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A Rare Victory for the Plaintiffs' Bar: US Supreme Court Holds That Materiality of Alleged Misrepresentations Need Not Be Proven at Class-Certification Phase in Securities Fraud Cases

On February 27, 2013, the US Supreme Court decided *Amgen Inc. v. Connecticut Retirement Plans and Trust Funds*, 568 US ___ (2013), a securities fraud class action against Amgen Inc., one of the world's largest independent biotechnology companies. In a 6-3 decision, the Court ruled that at the class-certification stage—i.e., well before any trial in the case—plaintiffs in securities fraud suits are not required to prove that alleged misrepresentations or omissions were material in order to use the fraud-on-the-market presumption to establish that common questions predominate as to the proposed class. The Court further held that courts need not consider at the class-certification stage evidence put forward by defendants challenging the materiality of such misrepresentations or omissions. Although a (rare) victory for the plaintiffs' class action bar, plaintiffs in securities cases still face significant hurdles in moving class action securities cases forward. Hence, it is unclear whether *Amgen* will significantly alter the dynamics of large securities fraud cases.

Background

In 2007, a group of pension funds sued Amgen on behalf of purchasers of the company's stock. The pension funds claimed securities fraud under US securities laws, alleging that the company reassured investors that anemia drugs Aranesp and Epogen were safe while clinical trial data raised concerns that the drugs could harm cancer patients. The pension funds argued that the share price of Amgen's shares dropped when the truth was disclosed about the drugs.

In opposing plaintiffs' motion for class certification, Amgen argued that the plaintiffs were required to establish the materiality of the misrepresentations in order to invoke the so-called fraud-on-the-market presumption. Under this presumption, it is presumed that all members of the market for Amgen's shares relied on available public information and so could have been similarly misled by the alleged misrepresentations. The company presented evidence that the alleged misrepresentations were immaterial because the truth had been disclosed to the market at the time the challenged statements were made. Nevertheless, the federal district court granted plaintiffs' motion for class certification.

On appeal, the company alleged that the district court erred by certifying the proposed class without first requiring plaintiffs to prove that its alleged misrepresentations and omissions were material. The company also contended that the district court erred by refusing to consider its rebuttal evidence in opposition to plaintiff's motion for class certification.

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The Ninth Circuit Court of Appeals rejected the company's arguments and affirmed, concluding that (i) plaintiffs did not need to prove the alleged misrepresentations were material to show that common questions of law or fact predominate and (ii) defendants could not rebut the fraud-on-the-market presumption at the class-certification stage with evidence refuting the materiality of the alleged misrepresentations.

Federal Rule 23 and the Amgen Case

To establish a securities fraud claim under section 10b of the Securities Exchange Act of 1934, a plaintiff must prove "(1) a material representation or omission by the defendant; (2) scienter; (3) a connection between the misrepresentation or omission and the purchase or sale of a security; (4) reliance upon the misrepresentation or omission; (5) economic loss; and (6) loss causation."[1] To certify a class, plaintiffs must establish that the class meets the requirements of Rule 23 of the Federal Rules of Civil Procedure, including the requirement under Rule 23(b)(3) that "questions of law or fact common to class members predominate over any questions affecting only individual members."

Thus to certify a class in a securities fraud case, plaintiffs must show that reliance on the alleged misrepresentation or omission is common to the whole class of alleged victims who bought or sold the securities at issue. However, the Supreme Court has recognized that plaintiffs may rely on a fraud-on-the-market presumption to establish reliance.[2] Under the fraud-on-the-market presumption, the Court will presume that the price of a security traded in an open, efficient market incorporates all publicly available information. Therefore it may be presumed that an investor relies on the alleged misrepresentations through a reliance on the integrity of the market price. To invoke the fraud-on-the-market presumption, a plaintiff must establish that (1) the security traded in an open, efficient market; (2) the alleged misrepresentations were publicly made; and (3) relevant transactions took place between the time the misrepresentations were made and the time of the corrective disclosures. Before *Amgen*, there was a split among the US circuit courts as to whether, at the class-certification stage, plaintiffs also needed to prove that the misrepresentations were material—that is, that a reasonable person would have found the information relevant to making a decision to buy, sell or hold the securities in question.

The Supreme Court's Decision

The Supreme Court affirmed the decision of the Ninth Circuit that certification of the class was proper. The Court ruled 6-3 in a decision penned by Justice Ruth Bader Ginsberg that the predominance requirement was satisfied for the purposes of class certification based on the fraud-on-the-market presumption, and the question of materiality was properly deferred until summary judgment or trial (i.e., later phases of the case that would follow pre-trial discovery). In so ruling, the Court resolved a conflict among the Courts of Appeals and overruled established precedent in the Second and Third Circuits.[3]

While the Court recognized that materiality is an essential predicate of the fraud-on-the-market theory, it nonetheless held for two reasons that proof of materiality was not needed to ensure that common questions predominate.[4] First, the Court explained, materiality is a "common question" for purposes of Rule 23(b)(3). Materiality is judged on an objective standard, and thus can be proven through evidence common to the class. Second, a failure of proof on the common question of materiality will not result in individual questions predominating. Materiality is also an essential element of a Rule 10b-5 claim, and without it, the Rule 10b-5 class will fail in its entirety, and there will be no remaining individual questions to adjudicate.

