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Lessons From Reed V. Advocate Health Care

Law360, New York (October 22, 2009) -- On Sept. 29, 2009, Judge John F. Grady of the U.S. District Court for the Northern District of Illinois denied certification of a putative class of registered nurses in a lawsuit alleging that several Chicago area hospitals conspired to depress their pay in violation of federal antitrust law.

Judge Grady's decision shows that district courts are continuing to apply increasing scrutiny to expert opinion at the class certification stage.

The case, *Reed v. Advocate Health Care, et al.*, is one of five nurse wage-fixing lawsuits currently pending in district courts throughout the United States.

The Reed plaintiffs filed their case on June 20, 2006, the same day as nearly identical complaints were filed in federal courts in Albany, Memphis and San Antonio. Plaintiffs in Detroit filed a fifth lawsuit in December 2006.

In *Reed*, the plaintiffs alleged that hospitals in the Chicago metropolitan area conspired to depress registered nurse pay through their joint participation in wage and salary surveys and through informal, direct communications between hospital human resources employees.

The plaintiffs asserted two claims under Section 1 of the Sherman Act — a *per se* claim alleging a conspiracy to depress wages and a rule of reason claim alleging a conspiracy to exchange compensation information.

After nearly three years of fact and expert discovery, Judge Grady held four days of hearings on class certification on June 1 and 2 and July 14 and 15, 2009.

Judge Grady's 52-page opinion, issued two months after the parties filed their post-hearing briefs, is noteworthy in a number of respects.

First, the opinion shows that district courts outside the Third Circuit are applying *In re Hydrogen Peroxide Antitrust Litigation*, 552 F.3d 305 (3d Cir. 2008), in antitrust class certification decisions.

Indeed, to the author's knowledge, *Reed* is the first reported district court opinion in the Seventh Circuit to deny class certification following the principles articulated in *Hydrogen Peroxide*.

Judge Grady cited *Hydrogen Peroxide* several times in his opinion for the propositions that courts must resolve factual and legal disputes relevant to class certification, even if they overlap with the merits; that factual findings must be made by a preponderance of the evidence; that antitrust impact is critically important in evaluating predominance under Rule 23(b)(3), and plaintiffs have the burden of demonstrating that impact is capable of proof at trial that is common to the class; and that weighing expert opinion at the class certification stage is not only permissible, it is integral to a rigorous analysis of Rule 23.

In these respects, it should be noted that *Hydrogen Peroxide* actually codified — and Judge Grady followed — existing Seventh Circuit law.

Szabo v. Bridgeport Machines Inc., 249 F.3d 672, 676 (7th Cir. 2001), held that district judges should make whatever factual and legal inquiries are necessary under Rule 23, even if that requires a preliminary inquiry into the merits.

West v. Prudential Securities Inc., 282 F.3d 935, 938 (7th Cir. 2002), held that a clash between experts is not enough to certify a class and that district judges must squarely decide tough questions, even if doing so may affect the decision on the merits or means choosing between competing perspectives.

Indeed, *Hydrogen Peroxide* itself cited *Szabo* and *West* extensively. See *Hydrogen Peroxide*, 552 F.3d at 307, 316, 323, 324 & nn.15, 17, 18.

Hydrogen Peroxide's holding that district courts should weigh and resolve conflicting expert opinion at the class certification stage proved to be crucial to Judge Grady's ruling in *Reed*.

During four days of hearings, Judge Grady heard extensive arguments from both sides relating to the econometric model the plaintiffs' expert proposed to prove antitrust impact and damages on a class-wide basis.

The cornerstone of the expert's opinion that the alleged wage suppression conspiracy injured virtually all of the defendants' nurses was his so-called wedge analysis.

The plaintiffs' expert proffered an econometric model that purported to measure the hypothetical "competitive" wage for nurses in Chicago during the proposed class period and compare that "but-for" wage to the actual wages the defendants paid their nurses.

