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The Material Impact of the Amgen Decision on D&O Insurance

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In *Amgen, Inc. v. Connecticut Retirement Plans and Trust Funds*, No. 11-1085 (Slip Op. Feb. 27, 2013), the U.S. Supreme Court, in a 6-3 majority opinion (Ginsburg, J.), affirmed the U.S. Court of Appeals for the 9th Circuit's ruling that a securities class action plaintiff need not prove materiality of alleged misrepresentations or misleading omissions as a prerequisite to class certification under Fed. R. Civ. P. 23. Justices Kennedy, Scalia, and Thomas dissented. Justice Alito concurred with the majority but added a separate and important note (discussed below). The Court's decision lowers the bar for investors seeking to obtain class certification, which has significant implications for D&O insurers, companies, their Directors and Officers (Ds and Os), and securities fraud plaintiffs alike. The Court's ruling in *Amgen* also settles a split among the 2nd, 3rd, 7th, and 9th Circuits. Although the ruling is clearly favorable to securities fraud class action plaintiffs, the four concurring and dissenting justices appear willing to entertain arguments over the continued validity of the fraud-on-the-market presumption, which could drastically alter the landscape for securities class actions.

In *Amgen*, Connecticut Retirement Plans and Trust Funds (CRPTF) filed suit against Amgen and several of its Ds and Os under § 10(b) of the Securities Exchange Act of 1934 and Rule 10b-5 stemming from certain alleged "misrepresentations and misleading omissions regarding the safety, efficacy, and marketing of two of its flagship drugs." Slip. Op. at 6. CRPTF sought class certification under Rule 23 and invoked the fraud-on-the-market presumption endorsed 25 years ago by the Court in *Basic, Inc. v. Levinson*, 485 U.S. 224 (1988). The presumption allows plaintiffs to satisfy the reliance element of the § 10(b) private cause of action in class actions without proving that each member of the class actually relied on the alleged misrepresentation or omission.

In *Basic*, the Court recognized that "requiring proof of direct reliance would place an unnecessarily unrealistic evidentiary burden on [a] plaintiff who has traded on an impersonal market." *Id.* at 4 (quoting *Basic*). The *Basic* Court thus held that "if a market is shown to be efficient, courts may presume that investors who traded securities in that market relied on public, material misrepresentations regarding those securities." *Id.* at 5. This gives rise to 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 [including any misrepresentations or misleading omissions] in purchasing the security." *Id.* at 1. The presumption is critical to securities fraud class action plaintiffs because, without it, individual issues of reliance would predominate, thereby precluding class certification.

The specific issue before the Court in *Amgen* was whether a plaintiff was required to prove materiality as a prerequisite to obtaining class certification. *Id.* at 3. Amgen argued a class action plaintiff must *prove* at the certification stage that the alleged misrepresentations and misleading omissions materially affected Amgen's stock price. It based this argument on the premise that materiality, like the existence of an efficient market and trading during the class period, is a prerequisite for invoking the *Basic* presumption, without which certification would not be possible. Alternatively, Amgen argued the lower courts erred by refusing to consider evidence offered by Amgen to rebut materiality in opposition to CRPTF's certification motion.

The Court granted *certiorari* to resolve a split in which the 2nd Circuit held a plaintiff must prove materiality but the defendant could present rebuttal evidence prior to certification; the 3rd Circuit held a plaintiff need not prove materiality but a defendant

was entitled to present rebuttal evidence prior to certification; and the 7th and 9th Circuits held that materiality need not be proven at the certification stage.

Timing of Proof

The majority agreed with the 7th and 9th Circuits that "while [CRPTF] certainly must prove materiality to prevail on the merits … such proof is not a prerequisite to class certification." The majority observed that materiality is both a substantive element of a 10b-5 claim itself and is also "indisputably" an essential predicate to the fraud-on-the-market presumption. *Id.* at 10. The majority stressed, however, that Rule 23 requires only a showing that *questions* common to the class predominate, but not that those questions must be answered at the class certification stage. *Id.* at 2. The Court explained that, although courts may consider limited merits questions to determine whether certification is proper, "Rule 23 grants courts no license to engage in free-ranging merits inquiries at the certification stage." *Id.* at 9.

The difference of opinion between the majority and the dissenters focused on the *timing* of when materiality should be required to be proven, *i.e.* before or after certification. Justice Thomas's dissent, in contrast to the majority, took the view that a plaintiff's failure to establish materiality would mean the presumption never should have applied and the class never should have been certified in the first place under Rule 23. *Id.* at 2. The dissent traced the development of the fraud-on-the-market presumption, to argue that the presumption of reliance stemmed from the *materiality* of the misrepresentation or omission itself and that, therefore, materiality must be proven prior to invoking the presumption. *See id.* at 14 ("Materiality was not merely an important factor that allowed reliance to be presumed at certification; materiality was *the* factor." (emphasis in original).