Significantly, for the same reason, the Court also held that the lower courts were correct in disregarding Amgen's rebuttal evidence aimed at proving that the alleged misrepresentations and omissions were immaterial at the class-certification stage. "[J]ust as a plaintiff class's inability to prove materiality creates no risk that individual questions will predominate," the Court reasoned, "so even a definitive rebuttal on the issue of materiality would not undermine the predominance of questions common to the class."[5] Proof of materiality, therefore, is "not required to establish that a proposed class is sufficiently cohesive to warrant adjudication by representation—the focus of the predominance inquiry under Rule 23(b)(3)."[6]

1 Op. at 3-4 (*citing Matrixx Initiatives, Inc. v. Siracusano*, 563 US __, __ (2011) (slip op., at 9) (internal quotation marks omitted)).

2 *Basic Inc. v. Levinson*, 485 US 224, 245 (1988).

3 *See In re Salomon Analyst Metro. Litig.*, 544 F.3d 474, 484-85, 486 n. 9 (2d Cir. 2008) (plaintiff must prove, and defendant may present evidence rebutting, materiality at class-certification stage); *In re DVI, Inc. Secs. Litig.*, 639 F.3d 623, 631-32, 637-38 (3d Cir. 2011) (plaintiff need not prove, but defendant may present evidence rebutting, materiality at class-certification stage).

4 Op. at 10-11.

5 Op. at 25.

6 Op. at 12 (internal quotation marks omitted). Plaintiffs must still prove the predicates of market efficiency and publicity to benefit from the fraud-on-the-market presumption, however. The Court explained that materiality differs from these predicates because "the failure of common, classwide proof on the issues of market efficiency and publicity leaves open the prospect of individualized proof of reliance, [while] the failure of common proof on the issue of materiality ends the case for the class and for all individuals alleged to compose the class." Op. at 17.

Although raised by the Court in other cases involving securities fraud class action cases, the Court also dismissed concerns that the *in terrorem* effect of class certification (in which companies potentially face damages multiplied by all the potential class members, as opposed to just the named plaintiffs) weighed in favor of addressing the materiality question at the certification stage.[7] The Court explained that the question of materiality does not differ from proving the other essential elements of a Rule 10b-5 claim on the merits, on summary judgment or at trial.[8] Moreover, Congress addressed these *in terrorem* concerns when it introduced heightened pleading standards for plaintiffs in securities fraud cases under the Private Securities Litigation Reform Act of 1995 and the Securities Litigation Uniform Standards Act of 1998. Nor did the Court believe that requiring proof of materiality before class certification would conserve judicial resources because it would "necessitate a mini-trial on the issue of materiality at the class-certification stage."[9]

Implications of the *Amgen* Decision

Amgen is significant because it failed to raise the bar further for plaintiffs seeking class certification in securities fraud actions. However, the decision does not necessarily pave the way for certifed classes in all securities fraud suits. Defendants still have the opportunity to challenge materiality under existing pleading standards, and to raise substantive challenges to class certification under Rule 23.[10] As the Supreme Court made clear in *Wal-Mart*, "Rule 23 does not set forth a mere pleading standard" and a plaintiff seeking class certification "must be prepared to prove" that he has met the Rule 23 prerequisites, regardless whether such proof ends up duplicating questions of fact or law that will need to be demonstrated in order to prevail on the merits.[11]

Moreover, *Amgen* merely affirmed existing law in the Seventh and Ninth Circuits, where plaintiffs are not required to prove materiality for class certification. The Court's decision only overturned established precedent in the Second and Third Circuits.[12]

Interestingly, four Justices also questioned the Court's reliance on the fraud-on-the-market presumption, perhaps foreshadowing the possibility that the Court may soon revisit the issue. If so, this would be a significant development, as that theory is a linchpin in securities fraud cases where it would be impractical for plaintiffs to have to plead and prove reliance one securities holder at a time.

7 Op. at 18-19; *see also Dura Pharms., Inc. v. Broudo*, 544 U.S. 336, 347-48 (2005); *Tellabs, Inc. v. Makor Issues & Rights, Ltd.*, 551 US 308, 313 (2007); *Stoneridge Inv. Partners, LLC v. Scientific-Atlanta, Inc.*, 552 US 148, 163-64 (2008).

8 Op. at 18-19.

9 Op. at 21.

10 For example, under the Supreme Court's decisions in *Ashcroft v. Iqbal*, 556 US 662 (2009) and *Bell Atlantic Corp. v. Twombly*, 55 US 544 (2007), plaintiffs must plead facts sufficient to make a plausible case for materiality. A case has "plausibility when the plaintiff pleads factual content that allows the court to draw the reasonable inference that the defendant is liable for the misconduct alleged." *Iqbal*, 556 US at 663. Thus, to defeat class certification, defendants may still show that plaintiffs have failed to plead facts sufficient to show that a reasonable person would have found the information relevant to making a decision to buy, sell or hold the securities in question.

11 564 US ___, 131 S.Ct. 2541, 2551 (2011)

12 *See supra* n. 3.