Client Alert.

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Supreme Court Holds That Securities Fraud Plaintiffs Do Not Have to Prove Materiality to Certify a Class

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The Supreme Court issued a much-anticipated decision today in *Amgen Inc. v. Connecticut Retirement Plans and Trust Funds*, No. 11-1085, 568 U.S. __ (2013),[1] affirming the Ninth Circuit and holding that securities class action plaintiffs do not have to prove that alleged misrepresentations or omissions were material at the class certification stage. The ruling has substantial implications for future securities fraud class actions, where materiality could otherwise have proven a significant hurdle for plaintiffs.

The case involved purportedly fraudulent statements concerning "the safety, efficacy, and marketing of two of [Amgen's] flagship drugs" alleged to have artificially inflated its stock price.[2] Amgen argued that the market was well aware of the truth during the class period based on other public information, thus rendering the allegedly fraudulent statements immaterial.[3]

The focus in *Amgen* was the requirement for class certification under Federal Rule of Civil Procedure 23(b)(3) that "questions of law or fact common to class members predominate over any questions affecting only individual members."[4] The question before the Court was whether plaintiffs were required to prove that the alleged misstatements were material in order to demonstrate that the element of reliance would involve common issues of fact and law.

Securities class action plaintiffs typically rely on the "fraud-on-the-market" presumption to establish reliance, a cornerstone of securities fraud litigation established in a 4-2 decision in *Basic Inc. v. Levinson*, 485 U. S. 224 (1988). The fraud-on-the-market presumption allows courts to presume "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."[5]

In *Amgen*, there was no dispute that the market was efficient and the alleged statements were public. However, the fraud-on-the-market presumption recognizes that in an efficient market, only a "*material* misrepresentation will be reflected in the security's price."[6] Amgen therefore argued that plaintiffs could not rely on the fraud-on-the-

[1] Justice Ginsburg wrote for the majority, joined by Chief Justice Roberts and Justices Breyer, Alito, Kagan, and Sotomayor. Justice Thomas filed a dissenting opinion joined by Justice Kennedy and joined in part by Justice Scalia, who also filed a separate dissenting opinion. As noted below, Justice Alito also filed a brief but intriguing concurrence.

[2] Slip op. at 6.

[3] *Id.* at 7.

[4] *Id.* at 2.

[5] *Id.* at 1.

[6] *Id.* at 5 (emphasis added).

market presumption to overcome individual reliance issues, unless they first established that the misrepresentations at issue were "material" and thus presumed to be reflected in the stock price.[7]

The Court agreed with that premise, but disagreed that class certification must be denied on that basis. "[T]he key question in this case is not whether materiality is an essential predicate of the fraud-on-the-market theory; indisputably it is. Instead, the pivotal inquiry is whether proof of materiality is needed to ensure that the *questions* of law or fact common to the class will predominate over any questions affecting only individual members as the litigation progresses."[8]

The Court's analysis was driven by a concern that requiring plaintiffs to prove materiality to certify a class would "put the cart before the horse" by making plaintiffs establish that they "will win the fray" in order to proceed.[9] "Rule 23 grants courts no license to engage in free-ranging merits inquiries at the certification stage. Merits questions may be considered to the extent—but only to the extent—that they are relevant to determining whether the Rule 23 prerequisites for class certification are satisfied."[10]

Crucially, the Court was of the view that "the plaintiff class's inability to prove materiality would not result in individual questions predominating. Instead, a failure of proof on the issue of materiality [if it resulted in denial of class certification] would end the case."[11] The Court also found it important that "materiality is judged according to an objective standard" and thus "is a question common to all members of the class." Thus, the Court did not perceive a risk that the case would devolve into individualized issues at a later stage.

The Court took note of Amgen's policy argument that, in practice, granting class certification "can exert substantial pressure on a defendant to settle."[12] However, the Court dismissed the argument, noting that Congress had enacted certain limitations on class actions in recognition of such concerns, but had declined to require plaintiffs to prove materiality at the class-certification stage, as well as to undo the fraud-on-the-market presumption.[13]

In dissent, Justice Thomas argued that it is the majority, not Amgen, putting the cart before the horse, by allowing the plaintiffs to proceed without demonstrating that they are entitled to rely on the fraud-on-the-market presumption. Perhaps equally noteworthy is Justice Alito's one-paragraph concurrence. Picking up one theme from the dissent, Justice Alito noted that the Court was not asked to directly reconsider the fraud-on-the-market presumption itself, but that "more recent evidence suggests that the presumption may rest on a faulty economic premise." It will be interesting to see how lower courts react as defendants take up that invitation to directly challenge the validity of the court-created, fraud-on-the-market presumption.

[7] *Id.* at 2.

[8] *Id.* at 10 (emphasis in original, quotation marks and citation omitted).

[9] *Id.* at 3.

[10] *Id.* at 9.

[11] *Id.* at 2.

[12] *Id.* at 18.

[13] *Id.* at 19-20.

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