The analysis purported to calculate wage suppression based on a supply and demand graph that showed a “wedge” or departure in nurse wages from a theoretical model of a competitive market.

The wedge supposedly showed the difference between the hourly wage for nurses as determined by the expert’s calculation of demand and the hourly wage for nurses as determined by his calculation of supply.

The wedge analysis was critical to the plaintiffs’ argument that they could prove antitrust impact and damages with proof common to the class.

The defendants offered their own expert, who opined that the wedge analysis was conceptually flawed, lacked a basis in the economics literature, and was poorly executed.

Judge Grady dove deeply into the competing opinions of the parties’ experts and found that the methodologies of the plaintiffs’ expert were so unreliable that they were “essentially inadmissible.”

In what may be the most important aspect of the opinion for future antitrust class actions, Judge Grady was critical of the plaintiffs’ expert’s use of averages and regression methodology.

As a way to prove antitrust impact, the plaintiffs’ expert proposed an econometric model that resulted in a single estimated average percentage of wage suppression to be applied to all nurses in the class.

Judge Grady ruled that the expert’s reliance on averages was a “critical” flaw in his analysis.

In addition, as a “precursor” to his proposed damages methodologies, the plaintiffs’ expert ran a regression using individual nurse characteristics such as age, tenure, and employment status in an effort to control for the effects of those characteristics on nurse wages.

Judge Grady ruled that multiple regression analysis is not a “magic formula” and that the expert’s regression was “too imprecise” because it explained only 48 percent to 63 percent of the variance in nurse wages.

In delving into the parties’ competing expert opinions, Judge Grady rejected two arguments that have started to gain some currency among plaintiffs seeking certification of antitrust class actions.

First, the plaintiffs in Reed relied heavily at the class certification hearing and in their briefs on *In re Ethylene Propylene Diene Monomer (EPDM) Antitrust Litigation*, 256

F.R.D. 82, 100 (D. Conn. 2009), for the notion that at the class certification stage, they only needed to offer a model that was workable, not one that actually works.

While Judge Grady did not cite EPDM in his decision, he found that the “works versus workable” distinction was unhelpful and rejected the plaintiffs’ argument because it seemed to suggest that the court should not subject their expert’s models to rigorous analysis.

According to Judge Grady’s opinion, a rigorous analysis of expert opinion is not only appropriate, it is “necessary.”

The second argument Judge Grady rejected was plaintiffs’ contention that the conflict in the experts’ opinions amounted to a “battle of the experts” that was better resolved by a jury.

Judge Grady rejected that argument, holding that the reliability of an expert’s methods is “integral” to Rule 23.

Judge Grady’s decision also addresses the role of *Daubert v. Merrell Dow Pharmaceuticals Inc.*, 509 U.S. 579 (1993), in class proceedings. Contemporaneous with their brief in opposition to class certification, the defendants filed a motion to strike the impact and damages analyses of the plaintiffs’ expert under *Daubert*.

In a footnote, Judge Grady noted that the Federal Rules of Evidence apply to proceedings under Rule 23 and that a “full-blown” *Daubert* inquiry is appropriate at the class certification stage.

Judge Grady found that the expert’s testimony was “essentially inadmissible” because the expert did not apply econometric principles and methods reliably to the facts of the case.

However, Judge Grady denied the defendants’ *Daubert* motion because, in order to reach that conclusion, he had to examine the weight of the expert’s analyses to the same degree that he would have if he had ruled them to be admissible and simply held against the plaintiffs on the substance of those analyses.

The plaintiffs also offered a factual argument in support of their contention that they could prove antitrust impact on a classwide basis.

According to the plaintiffs, the defendant hospitals set wages for registered nurses according to standardized wage “grids” that were purportedly tied to the wage and salary surveys.

Judge Grady found that the defendants only used grids for starting nurses, not experienced nurses, and that the defendants’ compensation data showed that the hospitals did not use the survey data in a uniform or systematic way.

Plaintiffs have not appealed or moved to reconsider Judge Grady's ruling.

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