ascendant Solutions, Inc.*, 422 F.3d 307, 312-13 (5th Cir. 2005); *Blades v. Monsanto Co.*, 400 F.3d 562, 575 (8th Cir. 2005); *Gariety v. Grant Thornton, LLP*, 368 F.3d 356, 366 (4th Cir. 2004); *Valley Drug Co. v. Geneva Pharms., Inc.*, 350 F.3d 1181, 1188 n.15 (11th Cir. 2003); *Newton v. Merrill Lynch, Pierce, Fenner & Smith, Inc.*, 259 F.3d 154, 166-69 (3d Cir. 2002); *Szabo v. Bridgeport Machs., Inc.*, 249 F.3d 672, 676 (7th Cir. 2001).
6. 191 F.3d 283, 293 (2d Cir. 1999).
7. Fed. R. Civ. P. 23(b)(3) (providing that a class action may be maintained if, inter alia, "the court finds that the questions of law or fact common to the members of the class predominate over any questions affecting only individual members").
8. 2006 WL 45859, at *3.
9. Brief of Appellees at 20, *Heerwagen v. Clear Channel Commc'ns*, 2006 WL 45859 (2d Cir. Jan. 10, 2006) (No. 04-0699-CV).
10. *Heerwagen v. Clear Channel Entm't Inc.*, No. 02 Civ. 4503 (S.D.N.Y. Aug. 11, 2003) (summary order).
11. 2006 WL 45859, at *10-11.
12. 142 F.3d 90, 97-98 (2d Cir. 1997), quoted in Brief of Plaintiff-Appellant (hereinafter "Appellant's Brief") at 22, *Heerwagen v. Clear Channel Commc'ns*, 2006 WL 45859 (2d Cir. Jan. 10, 2006) (No. 04-0699-CV).
13. 2006 WL 45859, at *7.
14. Id.
15. 384 U.S. 563, 575-76 (1966).
16. 2006 WL 45859, at *9.
17. Id. (quoting *Tampa Elec. Co. v. Nashville Coal Co.*, 365 U.S. 280, 327 (1961)).
18. Id. at *11.
19. 2006 WL 45859, at *11 (quoting *Amchem Prods., Inc. v. Windsor*, 521 U.S. 591, 623 (1997)).
20. *Robinson v. Metro-North Commuter R.R. Co.*, 175 F.R.D. 46, 48 (S.D.N.Y. 1997).
21. 191 F.3d at 293.
22. 2006 WL 45859, at *10.
23. Id.
24. Id. at *11; see also supra note 5 (citing cases).
25. Appellant's Brief, supra note 12, at 22.