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LEGAL ALERT

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Supreme Court Decides Materiality Need Not Be Demonstrated for Class Certification

This morning the United States Supreme Court affirmed class certification in *Amgen, Inc. v. Connecticut Retirement Plans and Trust Funds*, a securities fraud case. The question presented was whether plaintiffs seeking class certification under Fed. R. Civ. P. Rule 23(b)(3) of a claim for securities fraud and relying on a "fraud-on-the-market" presumption must prove the materiality of the alleged misstatements and omissions as a prerequisite to class certification. The Court held that materiality need not be proved at that stage.

The *Amgen* plaintiffs brought claims for securities fraud based on alleged misstatements and omissions by Amgen and several of its officers. To establish the required reliance, the plaintiffs invoked the "fraud-on-the-market" presumption endorsed by the Supreme Court in *Basic, Inc. v. Levinson*, 485 U.S. 224 (1988). In *Basic*, the Court had held that it was not inappropriate to apply a rebuttable presumption "that persons who traded Basic shares had done so in reliance on the integrity of the price set by the market, but because of petitioners' material misstatements that price had been fraudulently depressed." *Basic*, 485 U.S. at 245. The question presented in *Amgen* was whether "materiality" had to be proven (or rebutted) at the class-certification stage in a putative class action under § 10(b) and Rule 10b-5.[1]

In a majority opinion written by Justice Ginsburg, the Court held that materiality need not be proven as a prerequisite to class certification. Key to the holding was the fact that "materiality" would be decided by an objective standard: "Because materiality is judged according to an objective standard, the materiality of Amgen's alleged misrepresentations and omissions, whether material or immaterial, would be so equally for all investors composing the class." (Slip Op. at 2.) If the alleged misrepresentations were material, they would by definition have affected the open market price, establishing reliance for all class members.[2] Conversely, if the alleged misrepresentations were *not* material, they would not have affected the open market price, dooming a claim of reliance by any class member. And so there could not be individualized answers to the question whether the alleged misrepresentations were material, because an objective standard of materiality would be applied in any case. Slip Op. at 11 ("there is no risk whatever that a failure of proof on the common question of materiality will result in individual questions predominating"). Therefore, the Court held, "materiality" is always a common question within the meaning of Rule 23(b)(3) in a securities fraud case involving an alleged "fraud on the market." For essentially the same reasons, the Court rejected Amgen's argument that evidence rebutting the presumption of reliance should be allowed at the class-certification stage. (Slip Op. at 25 ("just as a plaintiff class's inability to

[1] There had been a circuit split on the issue, with the Seventh and Ninth Circuits holding that materiality need not be proved at the class-certification stage, see *Amgen*, 660 F.3d 1170 (9th Cir. 2011); *Schleicher v. Wendt*, 618 F.3d 679 (7th Cir. 2010); the Second Circuit holding that the plaintiff must prove, and the defendant may rebut, materiality at the class-certification stage, *see In re Salomon Analyst Metromedia Litig.*, 544 F.3d 474 (2d Cir. 2008); and the Third Circuit holding that a plaintiff need not prove materiality before class certification, but a defendant could present rebuttal evidence at the class-certification stage, *see In re DVI, Inc. Sec. Litig.*, 639 F.3d 623 (3d Cir. 2011).

[2] Amgen conceded the efficiency of the market for the securities at issue and did not contest the public character of the allegedly fraudulent statements. (Slip Op. at 1.)

prove materiality creates no risk that individual questions will predominate, so even a definitive rebuttal on the issue of materiality would not undermine the predominance of questions common to the class").

The Court disagreed with Amgen's argument that not requiring materiality at class certification would be inconsistent with the Court's statement in *Erica P. John Fund, Inc. v. Halliburton Co.*, ___ U.S. ___, 131 S. Ct. 2179 (2011) that market efficiency and the public nature of the alleged misrepresentations must be proved before a class may be certified in a securities fraud case. "Materiality . . . differs from the market-efficiency and publicity predicates in this critical respect: While the failure of common, classwide proof on the issues of market efficiency and publicity leaves open the prospect of individualized proof of reliance, 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." (Slip Op. at 17.)

The Court also rejected Amgen's argument that "policy considerations" – notably the settlement pressure brought to bear by an order certifying a class – militated in favor of requiring proof of materiality before allowing class certification based on the "fraud on the market" presumption. (Slip Op. at 18.) Congress, the Court noted, "has addressed the settlement pressures associated with securities-fraud class actions through means other than requiring proof of materiality at the class-certification stage" – in its enactment of the Private Securities Litigation Reform Act – but "rejected calls to undo the fraud-on-the-market presumption of classwide reliance endorsed in *Basic.*" (Slip Op. at 19-20.)

Justice Scalia filed a dissenting opinion citing the Court's observation in *Wal-Mart Stores, Inc. v. Dukes*, 564 U.S. ___ (2011) that "Rule 23 does not set forth a mere pleading standard"; observing that reliance is a requirement not only for substantive liability for securities fraud, but also for class certification of such a claim; and arguing that the majority opinion would allow an impermissible short-cut to class certification.

Justice Thomas filed a dissenting opinion, joined by Justice Kennedy and in part by Justice Scalia, arguing that the majority opinion "reverses" the proper order of the class-certification and merits inquiries: "A plaintiff who cannot prove materiality does not simply have a claim that is 'dead on arrival,' at the merits [cit.]; he has a class that should never have arrived at the merits at all because it failed Rule 23(b)(3) certification from the outset." (Thomas, J., dissenting, slip op. at 10.)[3]

Justice Alito filed a concurrence joining the Court's opinion "with the understanding that the petitioners did not ask us to revisit *Basic*'s fraud-on-the-market presumption."

Amgen will have a significant impact in securities fraud cases by removing the issue of materiality from the class-certification arena, though immateriality of the alleged misrepresentations may still be the basis for an early motion for summary judgment. Because the linchpin of the holding is that reliance in securities fraud cases may be established by showing "fraud on the market" with materiality judged by an objective standard, *Amgen*'s effect on putative class actions in other contexts may be more limited.

[3] Justice Scalia did not join the portion of the opinion quoted here.

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