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Supreme Court Holds That Proof Of Materiality Is Not A Prerequisite To Certification Of Fraud-On-The-Market Securities Class Actions

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On February 27, 2013, the United States Supreme Court issued its decision in *Amgen Inc. v. Connecticut Retirement Plans & Trust Funds*, No. 11-1085, 568 U.S. __ (2013). In an opinion authored by Justice Ginsburg,[1] the Supreme Court affirmed the decision of the U.S. Court of Appeals for the Ninth Circuit and held that securities plaintiffs do not have to prove materiality as a prerequisite to class certification under Federal Rule of Civil Procedure 23(b)(3). The decision resolved a split on this issue among the Courts of Appeals. *Compare Conn. Ret. Plans & Trust Funds v. Amgen, Inc.*, 660 F. 3d 1170 (9th Cir. 2011) and *Schleicher v. Wendt*, 618 F. 3d 679 (7th Cir. 2010) (materiality need not be proved at the class-certification stage), with *In re Salomon Analyst Metromedia Litig.*, 544 F. 3d 474 (2d Cir. 2008) (plaintiff must prove, and defendant may present evidence rebutting, materiality before class certification); *see also In re DVI, Inc. Sec. Litig.*, 639 F. 3d 623 (3d Cir. 2011) (plaintiff need not prove materiality before class certification, but defendant may present rebuttal evidence on the issue).

Plaintiff, the Connecticut Retirement Plans and Trust Funds (Plaintiff), brought this securities fraud action on behalf of a putative class of shareholders of Amgen, Inc. (Amgen) based on Amgen's alleged "misrepresentations and misleading omissions regarding the safety, efficacy, and marketing of two of its flagship drugs," which Plaintiff contended artificially inflated the price of Amgen's stock. Slip. Op. at 6. In order to establish class-wide reliance, Plaintiff invoked the "fraud-on-the-market" theory articulated by the Supreme Court in *Basic, Inc. v. Levinson*, 485 U.S. 224 (1988). The fraud-on-the-market theory permits a rebuttable presumption "that the price of a security traded in an efficient market will reflect all publicly available information about a company; accordingly, a buyer of the security may be presumed to have relied on that information in purchasing the security." Slip. Op. at 1. Amgen conceded the efficiency of the market and did not contest the public character of the allegedly fraudulent statements. *Id.* Amgen argued, however, that Plaintiff was required to prove that the allegedly fraudulent statements materially affected Amgen's stock price in order to meet Rule 23(b)(3)'s requirement that "the questions of law or fact common to class members predominate over any questions affecting only individual members." *Id.* at 2.

The District Court granted Plaintiff's motion for class certification, finding that Plaintiff satisfied all the prerequisites of Rule 23(a) and (b). *Conn. Ret. Plans & Trust Funds v. Amgen, Inc.*, No. 2:07-cv-02536, 2009 WL 2633743 (Aug. 12, 2009). Notably, the District Court found that to trigger the fraud-on-the-market theory's presumption of reliance, Plaintiff only needed to establish that an efficient market existed, and that "[other inquiries into issues such as materiality . . . are properly taken up at a later stage in this proceeding." *Id.* at *12. The District Court also rejected

Amgen's attempt to rebut the presumption of reliance by showing that the "truth" was known to the market, finding that to be a matter for trial or summary judgment. *Id.* at 12-14.

After granting Amgen's request to take an interlocutory appeal from the class-certification order, the Ninth Circuit affirmed the District Court. 660 F. 3d 1170. On appeal to the Ninth Circuit, Amgen argued that the District Court erred by certifying the class without first requiring Plaintiff to prove that Amgen's alleged misrepresentations and omissions were material. *Id.* at 1175. The Ninth Circuit rejected that contention, finding that "[the problem with that argument is that, because materiality is an element of the *merits* of their securities fraud claim, the plaintiffs cannot both fail to prove materiality yet still have a viable claim for which they would need to prove reliance individually." *Id.* (emphasis in original). The Ninth Circuit concluded that "because proof of materiality is not necessary to ensure that the question of reliance is common among all prospective class members' securities fraud claims, we hold that plaintiffs need not *prove* materiality to avail themselves of the fraud-on-the-market presumption of reliance at the class certification stage." *Id.* at 1177 (emphasis in original). The Ninth Circuit also rejected Amgen's claim that the District Court erred by not affording it an opportunity to rebut the fraud-on-the-market presumption at the class certification stage, stating that such a "truth-on-the-market defense is a method of refuting an alleged misrepresentation's *materiality*," which is a "merits issue." *Id.* (emphasis in original).