Predominance

The majority also reasoned that delaying proof of materiality to a later stage of the case would not affect the predominance requirement of Rule 23(b)(3). According to the majority, because materiality is judged by an *objective standard*, any misstatements or omissions would either be commonly material or commonly immaterial to the class as a whole, and thus individual questions would never predominate over common ones. *Id.* at 11. Thus, the class would either "prevail or fail in unison." *Id.* at 3. The dissent, on the other hand, presumed that a lack of materiality, and therefore the non-application of the fraud-on-the-market presumption, would lead to individual questions of reliance predominating over questions common to the class as a whole.

Public Policy

The Court also rejected Amgen's public policy arguments. Amgen observed that the mere entry of an order certifying a class "can exert substantial pressure on a defendant to settle rather than incur the costs of defending a class action and run the risk of potentially ruinous liability." *Id.* at 15. Amgen pointed out that the issue of materiality, if not addressed early on at the certification stage, likely would never be addressed due to the overwhelming percentages of securities fraud cases that settle. Justice Scalia expressed similar concerns in his separate dissenting opinion.

The majority, however, found it significant that Congress, in enacting legislation like the Private Securities Litigation Reform Act (PSLRA) and the Securities Litigation Uniform Standards Act (SLUSA), considered the settlement pressures voiced by Amgen but still saw fit to act "through means other than requiring proof of materiality at the class certification stage." *Id.* at 19. According to the majority, Congress was well aware of the potential for abuse and the extraction of "extortionate settlements" but chose to address these concerns by imposing heightened pleading requirements, limiting recoverable damages and attorneys' fees, and by imposing other restrictions. *Id.* at 19-20.

In fact, Congress specifically "rejected calls to undo the fraud-on-the-market presumption" and the majority was therefore of the opinion that it should not substitute its own judgment for that of Congress. *Id.* at 19-22. The majority pointed out that private securities actions have been recognized by all three branches of government as an "essential supplement" to criminal and civil enforcement by the DOJ and SEC and that, despite Amgen's position, a pre-certification materiality requirement would actually serve to increase the burden (not spare) judicial resources because it would necessitate mini-trials on materiality at the certification stage. *Id.*

Concurring and Dissenting Opinions

In a single paragraph, Justice Alito concurred with the majority but noted that, "[a]s the dissent observes, more recent evidence suggests that the presumption may rest on a faulty economic premise. In light of this development, reconsideration of the *Basic* presumption may be appropriate."[1] Justice Thomas's dissent noted in a lengthy footnote that the *Basic* decision is questionable. *Id.* at 4 n. 4. Justice Thomas explained that *Basic* was decided by a majority of only four of six justices (a bare quorum), that it was based on an economic theory rather than traditional legal analysis, and that questions exist as to whether market efficiency operates differently depending on the information at issue.

Conclusion

In the final analysis, *Amgen* is a victory for the plaintiffs securities class action bar. Although materiality remains an essential element of plaintiff's case, it will no longer be available as an issue on which defendants may challenge class certification. For defendants and their D&O insurers, this is unwelcome news.

Extremely few securities class actions ever reach trial because of the high risk that an adverse class judgment bears for the defendants. The huge expense of conducting discovery also discourages taking a case to the summary judgment stage. In such an environment, the crucial strategy for plaintiffs is to survive dismissal, obtain class certification, and negotiate a settlement. By removing a tool for challenging class certification from the defense toolkit, *Amgen* increases plaintiffs' odds of reaching the settlement goal line.

Defendants and their insurers, however, may take some small comfort from the concurring and dissenting opinions indicating that several of the justices seem open to revisiting the fraud-on-the-market presumption of reliance in a proper case. Any limitation on the use of that presumption may prove to be a far greater obstacle to securities class actions than that of challenging materiality at the certification stage.

1 Justice Alito, like the majority and dissenters, cited to Donald C. Langevoort, *Basic at Twenty: Rethinking Fraud on the Market*, 2009 Wis. L. Rev. 151 (2009). Indeed, Justice Ginsburg writing for the majority also noted: "this case is a poor vehicle for exploring whatever implications the research Amgen cites may have for the fraud-on-the-market presumption recognized in *Basic*. . . . Amgen conceded in its answer that the market for its securities is 'efficient' and thus 'promptly digest[s] current information regarding Amgen from all publicly available sources and reflect[s] such information in Amgen's stock price.'"

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