On appeal to the Supreme Court, Amgen primarily argued that to meet Rule 23(b)(3)'s predominance requirement, Plaintiff must prove – *before class certification* – that Amgen's alleged misrepresentations and omissions materially affected its stock price. Slip. Op. at 2, 10. Amgen also argued that "policy considerations" favored requiring precertification proof of materiality (*id.* at 18) and that it should have been permitted to offer rebuttal evidence opposing Plaintiff's class certification motion (*id.* at 24).

Affirming the Ninth Circuit, the Supreme Court rejected each of Amgen's arguments. To begin, it found that materiality is judged according to an objective standard, and therefore the materiality of Amgen's alleged misrepresentations and omissions is a question common to all potential class members. *Id.* at 11. It further explained that failing to prove the common question of materiality would not result in individual questions predominating; rather, it would end the case because materiality is an essential element of a Rule 10b-5 claim. *Id.*

The Supreme Court disagreed with Amgen's argument that materiality must be proved before class certification like other fraud-on-the-market predicates, such as market efficiency and publicity. *Id.* at 15. The Supreme Court stated that while market efficiency, publicity, and materiality are all fraud-on-the-market predicates, only materiality is an indispensable element of a Rule 10b-5 claim and it can be proven at the summary judgment or trial stages post-class certification. *Id.* at 16-17. The Supreme Court also held that the District Court did not err in disregarding Amgen's attempt to present a "truth-on-the-market" rebuttal defense because, if proved, it would destroy the fraud-on-the-market presumption and end the litigation. *Id.* at 25. Thus, rebuttal evidence was correctly reserved for summary judgment or trial. *Id.* at 26.

Citing the Private Securities Litigation Reform Act of 1995 and the Securities Litigation Uniform Standards Act of 1998, the Supreme Court rejected Amgen's policy argument, stating that "Congress, we count it significant, has addressed the settlement pressures associated with securities-fraud class actions through means other than requiring proof of materiality at the class-certification stage." *Id.* at 19-20. The Supreme Court further reasoned that, contrary to

Amgen's position, requiring proof of materiality before class certification would waste judicial resources by necessitating a "mini-trial." *Id.* at 21.

In dissent, Justice Thomas reasoned that materiality is a prerequisite to the fraud-on-the-market presumption, without which individualized questions of reliance would predominate. *Id.* at 1 (Thomas, J., dissenting). Addressing the majority's position that materiality is a merits inquiry, Thomas responded that, if a plaintiff fails to establish materiality at the merits stage, "the class should not have been certified in the first place, because reliance was never a common question." *Id.* at 2. Thomas also pointed out that *Basic*'s presumption had been established in a four-Justice opinion. *Id.* at 4, n.4. In a short dissent, Justice Scalia criticized the majority for misinterpreting *Basic* to establish a regime in which "*all* market-purchase and market-sale class action suits [pass beyond the crucial class certification stage] no matter what the alleged misrepresentation." *Id.* at 4 (Scalia, J. dissenting) (emphasis in original). Notably, Justice Alito filed a concurring opinion that agreed with the majority's reasoning but suggested "reconsideration of the *Basic* presumption" because the fraud-on-the-market theory "may rest on a faulty economic premise." *Id.* at 1 (Alito, J., concurring).

The Supreme Court's decision is significant because it may increase the pressure on class action defendants to settle claims that survive a motion to dismiss in order to avoid the substantial cost of litigation. In holding that materiality issues are not properly resolved at the class certification stage, the Supreme Court has eliminated a basis for defendants to dispose of meritless class action lawsuits prior to engaging in costly and time-consuming discovery. Given that so many class actions settle after a class is certified, the majority's position that materiality can be rebutted at the merits stage will often prove illusory. In light of the questions raised by the dissent and concurrence, the defense bar is likely to soon mount a challenge to the "economic premise" of the fraud-on-the-market theory in an effort to avoid incurring the expense of litigating class actions which relate to non-material disclosures and omissions.

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[1] Chief Justice Roberts and Justices Breyer, Alito, Sotomayor and Kagan joined in Ginsburg's majority opinion. Justice Alito filed a concurring opinion. Justice Scalia filed a dissenting opinion, as did Justice Thomas, which Justice Kennedy joined and Justice Scalia joined in part.